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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

A list of the items we are currently inviting submissions on can be found at **www.ird.govt.nz**. On the homepage, click on "Public consultation" in the right-hand navigation. Here you will find drafts we are currently consulting on as well as a list of expired items. You can email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

Below is a selection of items we are working on as at the time of publication. If you would like a copy of an item please contact us as soon as possible to ensure your views are taken into account. You can get a copy of the draft from **www.ird.govt.nz/public-consultation/** or call the Senior Technical & Liaison Advisor, Office of the Chief Tax Counsel on 04 890 6143.

Ref	Draft type/title	Description/background information	Comment deadline
ED0159	Draft Standard Practice Statement: Tax payments – when received in time	This draft SPS will update and replace "SPS 07/01: Tax payments – when received in time". It sets out when Inland Revenue will accept payments as having been received in time. In particular it notes that from 1 October 2014, payments which are sent by post must be received by Inland Revenue on or before the due date for payment. The draft also sets out changes to the way payments may be made at branches of Westpac bank that are intended to take effect from 1 October 2014.	30 May 2014

IN SUMMARY

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

STUDENT LOAN SCHEME AMENDMENT ACT 2014

The Student Loan Scheme Amendment Bill (No 3) was introduced into Parliament on 19 August 2013, receiving its first reading on 27 August 2013, its second reading on 13 February 2014 and the third reading on 6 March 2014. It received Royal assent on 7 March 2014.

The new legislation brings into effect three key measures to:

- enable Inland Revenue to request an arrest warrant for borrowers who persistently default on their student loan obligations and attempt to leave the country;
- speed up repayments from compliant overseas-based borrowers by imposing fixed repayment obligations and adding two new thresholds to the overseas-based borrower repayment rules; and
- enable Inland Revenue to amend the information-sharing agreement with the Department of Internal Affairs to obtain the contact details of all overseas-based student loan borrowers who apply for a passport rather than just those in default.

The new legislation also contains a number of remedial amendments that align the student loan scheme with the treatment of other tax types and measures to ensure the law works as intended.

The new legislation amends the Student Loan Scheme Act 2011.

ARREST AT BORDER

Sections 162A and 162B of the Student Loan Scheme Act 2011

There is a group of borrowers who persistently default on their student loan repayment obligations. The new legislation strengthens Inland Revenue's ability to deal with those individuals by making it an offence for overseas-based borrowers to continue avoiding repayments. The legislation enables Inland Revenue to request an arrest warrant for borrowers if the District Court is satisfied that a borrower has committed the offence and is about to leave or attempt to leave New Zealand after returning from overseas.

Background

Some borrowers refuse to repay their loans despite having the ability to do so. For this group, applying penalties for overdue payments and potential Inland Revenue debt-recovery action does not deter them from defaulting on their loan repayments. New section 162A makes it an offence for them to continue to do so.

The amendment enables Inland Revenue to apply for an arrest warrant to prevent an overseas-based borrower who is visiting New Zealand from leaving the country if the District Court is satisfied that they have committed the offence.

The provision is modelled on a similar provision in the Child Support Act 1991, under which Inland Revenue can request the District Court to issue an arrest warrant for a liable parent who is about to leave New Zealand with the intent to avoid their obligations.

Similar provisions for student loan borrowers will send a clear message to all borrowers that non-compliance is unacceptable and there are consequences for ignoring repayment responsibilities. This is a targeted measure that will be applied to the worst cases of default, while acting as a deterrent to the wider group of borrowers.

Key features

Section 162A makes it a criminal offence for a borrower who is in default of their overseas-based repayment obligation and who, having been notified by the Commissioner that he or she is in default, knowingly fails, or refuses by the due date specified in the notification to make reasonable efforts to pay the amount in default or to make arrangements with Inland Revenue to pay the amount in default.

Section 162B enables the District Court to issue a warrant for the arrest of a person if it is satisfied that the person has committed the offence and is about to leave or attempt to leave New Zealand.

A person who is arrested under this provision must be brought before a District Court as soon as possible. The District Court may make a range of orders if it is satisfied that the person is about to leave or attempt to leave New Zealand without making reasonable efforts to pay the amount in default or without making arrangements with Inland Revenue to pay the amount in default.

These include orders that the liable person:

- pay the amount in default;
- make arrangements with Inland Revenue to pay the amount in default;
- give security (including the provision of sureties) for the payment of the liability as specified by the court;
- not leave New Zealand without written permission of the court;
- surrender to the court, for a specified period, any travel documents or tickets in the person's possession; and
- provide the court, within a specified period, with any information the court thinks appropriate.

Sections 164 to 166 have been amended so administration of the new offence is consistent with the treatment of other offences under the Student Loan Scheme Act 2011. This includes requiring prosecution of the offence to be done within ten years of the offence being committed, allowing multiple prosecutions using the same documents and allowing prosecutions to be made summarily (enabling a faster court process).

Application date

The amendments apply from the day after Royal assent, being 8 March 2014.

ADJUSTING THE OVERSEAS-BASED BORROWER REPAYMENT RULES

Section 110 of the Student Loan Scheme Act 2011

The legislation adjusts the overseas-based borrower repayment rules by introducing a fixed repayment obligation and two new repayment thresholds.

Background

Under the previous rules, there was a four-step repayment obligation for overseas-based borrowers based on their loan balance, as shown in the table below.

Loan balance (at start of year)	Amount due per year
<=$1,000	The whole balance
>$1,000 and <=$15,000	$1,000
>$15,000 and <= $30,000	$2,000
>$30,000	$3,000

Under those rules, as a borrower repaid their loan, their loan balance would decrease, along with their repayment obligation. This meant that a compliant borrower's repayment obligation decreased over time, while their ability to pay was likely to be the same or better (as, for most people, their income increases over time).

The new legislation introduces fixed repayment obligations for overseas-based borrowers. This will reduce repayment times and the interest cost for compliant overseas-based borrowers. It also brings overseas-based borrowers' repayment obligations more in line with how commercial loans operate and their New Zealand-based counterparts.

Key features

The new legislation introduces fixed repayment obligations for overseas-based borrowers, which ensures that their repayment obligation is maintained, even when their loan balance is decreasing.

It also introduces two new repayment thresholds. Overseas-based borrowers with a relevant loan balance of more than $45,000 but less than or equal to $60,000 will have an annual repayment obligation of $4,000, and borrowers with a relevant loan balance greater than $60,000 will have a repayment obligation of $5,000.

The new repayment obligations are:

Relevant loan balance	Amount due per year
<=$1,000	The whole balance
>$1,000 and <=$15,000	$1,000
>$15,000 and <= $30,000	$2,000
>$30,000 and <= $45,000	$3,000
>$45,000 and <= $60,000	$4,000
>$60,000	$5,000

Detailed analysis

Under the previous rules, an overseas-based borrower's repayment obligation was determined based on their current loan balance. As a borrower repaid their loan, their loan balance decreased along with their repayment obligation.

New section 110 fixes an overseas-based borrower's repayment obligation so their repayment obligation does not decrease as their loan balance decreases.

From 1 April 2014, overseas-based borrowers will have their repayment obligation maintained at the same rate as when they became overseas-based.[1]

Borrowers who are already overseas-based at 31 March 2014 will have their repayment obligation fixed at the same rate they had on 1 April 2014.

These rules only apply if an overseas-based borrower's loan balance is decreasing. A borrower may have their loan balance increase if they continue to draw down on a loan while overseas or if they are charged interest.

[1] A borrower is overseas-based if they are not in New Zealand for 184 consecutive days. When a borrower meets the 184-day test they are treated as being overseas-based from the first day of the 184-day period.

If a borrower's loan balance increases so that it rises into a higher repayment threshold, the on-going repayment obligation will be fixed at the new higher threshold.

Borrowers whose loan balance is decreasing

New section 110 achieves the goal of fixing a borrower's repayment obligation by setting a borrower's repayment obligation based on their "relevant loan balance". For a borrower whose loan balance is decreasing, the "relevant loan balance" is the borrower's loan balance on their "start date".

A borrower's "start date" differs depending on whether the borrower is an "existing borrower".

An "existing borrower" is a person who was overseas-based on 31 March 2014 and has been continuously overseas-based since then. For "existing borrowers" their relevant loan balance is their balance at 31 March 2014 (their start date).

For all borrowers who are not "existing borrowers", their relevant loan balance is their loan balance at the date they became overseas-based.

This distinction ensures that current borrowers have their repayment obligation fixed based on the loan balance at 31 March (which is the end of the annual assessment period).

The requirement that borrowers be "continuously" based overseas will affect borrowers who are existing overseas-based borrowers at 31 March 2014, but who later become New Zealand-based borrowers. If a borrower were to become overseas-based again following being New Zealand-based, they will no longer be classified as an "existing borrower".

These rules result in a borrower having their relevant loan balance remain the same over time as it is fixed at the amount of their loan balance at the "start date". As a result, their associated repayment obligation also remains the same over time.

Example: Calculating a borrower's repayment obligation based on the relevant loan balance at their start date

Shannan becomes overseas-based on 1 May 2014 with a loan balance of $31,000.

Shannan is not an "existing borrower", because she became overseas-based after 31 March 2014. Her "start date" is therefore 1 May 2014 (the day she became overseas-based).

For the purposes of calculating her full-year repayment obligation as an overseas-based borrower for the year to 31 March 2015, her "relevant loan balance" is her consolidated loan balance at the start date.

So her relevant loan balance is $31,000 and her full year repayment obligation is $3,000.

Shannan is an overseas-based borrower for only part of the tax year. As a result, she does not have to pay her full year repayment obligation. Instead, her repayment obligation is apportioned to the amount of the year she is overseas-based. Her part-year repayment obligation is therefore $2,750.

Shannan makes payments throughout the year and at 31 March 2015 her loan balance is $29,500 (after interest is applied).

For the 2015–16 year her relevant loan balance will be $31,000 (the consolidated loan balance at the start date). This ensures her repayments are fixed in relation to her loan balance when she became an overseas borrower. Her full-year repayment obligation therefore remains at $3,000.

Note: The loan balance numbers used in these examples are rounded, and are used for illustrative purposes only. The actual amount of interest charged to overseas-based borrowers on any given loan balance, plus any penalties for non-payment, will vary.

Borrowers whose loan balance is increasing

Some borrowers' consolidated loan balances may increase after their start date.

If a borrower's consolidated loan balance has increased since their start date, their "relevant loan balance" is the borrower's highest loan balance on any 31 March balance date.

This means that if a borrower's loan balance is increasing, the associated repayment obligation also increases. This ensures that borrowers whose loan balance is increasing make payments sufficient to make progress on their loan repayment.

Example: Calculating a borrower's repayment obligation based on their relevant loan amount at 31 March date

Hannah becomes overseas based on 16 May 2014 with a loan balance of $14,500. Her annual repayment obligation is $1,000.

Her start date is 16 May 2014 (the day she became overseas-based).

Hannah fails to make any repayments on her loan for the next two years, and fails to contact Inland Revenue to discuss a repayment plan. Hannah therefore accrues both interest and penalties.

By March 2015 her loan balance has increased to $15,500. Her relevant loan balance is therefore based on this higher amount of $15,500 and the amount she is required to repay for the year to 31 March 2016 is now $2,000.

In the year to 31 March 2017 Hannah makes arrangements to repay her loan. Her loan balance at 31 March 2017 now sits at $14,600. However, in calculating her "relevant loan balance" the highest of the loan balances as at her start date, or any subsequent balance date, 31 March is used. So Hannah's "relevant loan balance" remains as at 31 March 2016 ($15,500) and her repayment obligation for the year to 31 March 2017 is still $2,000.

Repayment thresholds

Section 110(2) introduces two new repayment thresholds. Borrowers with a relevant loan balance of more than $45,000 but less than or equal to $60,000 will have a repayment obligation of $4,000 and borrowers with a relevant loan balance that is more than $60,000 will have a repayment obligation of $5,000.

The new repayment obligations are:

Relevant loan balance	Amount due per year
<=$1,000	The whole balance
>$1,000 and <=$15,000	$1,000
>$15,000 and <= $30,000	$2,000
>$30,000 and <= $45,000	$3,000
>$45,000 and <= $60,000	$4,000
>$60,000	$5,000

These new thresholds for borrowers with higher loan balances will ensure that more borrowers will have repayment obligations which will at least cover their annual interest charge.

Application date

The amendment applies from 1 April 2014.

SHARING BORROWERS' CONTACT DETAILS WITH OTHER AGENCIES

Sections 193A and 193C of the Student Loan Scheme Act 2011

The amendment extends the approved information-sharing agreement between Inland Revenue and the Department of Internal Affairs to include all borrowers, not just those who are in default.

Background

Accurate contact details for all borrowers are crucial so that Inland Revenue can keep in touch with borrowers and keep them updated about their repayment obligations. Early contact and intervention has been shown to increase the compliance of overseas-based borrowers with their repayment obligations.

An approved information-sharing agreement was made in October 2013, enabling the Department of Internal Affairs to provide Inland Revenue with the contact details of borrowers based on passport renewals. This sharing is limited to contact details of borrowers in default of their loan but not those who are compliant. This is because the Student Loan Scheme Act 2011 did not explicitly allow for the sharing of contact details of borrowers who are not in default.

For borrowers who are not in default, obtaining accurate contact details will help Inland Revenue to engage directly with these borrowers to prevent them from falling into default.

Key features

The amendment allows the Commissioner to obtain the contact details of borrowers who are not in default. This will enable Inland Revenue to amend the approved information-sharing agreement with the Department of Internal Affairs to include all borrowers, not simply those in default.

Application date

The enabling amendment to the Student Loan Scheme Act 2011 will apply from the day after Royal assent, being 8 March 2014.

Inland Revenue will seek to amend its existing approved information-sharing agreement with the Department of Internal Affairs by regulation shortly afterwards, to include borrowers not in default.

DEFINITION OF "INCOME" FOR STUDENT LOAN PURPOSES

Schedule 3 of the Student Loan Scheme Act 2011

This amendment aligns the definition of "income" for student loan purposes with that used for Working for Families tax credits.

Background

The definition of "income" for student loan purposes is largely based on the definition used for Working for Families tax credits.

The definition for student loans includes income from close companies of which the borrower is a major shareholder. Income from close companies is allocated to borrowers based on the share of the interest the borrower has in the company.

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 makes changes to the formula used to calculate company income for Working for Families purposes. It also makes amendments to ensure the wording and formulas used in the calculation of a borrower's interest in a company are consistent with the wording and formula used to calculate a borrower's interest in a trust and trust-owned companies.

Key features

The Student Loan Scheme Amendment Act 2014 makes the changes to the formula in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 apply to the definition of "adjusted net income" for calculating student loan repayment obligations.

The changes will:

- simplify the formula used to calculate company income so that dividend income is subtracted as part of the formula rather than subtracted in a separate section. This ensures that dividend income from a close company is not counted twice as income of the borrower;
- clarify that income from the formula used to calculate company income cannot be a negative amount;
- clarify that only living settlors should be counted when determining the numbers of settlors for a borrower's trust;
- provide that the method to determine a person's interest in a company is based on the voting interest being held by the major shareholder, rather than the proportion of total shares they own (consistent with the method used to determine a borrower's interest in a trust and trust-owned company);
- provide that the date the voting interest is measured is calculated on the last day of the income year;
- provide that the references to "market value interests if there is a market value circumstance" are removed, as they seldom occur; and
- ensure formulas that determine income from companies, and trusts or trust-owned companies are aligned.

For more information on these amendments, see the relevant section of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 commentary in this *Tax Information Bulletin*.

Application date

The amendments apply from 1 April 2014.

INCLUDING INCOME FROM EMPLOYMENT BENEFITS IN "ADJUSTED NET INCOME"

Schedule 3 of the Student Loan Scheme Act 2011

The amendment aligns the definition of "income" for student loan purposes with that used for Working for Families tax credits by requiring employees who receive certain non-cash benefits to include them in their income calculations.

Background

The Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013 included an amendment to require employees who receive certain non-cash benefits to include them in their Working for Families income calculations. The availability of an employer-provided motor vehicle is included as income for Working for Families purposes if it is part of an explicit salary trade-off. That is, if the employee would be entitled to a greater amount of employment income if they chose not to receive the non-cash benefit. An employee who receives short-term charge facilities will also be required to include these if the value of benefits received in a year is more than the specified threshold.

When a non-cash benefit is provided as a substitute for salary or wages, if it is not included in "adjusted net income" for student loans in the same way salary or wages would be, inequity arises. Including these types of benefits in the definition of "adjusted net income" ensures greater fairness.

Key features

The amendment in the Student Loan Scheme Amendment Act 2014 aligns the definition of income for student loans to include income from employer-provided motor vehicles and short-term charge facilities.

If an employee who is a student loan borrower receives a motor vehicle from their employer, and the employee would be entitled to a greater amount of employment income if they chose not to receive the non-cash benefit, that benefit will be included in the calculation of "adjusted net income", regardless of its value. The amount which the employee would be required to report would be the amount by which their employment income would be greater in the absence of the benefit.

Employees who are student loan borrowers will also be required to include short-term charge facilities (for example, vouchers) they have received in "adjusted net income" when the value of the facility is above a certain threshold. This will only be when the value of the benefit provided under short-term charge facilities provided in an income year (not including the fringe benefit tax payable on the benefits) is more than the lesser of 5 percent of the employee's salary or wages for the tax year, or $1,200.

For more information on these amendments refer to *Tax Information Bulletin* Vol 25, No 9, "Family scheme income from employment benefits".

Application date

The amendment applies from 1 April 2014.

REDUCED LATE PAYMENT INTEREST

Section 141A of the Student Loan Scheme Act 2011

The amendment reduces late payment interest when a deduction order is made for a borrower in default.

Background

Under section 157 of the Tax Administration Act 1994, Inland Revenue can take deductions from money payable to a taxpayer who is in default of their obligations (for example, deductions directly from salary and wages). This includes being able to deduct from money payable to a taxpayer who has an unpaid amount on their student loan. Individuals subject to a deduction order for tax debts are relieved of some late payment interest.

The previous rules provided a different treatment for student loan borrowers, because there was no reduction in late payment interest when a student loan debt was included under a deduction order.

Key features

The amendment makes the treatment of late payment interest for student loans consistent with the treatment for tax debts, and reduces the late payment interest charged on overdue student loan obligations by 2 percent when the debt is under a section 157 deduction order.

Application date

The amendment applies from 1 April 2013.

MISCELLANEOUS TECHNICAL AMENDMENTS

Disclosure of information to StudyLink

Section 207 of the Student Loan Scheme Act 2011

The amendment clarifies that Inland Revenue may disclose information to StudyLink (which administers student loan applications) to verify that an applicant for a student loan does not have an unpaid amount on their student loan that makes them ineligible for a student loan.

Application date

The amendment applies from the day after Royal assent, being 8 March 2014.

Filing dates for six-monthly GST filers

Section 84 of the Student Loan Scheme Act 2011

The amendment to section 84 corrects a drafting error in the Student Loan Scheme Amendment Act 2013 that caused changes to payment dates for six-monthly GST filers to apply only for the 2012–13 tax year. This amendment corrects the error so it applies for the 2013–14 tax year onwards.

Application date

The amendment applies from the day after Royal assent, being 8 March 2014

Deductions for borrowers in default only

Section 4 of the Student Loan Scheme Act 2011

The amendments to section 4 clarify the treatment of deductions for borrowers who are in default only. Under the previous rules, salary or wage deductions made for borrowers whose entire loan balance is in default could not be used to repay default amounts owed by the borrower. This is because such deductions could only be used to repay assessment amounts for that year. This amendment allows these deductions to be used to offset the borrower's default.

Application date

The amendment applies from 1 April 2012.

TAXATION (ANNUAL RATES, FOREIGN SUPERANNUATION, AND REMEDIAL MATTERS) ACT 2014

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill was introduced into Parliament on 20 May 2013. It received its first reading on 11 June 2013, second reading on 5 December 2013 and the third reading on 20 February 2014 followed by Royal assent on 27 February 2014.

The new legislation brings greater clarity and cohesion to the tax rules for New Zealand residents with interests in foreign superannuation schemes. It also introduces new rules to align the treatment of certain mineral miners with that of taxpayers more generally, and makes changes to a number of other tax rules to ensure they operate correctly.

The new Act amends the Income Tax Act 2007, Income Tax Act 2004, Income Tax Act 1994, Tax Administration Act 1994, Child Support Act 1991, Child Support Amendment Act 2013, KiwiSaver Act 2006 and the Health Entitlement Cards Regulations 1993.

TAXATION OF FOREIGN SUPERANNUATION

Sections CD 36B, CF 3, CQ 5, CW 28B, CW 28C, CZ 21B, DN 6, EX 29, EX 42B, HC 15, HC 27, HR 8, YA 1 and schedule 33 of the Income Tax Act 2007, section CF 3 of the Income Tax Act 2004, section CC 4 of the Income Tax Act 1994 and schedule 1 of the KiwiSaver Act 2006

Changes to the Income Tax Act 2007 have been made in relation to the taxation of interests in foreign superannuation schemes held by New Zealand residents.

From 1 April 2014, a new set of rules replaces the previous rules applying to interests in, and amounts derived from, foreign superannuation schemes.

The new rules are intended to bring greater clarity and cohesion to the rules, making it easier for taxpayers to understand and comply with their obligations.

Key features

From 1 April 2014, the foreign investment fund (FIF) rules generally cease to apply to interests in foreign superannuation schemes unless the interest was first acquired while the individual was a New Zealand tax resident or if it is grandparented.

Instead, from 1 April 2014, interests in foreign superannuation schemes are taxed only when:

- an amount has actually been received by the individual (either as a pension or as a cash lump sum);
- a transfer has been made into a New Zealand or an Australian superannuation scheme; or
- a transfer of an interest is made to another person (unless rollover relief is available).

Lump sums received or transferred in the first four years of New Zealand tax residence are generally exempt from tax.

Lump sums are taxed using one of two methods:

- The schedule method is the default method. It is designed to approximate the tax that would have been paid on accrual while the person was a New Zealand tax resident, in conjunction with an interest charge that recognises that the payment of tax has been deferred until receipt.
- The formula method taxes the person based on the actual gains that have been earned by their scheme while they were a New Zealand tax resident, again in conjunction with an interest charge that recognises that the payment of tax has been deferred until receipt. This is subject to certain criteria.

The new rules do not generally affect the taxation of foreign pensions received by New Zealand tax residents which continue to be taxed as most were before 1 April 2014 – that is, in full on receipt.

A low-compliance option is available to individuals who received (or applied to receive) a lump sum from their foreign superannuation scheme (either as a cash withdrawal or a transfer to another scheme) between 1 January 2000 and 31 March 2014 but did not comply with their tax obligations relating to the interest in their scheme. To remedy their non-compliance, an individual has the option of including 15 percent of the lump sum in their 2013–14 or 2014–15 income tax return and paying tax on that amount.

A new type of permitted withdrawal has been introduced into the KiwiSaver Act 2006 to allow individuals who have transferred their foreign superannuation into a KiwiSaver scheme to pay their tax liability resulting from the transfer. The individual may also use the withdrawal mechanism to pay their student loan repayment obligation, to the extent that it arises from the transfer being assessed as income.

Circumstances when the FIF rules continue to apply from 1 April 2014

A person who has already met their tax obligations in relation to their foreign superannuation interest under the FIF rules before the introduction of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill on 20 May 2013 has the option to continue using the FIF rules after 1 April 2014. This is known as "grandparenting". To remain grandparented, they must treat their interest as an attributing interest in a FIF in all subsequent returns of income following the return filed before 20 May 2013. If they miss one year, they are no longer grandparented and are subject to taxation on receipt under the new rules. Credit will not be available for previous tax paid on income arising under the FIF rules.

A person who first acquired their interest in a foreign superannuation scheme while they were a New Zealand tax resident must generally use the FIF rules in relation to their interest. This is irrespective of whether the interest was acquired before or after 1 April 2014.

The following flow charts show how the rules apply.

Diagram 1: What is the tax treatment of a foreign superannuation interest in a given income year from 1 April 2014?

The following diagram provides information about which rules apply to a foreign superannuation interest held in a given income year by a New Zealand resident beginning on or after 1 April 2014.

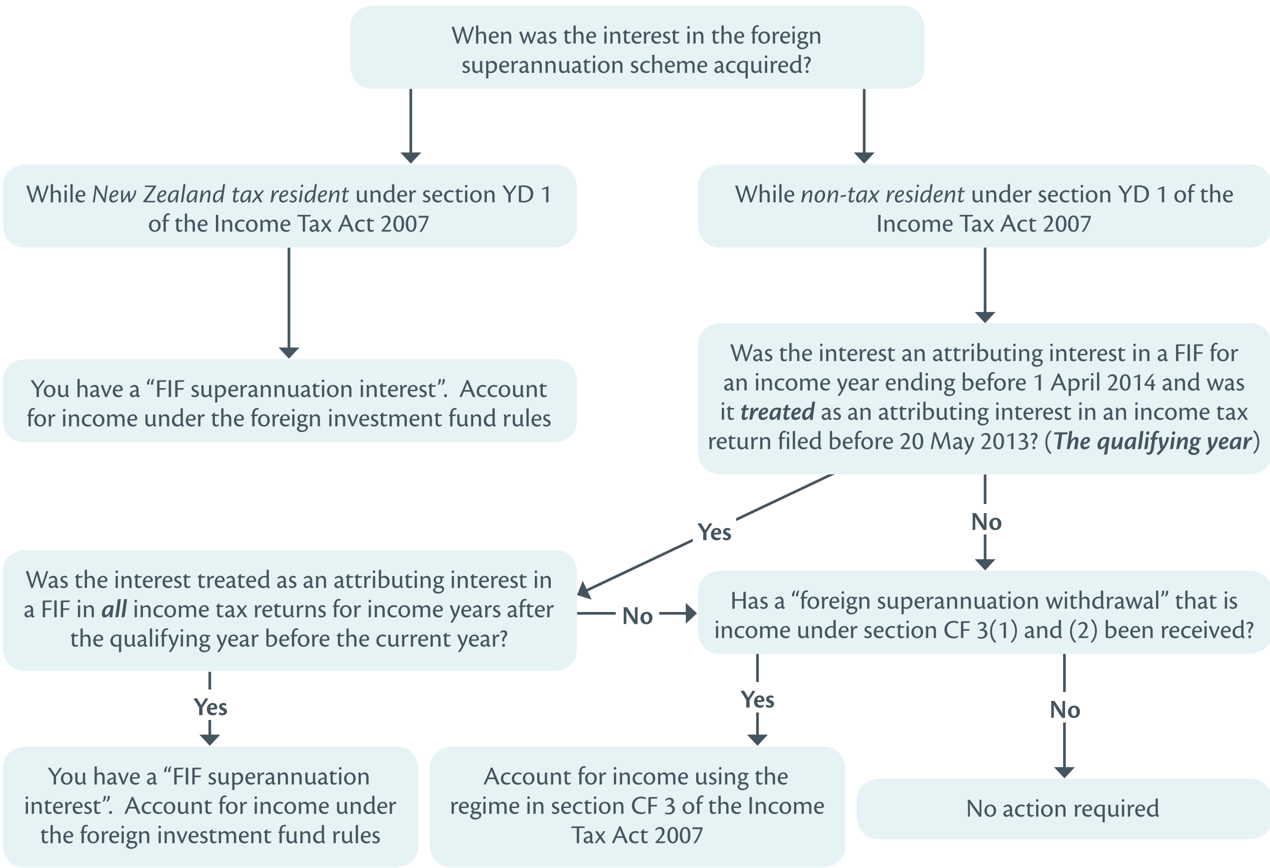
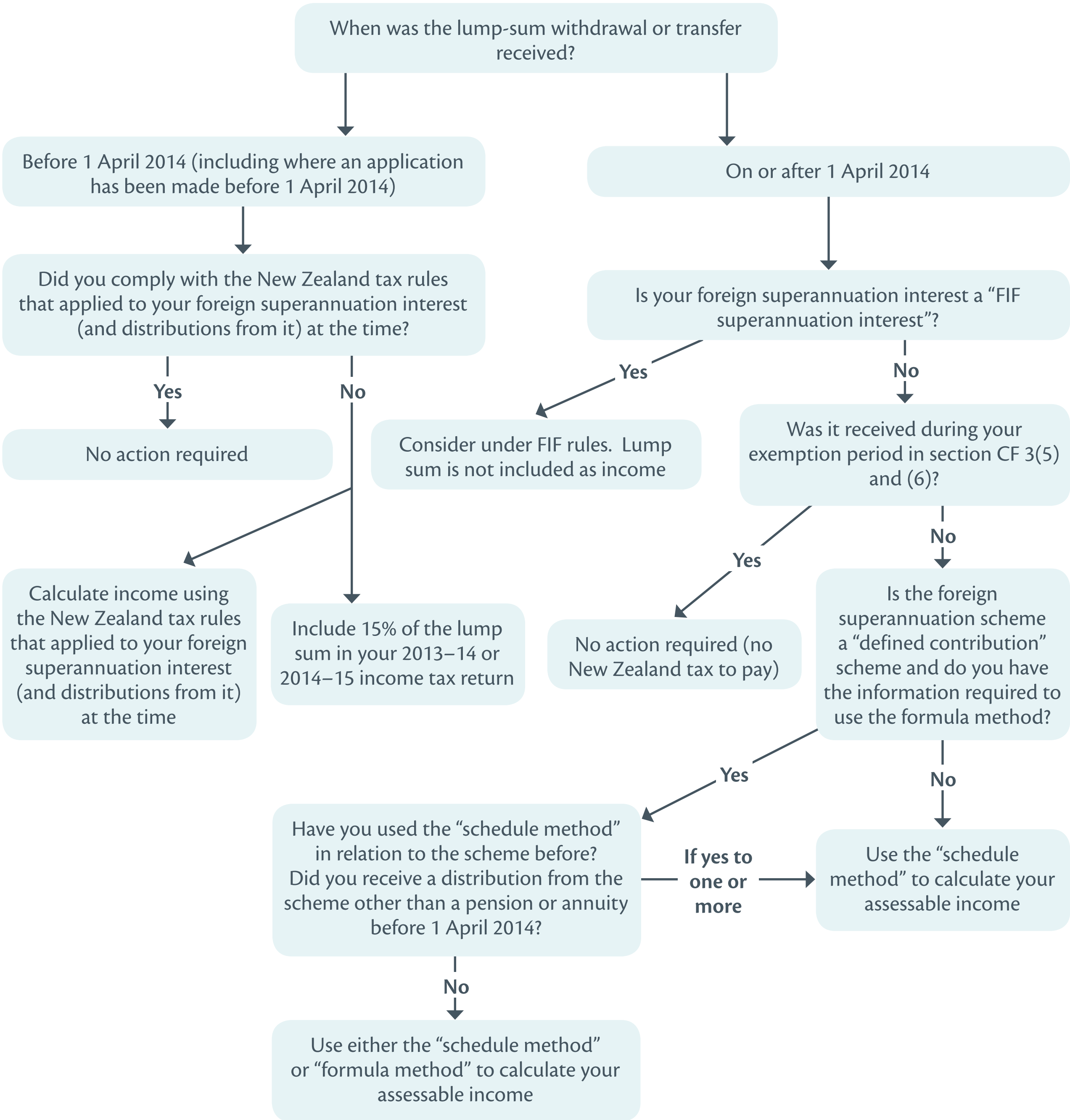


Diagram 2: What is the tax treatment of a lump sum received or transferred from a foreign superannuation scheme by a New Zealand resident?



Note that if the interest in the foreign superannuation scheme was acquired in a transaction described in section CF 3(21)(b) or (d) from a person who acquired the interest while non-resident, there may be other considerations to take into account.

Background

New Zealand residents are taxable on their worldwide income, including income from interests in foreign superannuation schemes. The previous rules for taxing New Zealand residents on their foreign superannuation were complex and difficult for taxpayers to understand.

In some cases, superannuation interests were subject to tax on accrual under the foreign investment fund (FIF) rules. In other cases, a person was taxed on receipt of their superannuation interest depending on the legal structure of the foreign scheme (such as whether the scheme is structured as a company or a trust). The tax treatment differed according to which set of rules applied. As a result, it was not always clear that the rules resulted in a fair outcome, particularly for lump-sum amounts.

A review of the taxation of foreign superannuation was announced in November 2011.

The policy review focused on the application of the foreign investment fund (FIF) rules to foreign superannuation, and the taxation of lump sums received from foreign schemes, including both transfers and withdrawals. As there were no concerns about the current tax treatment of pensions, no changes to pensions were proposed, except insofar as those interests were taxed under the FIF rules.

As a result of this review, an officials' issues paper, *Taxation of foreign superannuation*, was released in July 2012.

The issues paper proposed that the FIF rules would no longer apply to interests in foreign superannuation schemes. Instead, all foreign superannuation interests would be taxed on receipt, either as a periodic pension under the existing rules, or as a lump sum using a specific method proposed in the issues paper referred to as the "inclusion-rate approach". The inclusion-rate approach proposed in the issues paper is the predecessor to what is now known as the "schedule method".

The intention was to ensure that New Zealand-resident taxpayers pay a reasonable amount on their foreign superannuation, while also ensuring that the rules were relatively simple to apply. The solution also needed to take into account that individuals generally cannot access their superannuation scheme until retirement age.

The solution proposed in the issues paper had two key elements. First, payment of tax would be deferred until the person receives a distribution from their scheme or transfers it to a New Zealand or Australian superannuation scheme. The reason for taxing upon receipt rather than upon accrual was based on the fact that most foreign schemes are locked in to some extent. Further, because many other countries tax foreign superannuation when an amount is distributed to an individual (rather than taxing contributions to a fund and earnings derived by the fund), aligning the point at which tax is paid also reduces the likelihood of being effectively overtaxed in both tax jurisdictions.

Secondly, the issues paper provided for a special rule for taxing lump-sum transfers and withdrawals made from a foreign superannuation scheme – the inclusion-rate approach (now known as the schedule method).

The rationale behind the inclusion-rate approach (and now the schedule method) is that from a New Zealand tax perspective, the tax outcome for a person who migrates to New Zealand with a foreign superannuation should be broadly the same irrespective of whether the person transferred their funds to a New Zealand superannuation scheme on day one, or left it with the foreign scheme provider. This reflects the principle that tax should not distort a person's economic decision-making.

If a person transferred their funds into a New Zealand bank account or KiwiSaver scheme, for example, they would be paying tax on the interest that the bank account earns or on the gains made by the KiwiSaver scheme (that is, they would be paying tax on accrual). This is because New Zealand has a taxed tax-exempt (TTE) system, whereby contributions are generally made from post-tax income, gains that accrue are also taxed, but any payments made from the scheme or account are exempt from tax.

In designing New Zealand's tax rules, an important aim is to ensure that, where possible, taxpayers' decisions about their affairs – such as when to draw down on their superannuation – are not driven by tax considerations. Therefore, the amount of tax that a person pays on their foreign superannuation interest should mirror what would have been paid on accrual, to ensure that people do not transfer their funds solely because of any tax advantage. The rates under the schedule method/inclusion-rate approach were calculated to do this, based on how long the person was a New Zealand tax resident before bringing their funds to New Zealand. These rates tell a person how much of their lump sum they should include as income in their tax return, and increase with the number of years of residence. Funds that accumulated before the person migrated to New Zealand (both contributions and gains) are not taxed.

The issues paper also proposed a simple option for individuals who had already received a lump-sum withdrawal or transfer between 1 January 2000 and 31 March 2011, but did not comply with their tax obligations in relation to the lump sum. It proposed that these individuals would have the option to pay tax on only 15 percent of the lump sum.

It was proposed that the FIF rules would remain available in very limited circumstances to those who had returned FIF income in relation to their foreign superannuation interest in their 2011–12 income tax return filed by 31 March 2012. This is known as "grandparenting".

The issues paper received 59 submissions from a variety of interested parties, including legal and accounting firms, pension transfer agents, and individuals.

In response to these submissions, a number of modifications were made to the proposals in the issues paper, which were then introduced in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill on 20 May 2013. The inclusion-rate approach was renamed the "schedule method" in the bill. The main modifications to the proposals in the issues paper were to:

- defer the application date from 1 April 2011 to 1 April 2014;

- extend the availability of the 15 percent option to lump sums derived by 31 March 2014;
- extend the filing date required for grandparenting under the FIF rules to 20 May 2013;
- extend a tax-free window during which a person may receive a lump with no New Zealand tax to pay from two years to four years, and make it available to returning residents, as well as new migrants;
- change the timing of the schedule method so that income earned by the scheme during the four-year window would not be taxed if a person receives their lump sum after the four-year tax-free window;
- provide separate rates for each year of residence under the schedule method, rather than one rate for a band of several years;
- introduce a method that allows individuals to calculate the actual gains derived by their scheme while they have been New Zealand tax resident, if they have the information available (known as the formula method); and
- introduce a KiwiSaver withdrawal mechanism to allow those who transfer their foreign superannuation interest into KiwiSaver to withdraw funds to pay their tax liability arising from the transfer.

Further refinements to the proposals were recommended by the Finance and Expenditure Committee in response to submissions made at the select committee stage of the bill. The Committee's report was published in November 2013. The main recommendations were to:

- restrict the availability of the new regime (the schedule method and formula method) to when the interest in the foreign superannuation scheme is acquired while the person was non-tax resident;
- extend the KiwiSaver withdrawal mechanism to allow a person a withdrawal to pay their student loan repayment obligation, to the extent it arises from the transfer into KiwiSaver being assessed as income;
- provide rollover relief to transfers made from one person to another upon death of a spouse or relationship split; and
- use a lower tax rate when calculating the deferral benefit under the formula method.

Supplementary order paper 413 was introduced at the committee of the whole House stage. Supplementary order paper 413 proposed that the 15 percent option should be available to individuals who have applied to their foreign superannuation scheme provider to withdraw or transfer their funds by 31 March 2014, even if they have not actually received the funds by 31 March 2014.

The new legislation received Royal assent on 27 February 2014.

Application dates

The new rules generally apply from 1 April 2014.

A minor change to the definition of superannuation scheme that corrects an unintended change that occurred during the rewrite of the Income Tax Act in 2004 applies from 1 April 2005.

DETAILED ANALYSIS

New rules for interests in foreign superannuation schemes

New rules apply to interests in foreign superannuation schemes from 1 April 2014. The new rules apply to interests in a "foreign superannuation scheme" which is already defined in section YA 1 of the Income Tax Act 2007.

A new definition of "FIF superannuation interest" is included in section YA 1. This does two things.

First, it specifies when a person may use the FIF rules in relation to a foreign superannuation interest from 1 April 2014. Individuals who have complied with the FIF rules and treated their foreign superannuation interest as an attributing interest in a FIF in a return of income filed before 20 May 2013 have the option to continue using the FIF rules (known as grandparenting). To be grandparented, an individual must treat their interest as an attributing interest in a FIF in all returns of income following that return filed before 20 May 2013. Any distributions from the scheme are not treated as income of the individual at the time they are derived as the income has been taken into account under the FIF rules.

Secondly, the definition of "FIF superannuation interest" also specifies that individuals who acquire an interest in a foreign superannuation scheme while already tax-resident in New Zealand are required to use the FIF rules and are not permitted to use the new rules. This applies to interests first acquired both before and after 1 April 2014.

The FIF rules are not available to foreign superannuation interests that do not meet the definition of "FIF superannuation interest". Interests in foreign superannuation schemes which are not FIF superannuation interests are excluded from the FIF rules through amendments to section EX 29 and a broad new FIF exemption in section EX 42B. New section EX 42B provides that interests in or rights to benefit from a foreign superannuation scheme are not subject to the FIF rules for income years beginning on or after 1 April 2014, unless it is a FIF superannuation interest.

Accordingly, sections CQ 5, DN 6, EX 29, EX 33 and EX 42 have been amended or repealed to remove references to the FIF rules that are no longer required.

New section CD 36B clarifies that foreign superannuation withdrawals and pensions are not taxed as dividends under the company tax rules. Similarly, amendments to sections HC 15 and HC 27 provide that foreign superannuation withdrawals and pensions are not subject to the trust tax rules.

Instead, all amounts received from interests in foreign superannuation schemes that were acquired while the holder was non-tax resident – whether in the form of lump sums or pensions – are taxed on receipt.

The tax treatment of periodic pensions has not been altered. Periodic pensions continue to be taxed as most currently are – that is, in full at a person's marginal tax rate.

New section CF 3 introduces new rules for taxing "foreign superannuation withdrawals" – or lump sums – received from foreign superannuation schemes on or after 1 April 2014. A "foreign superannuation withdrawal" is defined as being a benefit other than a pension or annuity, and is income of the person, if it is a lump-sum withdrawal, a transfer from a foreign superannuation scheme into a New Zealand or Australian superannuation scheme, or a transfer of a foreign superannuation interest to another person. Lump sums received on or after 1 April 2014 are taxed either under the "schedule method" or the "formula method".

Any reference to a "lump sum" throughout this special report generally means a "foreign superannuation withdrawal" that is income of a person, as defined in the new legislation.

The new regime in section CF 3 is available only to taxpayers who acquired their interest in a foreign superannuation scheme while non-resident under section YD 1 of the Income Tax Act 2007. As long as this requirement has been met and the interest is not a FIF superannuation interest, the regime in section CF 3 is available irrespective of whether the person became a New Zealand tax resident before or after 1 April 2014.

New section CF 3(22) ensures that an individual who was non-compliant with the FIF rules before 1 April 2014 and receives a lump sum after 1 April 2014 that is taxed under the schedule or formula approach, is not assessed for that previously un-assessed FIF income. This to ensure that these people are not double taxed as both the schedule and formula methods take account of income earned by the scheme during the period that the scheme should have been treated as an attributing interest in a FIF.

However, as section CF 3 only applies to people who first acquired their interest in a foreign superannuation scheme while non-resident, section CF 3(22) does not apply to those who were already New Zealand tax-resident when they first acquired the rights in their foreign superannuation scheme. These people would be assessed for any previously unpaid tax on FIF income and are also required to account for FIF income in relation to their interest for all income years after 1 April 2014.

As with other forms of income, the portion of the lump sum that is assessable income may affect a person's entitlements and obligations for that tax year, such as child support, Working for Families tax credits, and student loan repayment obligations. Schedule 1 of the KiwiSaver Act 2006 has been amended to provide that where a transfer is made to a KiwiSaver scheme, the individual can withdraw an amount that represents the tax liability that arises in relation to the transfer.

What is a foreign superannuation scheme?

For the tax treatment of the new rules in section CF 3 to apply, section CF 3(1)(b) provides that a lump sum must arise from an interest in a foreign superannuation scheme.

A "foreign superannuation scheme" is defined in section YA 1 as a superannuation scheme constituted outside New Zealand. A superannuation scheme is a trust, company, or legislative arrangement established mainly for the purposes of providing retirement benefits to natural persons.

Most foreign employment-related retirement schemes that individuals contribute to while working overseas satisfy the definition of a "foreign superannuation scheme". This is because these schemes usually will have been established by an individual's employer to be used by the employer's eligible employees. Investments in these schemes are usually held by trustees for the benefit of the participating employees.

Similarly, retirement entitlements originating from arrangements made under foreign legislation also usually satisfy the definition of a foreign superannuation scheme.

A retirement scheme will satisfy the definition of a foreign superannuation scheme so long as the scheme is either a trust, company, or arrangement established under the other country's legislation, and is established mainly for the purpose of providing retirement benefits.

Sometimes savings in an individual's retirement scheme can be used for purposes unrelated to retirement. For example, in the United States, individuals are able to establish a retirement savings account known as an Individual Retirement Account (IRA). An IRA is a savings account set up for the exclusive benefit of the individual or the individual's beneficiaries. To discourage the use of IRAs for purposes other than retirement, a 10% penalty tax is imposed on any withdrawals made from the account before retirement. Some withdrawals can be made without penalty – for example, when withdrawals are made to meet higher education expenses, first home purchases or medical expenses, no penalty tax is imposed.

Nevertheless, IRAs are established *mainly* for the purpose of providing retirement benefits and therefore on the face of it, such accounts are likely to be "foreign superannuation schemes" for New Zealand tax purposes.

Where a retirement scheme is merely a "bare trustee" or similar arrangement for an individual, the scheme is unlikely to meet the definition for being a foreign superannuation scheme. If retirement savings are held by a bare trustee, section YB 21 provides that the underlying savings are deemed to be held by the individual personally. In those circumstances, New Zealand would generally tax the individual as if the individual is holding the underlying investments of the "scheme" directly.

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 also makes a minor change to the definition of "superannuation scheme" that corrects an unintended change that occurred during the rewrite of the Income Tax Act in 2004. This correction clarifies that the definition of superannuation scheme does not include schemes that pay a foreign social security pension that resembles New Zealand Superannuation and applies from 1 April 2005. This amendment ensures that the current rules for taxing such payments continue.

Tax treatment of foreign pensions and annuities

The tax treatment provided by section CF 3 does not apply to pensions and annuities paid from foreign superannuation schemes to New Zealand residents. Section CF 3(1)(a) provides this by defining a "foreign superannuation withdrawal" as a benefit that is not a pension or an annuity.

The tax treatment of pensions and annuities has not changed. Section CC 5 provides for the taxation of annuities, section CF 1(1)(g) provides for the taxation of pensions. Most pensions and annuities are taxable unless there is a specific exemption.

"A pension" is not defined in the Income Tax Act 2007. However, case law suggests that a payment from a superannuation scheme is generally a pension where:

- the payments are periodic;
- the amounts of the payments are fixed or ascertainable in advance; or
- the entitlement to the payments is for life or a fixed term.

New section CD 36B clarifies that pensions are not taxed as dividends under the company tax rules. Similarly, amendments to sections HC 15 and HC 27 provide that pensions are not taxed under the trust tax rules.

Example 1

Lisa worked for a few years in Hong Kong and has an interest in her employer's private superannuation scheme. She moves to New Zealand and, upon her retirement, begins to receive a monthly pension payment of NZ$500 ($6,000 per year) from the scheme. These payments continue at the same amount (with an increase to account for inflation each year) until her death, at which point they will stop. From these facts, it appears that her monthly payments are a pension. She needs to include $6,000 in her New Zealand tax return each year and pay tax on that amount. If her marginal tax rate is 33%, she will pay tax of $1,980 each year.

Taxable lump-sum withdrawals or transfers

The rules set out in new section CF 3 apply to "foreign superannuation withdrawals" received from 1 April 2014 onwards, where the interest in the foreign superannuation scheme was first acquired at a time when the person was not a New Zealand tax resident. Providing that this condition has been met, it does not matter whether the person first became a New Zealand tax resident while holding the interest before or after 1 April 2014.

When is a person not a New Zealand tax resident?

New Zealand tax residence is determined by section YD 1 of the Income Tax Act 2007, which states that a person is a New Zealand tax resident if they have a permanent place of abode in New Zealand. If a person does not have a permanent place of abode in New Zealand, they are considered to be a New Zealand tax resident if they are personally present in New Zealand for more than 183 days in a 12-month period.

It is possible for a person to be a tax resident of more than one country. New Zealand has a number of special agreements with other countries called "double tax agreements", or DTAs. These agreements allocate taxing rights to ensure that a person is not double-taxed when an item of income is sourced in one country and the person deriving it is a tax resident of the other, and also when a person is a tax resident in both countries. When a person is a tax resident of both countries, DTAs contain what is known as a "tie-breaker test" to determine where the person is tax-resident for the purposes of that DTA.

Consider a person who is a tax resident under domestic law of both country X and New Zealand. If the person tie-breaks to country X in the DTA, they are not considered to be a resident of New Zealand for the purposes of allocating taxing rights over certain income under that DTA. However, they are still considered to be a tax resident of New Zealand under section YD 1 of the Income Tax Act 2007.

When is a lump sum taxable?

A lump sum is taxable if it meets the definition of a "foreign superannuation withdrawal" and if it is received during the person's "assessable period". The rules for calculating when a person's assessable period begins and ends are discussed below.

New section CF 3(2) states that a "foreign superannuation withdrawal" is income of the person when the amount is in the form of one of the following:

- a cash withdrawal (section CF 3(2)(a));
- a transfer from a foreign superannuation scheme into a New Zealand superannuation scheme (section CF 3(2)(b));
- a transfer from a foreign superannuation scheme outside Australia into an Australian superannuation scheme (section CF 3(2)(c)); or
- a transfer of a superannuation interest to another person (section CF 3(2)(d)).

Example 2

James worked in the United Kingdom and has an interest in a UK pension scheme. He moves to New Zealand and transfers part of his interest into a KiwiSaver scheme under the UK's QROPS[2] legislation. The amount that is transferred comes within the definition of a foreign superannuation withdrawal, so James must calculate his tax liability on the transfer under the new rules.

A foreign superannuation withdrawal received during the person's assessable period is taxable under one of two methods – the schedule method or the formula method. These methods are discussed below.

Non-taxable lump-sum withdrawals and transfers

In certain circumstances, transfers or withdrawals will not be taxable. These are described below.

Withdrawals and transfers from Australian superannuation schemes

Withdrawals from Australian schemes, and transfers from Australian schemes to New Zealand schemes, are generally not taxed in New Zealand under the Australia-New Zealand double tax agreement or under the trans-Tasman superannuation portability agreement (which took effect from 1 July 2013). This treatment continues under the new rules.

As withdrawals and transfers from Australian superannuation schemes are not taxable, transfers from a foreign (non-Australian) scheme into an Australian scheme are taxable under the new rules.

Transfers between two non-Australian foreign schemes (rollover relief)

A transfer between two foreign superannuation schemes could give rise to a taxable event under the old rules, being a disposal of rights in the first scheme and an acquisition of rights in the new scheme.

New section CF 3(2) lists the types of lump sums that are taxable. Through its omission in section CF 3(2), a transfer from one foreign superannuation scheme to another non-Australian foreign superannuation scheme is not a taxable event. It does not matter whether the transfer is to a scheme in the same foreign country or a different foreign country, as long as the scheme to which it is transferred is not New Zealand or Australian.

This may occur, for example, when a person disposes of their interest to purchase an annuity with a different provider, or if a person transfers from one foreign scheme to another foreign superannuation scheme in order to obtain better returns.

Instead, the person is taxed on the eventual withdrawal or payment (or transfer to an Australian or New Zealand scheme). New section CF 3(21)(b) provides that the amount of tax payable is calculated from when they became New Zealand-resident while holding the interest in the first scheme.

Transfers from a foreign scheme to an Australian scheme are taxable under section CF 3(2)(c).The reason for taxing at this point is because transfers from Australian schemes are typically exempt, as noted above.

[2] Qualifying recognised overseas pension scheme.

Example 3

Kimberley, a New Zealand tax resident, has an interest in a foreign superannuation scheme in Spain that she acquired before migrating to New Zealand. She wants to change providers to get a better investment return, and decides to transfer her funds into another foreign superannuation scheme in France that offers better returns.

Under the new rules, Kimberley does not need to pay New Zealand tax on the amount she transfers to the French scheme. Instead, she is taxed when she transfers the interest in the French superannuation scheme to a New Zealand superannuation scheme. Her tax liability on the transfer of the French interest into New Zealand takes into account the period of time she held the interest in the Spanish scheme while she was New Zealand-resident, as well as the period she held the French interest before transferring.

Certain transfers following the death of a spouse or a relationship split

Under new section CF 3(2)(d), the transfer of an interest in a foreign superannuation scheme to another person is generally a taxable event to the transferor.

New section CF 3(3) provides an exception to this rule if all of the following conditions are met:

- the transferor's interest in a foreign superannuation scheme is partly or wholly transferred into a non-Australian foreign superannuation scheme in the name of the transferee;
- the transfer occurs upon the death of the transferor or under a relationship agreement that arises as a result of the dissolution of the transferor and transferee's marriage, civil union partnership, or de facto relationship ("relationship cessation");
- the transferee was the spouse, civil union partner, or de factor partner immediately before the death of the transferor or the relationship cessation; and
- the transferee is a New Zealand tax resident at the time of transfer.

This means when an interest is cashed out and merely distributed to another person, the conditions for rollover relief are not met. A cash distribution is a taxable event to the transferor under section CF 3(2)(a).

The condition that the transferee must be a New Zealand tax resident is a base protection measure as New Zealand does not tax foreign-sourced income derived by non-residents.

Where rollover relief is granted under section CF 3(3) to the transferor, section CF 3(1)(b)(ii) ensures that the transferee is ultimately taxable under the rules in section CF 3 rather than under the FIF rules.

Section CF 3(21)(d) provides that the transferee is taxed for the period they have held the interest in the superannuation scheme, as well as the period that the transferor held the interest in the foreign superannuation scheme while New Zealand tax-resident before the transfer. This is to ensure that all gains that accrued to the scheme while the transferor was a New Zealand tax resident while holding the interest are eventually taxed.

Example 4

Mary, her husband Martin, and their son Simon are all New Zealand tax residents. Mary first acquired an interest in a United Kingdom superannuation scheme while she was non-resident.

Mary dies unexpectedly. In her will, Mary transfers half of her interest in the UK superannuation scheme to Martin and the other half to Simon, rather than cashing out the interest and distributing the proceeds.

As Martin is a New Zealand tax resident and Mary's surviving spouse, the transfer to him is not a taxable event as it meets the requirements for rollover relief under new section CF 3(3).

Ten years later, Martin decides that he wants to transfer the interest to a New Zealand scheme. This is a taxable event for Martin under section CF 3(2)(b). Under section CF 3(21)(d), the amount of the transfer that is deemed to be assessable income will take into account how long Mary was New Zealand-resident while owning the interest before she died and it was transferred to Martin, as well as how long Martin has owned the interest.

In contrast, Simon is not provided rollover relief under section CF 3(3) as he is Mary's son and not a surviving spouse. This means that when the executor of Mary's estate transfers half of Mary's interest in the superannuation scheme to Simon, the transfer is a taxable event under section CF 3(2)(d) and the amount of the transfer that is deemed to be assessable income will depend on how long Mary was New Zealand-resident while owning the interest before she died and transferred it to Simon.

From the time that Simon acquires the interest, Simon has a FIF superannuation interest as Simon was already New Zealand-resident when it was transferred to him.

This means that Simon needs to account for income on an annual basis under the FIF rules. Five years after he acquires the interest, Simon decides to transfer the interest into a New Zealand scheme. Because Simon's superannuation interest has been taxed under the FIF rules, he does not pay any tax on the transfer to the New Zealand scheme.

Four-year exemption period

New sections CF 3(4)(a), CF 3(5), CF 3(6) and CW 28B provide that a lump sum that is received during a person's exemption period is exempt from New Zealand tax.

The exemption period is similar to the four-year tax-free window provided by the pre-existing "transitional resident rules" in section HR 8 of the Income Tax Act 2007. People who are transitional residents are generally not subject to tax on foreign income during the first four years of New Zealand tax residence.

Unlike the transitional resident rules, section CF 3(5) does not require a person to be non-tax resident for a minimum period in order to qualify for an exemption period. The exemption period is thus available to new migrants and returning New Zealanders alike (as long as they satisfy the overall requirement for section CF 3 that the interest in the foreign superannuation was first acquired while non-tax resident).

Also, unlike the transitional resident rules, it is not possible to opt out of the exemption period.

In addition, a person who receives Working for Families tax credits still receives a full exemption period in relation to their foreign superannuation interest.

To be eligible for an exemption period in relation to a foreign superannuation interest, new section CF 3(5) provides that a person must have first acquired the interest while non-tax resident and has not had an exemption period under section CF 3(5) before they acquired that interest. This means a person may only have one exemption period under section CF 3 during their lifetime, but it may apply to several interests simultaneously, provided that the interests were acquired while non-tax resident.

The wording provided in section CF 3(6) to determine the timing and length of the exemption period mirrors the transitional residence period provided in section HR 8(3). This provides consistency for individuals with foreign superannuation interests who are also transitional residents. This is reinforced by an amendment to section HR 8(1), which states that a lump sum derived under section CF 3 during a person's transitional residence period is not taxable in New Zealand.

The exemption period begins on the date a person becomes a New Zealand tax resident under section YD 1 of the Income Tax Act 2007 (either by acquiring a permanent place of abode or meeting the requirements of the 183-day rule). The exemption period ends at the end of the 48-month period beginning after the month in which the person meets the requirements of section YD 1(2) or YD 1(3), ignoring the rule in section YD 1(4).

If a person becomes a tax resident under section YD 1 part-way through a calendar month, their exemption period applies for that partial month as well as the subsequent 48-month period.

If a person becomes a New Zealand resident as a result of meeting the 183-day rule in section YD 1(3), the exemption period starts on the first day they are New Zealand-resident (under section YD 1(4)), but does not end until 48 months after they actually triggered the 183-day rule in section YD 1(3) (that is, on their 184th day in New Zealand).

Note that tax residence in this context means tax residence as provided in section YD 1 of the Income Tax Act 2007. As discussed in the section on "Taxable lump-sum withdrawals or transfers", a person could be considered to be a tax resident of New Zealand and another country under the domestic laws of each country. If the person "tie-breaks" to the other country under the DTA and is treated as not being a New Zealand resident for the purposes of the DTA, they are still considered to be a New Zealand tax resident under section YD 1 of the Income Tax Act 2007, which is relevant for the purposes of calculating the exemption period. (It should be noted that when the individual tie-breaks to the other country for the purposes of a DTA, in general New Zealand cannot tax lump sums originating from that other country and paid to the individual during the period that they tie-break to the other country).

Example 5

Jordan migrates to New Zealand with an interest in a foreign superannuation scheme. She is deemed to have acquired a permanent place of abode in New Zealand on 16 June 2015. Jordan is eligible for an exemption period which begins on the date she acquired her permanent place of abode. Her exemption period lasts for the remainder of June 2015, plus the 48 full calendar months following that. This means her exemption period ends on 30 June 2019, and her assessable period begins on 1 July 2019.

Methods for taxing lump sums

Lump sums are taxable if they are received during the person's assessable period.

A lump sum is taxed under one of two methods:

- the "schedule method" (the default method) in new section CF 3(9)(a), (10), (11), and (19); or
- the "formula method" in new section CF 3(9)(b), (12)–(19).

These two methods determine how much of a lump sum should be included as assessable income in an individual's income tax return (the assessable withdrawal amount).

New sections CF 3(4)(b) and CW 28C provide that the part of the lump sum that is not treated as assessable income under the schedule method or formula method is exempt income. The exempt income is not taken into account for student loan or Working for Families tax credit purposes.

The schedule method is the default method for calculating a person's assessable income in relation to a foreign superannuation withdrawal.

A person who satisfies the criteria in section CF 3(9)(b) is eligible to use the formula method in relation to a lump sum received from their foreign superannuation scheme, if they choose to do so. If they choose not to use the formula method, they must use the schedule method.

To be eligible to use the formula method the individual must meet several criteria in relation to the interest.

First, the foreign superannuation scheme must be a foreign defined contribution scheme for which a person has sufficient information about the value of the scheme and contributions made. A foreign defined contribution scheme is defined in section YA 1 as a foreign superannuation scheme that operates on the principle of allocating contributions to the scheme on a defined basis to individual members.

In addition, a person must not have used the schedule method for a past lump sum received from that particular interest, and must not have received a withdrawal (other than a pension or an annuity) before 1 April 2014. If the person received their interest from a spouse, civil union partner, or de facto partner, in a transaction referred to in section CF 3(21)(d), another condition is that the person who originally held the interest did not use the schedule method in relation to the interest.

Calculating the assessable period

As noted above, a person who receives a lump sum during their "assessable period" is required to calculate their assessable income in relation to that lump sum by using either the schedule or the formula method (the assessable withdrawal amount).

Generally speaking, the assessable period is the period during which a person is a New Zealand tax resident while holding an interest in a foreign superannuation scheme. The assessable period is calculated on an interest-by-interest basis. This ensures that the rules still work as intended if an individual has interests in multiple schemes acquired at different points in time (because, for example, they worked for different employers).

Determining the duration of a person's assessable period is necessary to calculate the assessable withdrawal amount under both the schedule method and formula method. New section CF 3(7) reinforces this.

The tax liability arising under the schedule method essentially depends on how long the person has been a New Zealand tax resident. It is calculated using the number of income years beginning in the person's assessable period.

The interest factor in the formula method is calculated using a person's years of tax residence.

Sections CF 3(11)(c) and CF 3(18)(c) provide that a person's years of residence is calculated as the greater of 1 and the number of income years which begin in the assessable period before a person receives a lump sum.

New section CF 3(8) provides how a person's assessable period for a foreign superannuation interest is calculated.

If the person has a four-year exemption period in relation to their foreign superannuation interest (as described above), their assessable period for that foreign superannuation interest begins as soon as the exemption period ends. This is provided for in new section CF 3(8)(a)(ii).

If the person does not have an exemption period in relation to their foreign superannuation interest (this will generally occur if the person has already had an exemption period before they acquired the foreign superannuation interest in question), their assessable period for that foreign superannuation interest begins when they become a New Zealand tax resident for the first time while owning that interest. This is given by section CF 3(8)(a)(i).

It is possible that a person could migrate to New Zealand with a foreign superannuation interest, lose their New Zealand tax residence, and then become tax resident again. New Zealand does not generally aim to tax foreign-sourced income derived by non-tax residents. To ensure that the schedule and formula methods do not contradict this principle, new section CF 3(8)(c) provides that the assessable period excludes periods of non-tax residence.

New section CF 3(8)(b) provides that a person's assessable period for an interest in a foreign superannuation scheme ends when the person derives a lump sum (the distribution time). This means when a person receives multiple lump sums from a given foreign superannuation interest, their assessable period for that interest is extended with each lump sum they receive.

Example 6

Brian's exemption period ends on 30 September 2015. His assessable period begins on 1 October 2015. Brian leaves New Zealand and his last day as a New Zealand tax resident is 27 March 2022. He becomes a New Zealand tax resident again on 1 August 2027. Brian receives a lump sum from his foreign superannuation scheme on 5 February 2029.

Brian's assessable period is from 1 October 2016 until 5 February 2029, but excludes the period 28 March 2022 to 31 July 2027 (which is when he was non-resident).

As noted above, section CF 3(2) provides that transfers between two non-Australian foreign superannuation schemes are generally not taxed. Instead, the holder of the interest is taxed when it is finally withdrawn or transferred to a New Zealand or Australian superannuation scheme. New section CF 3(21)(b) provides that in such a case, the assessable period begins when the person first became New Zealand tax-resident while owning the interest in the original foreign superannuation scheme or when their exemption period for that original interest ended.

Example 7

Matilda migrated to New Zealand with an interest in an employment-related German superannuation scheme and became tax-resident on 8 August 2012. Her exemption period is 8 August 2012 to 30 August 2016. Her assessable period for that superannuation interest begins on 1 September 2016.

On 7 July 2017 she transfers her interest into a different German superannuation scheme. This transfer is not a taxable event. On 21 March 2020, Matilda transfers that German superannuation interest to a New Zealand superannuation scheme, which is a taxable event.

Matilda's assessable period in relation to the transfer starts on 1 September 2016 and ends on 21 March 2020.

When an interest in a foreign superannuation scheme is transferred to another person, the transfer is generally taxable under new section CF 3(2)(d) to the transferor based on their assessable period, if the transferor is a New Zealand tax resident.

If the transferee is a New Zealand tax resident when they receive the interest from the transferor, the transferee generally does not qualify for the tax treatment provided in section CF 3 in relation to their acquired interest for subsequent lump sums received from the interest. In this case, the transferee has a FIF superannuation interest and is required to account for tax on an annual basis under the FIF rules.

The exception to this is where the transfer meets the conditions listed in section CF 3(3) for rollover relief following the death of the transferor or a relationship split involving the transferor and transferee. In this case, the transfer is not a taxable event to the transferor, but section CF 3(21)(d) provides that the transferee's assessable period begins when the transferor's assessable period for that interest began.

This approach ensures that all gains that have accrued to the scheme while the transferor was New Zealand tax-resident while holding the interest are eventually taxed.

Further explanation of the conditions for rollover relief arising under section CF 3(3) and an example can be found in the section "Certain transfers following the death of a spouse or a relationship split" of this report.

Example 8

Rebecca and Stella are sisters who migrated to New Zealand. Rebecca acquired an interest in an Italian superannuation scheme while she was working in Italy. Rebecca's exemption period ends on 30 November 2013 and her assessable period begins on 1 December 2013. On 16 October 2019, Rebecca decides to transfer her interest to Stella.

The transfer does not met the requirements for rollover relief under section CF 3(3) as Rebecca and Stella are not married, in a civil union, or in a de facto relationship.

Rebecca must account for the transfer using the rules in section CF 3. Rebecca's assessable period for calculating her assessable withdrawal amount arising from the transfer is 1 December 2013 to 16 October 2019. Rebecca must calculate her tax liability under either the schedule or formula method.

As Stella is a New Zealand tax resident when she acquires the interest from Rebecca, and does not qualify for rollover relief under section CF 3(3), Stella needs to account for income on the foreign superannuation interest using the FIF rules.

Schedule method

New sections CF 3(9)(a), CF 3(10), (11) and (19) provide for the schedule method. The schedule method is the default method for taxing foreign superannuation withdrawals received by individuals who first acquired their foreign superannuation interest while they were non-tax resident.

The schedule method deems a certain amount of the lump-sum transfer or withdrawal to be investment gains, based on the person's years of tax residence. The approach uses fractions that represent the proportion of the lump sum to be included in a person's assessable income – the assessable withdrawal amount. The schedule year fractions increase with years of residence. New sections CF 3(4)(b) and CW 28C provide that the remainder of the lump sum that is not deemed to be the assessable withdrawal amount is exempt from tax.

The fractions in new schedule 33 are set at the rate necessary to put a person who leaves their foreign superannuation overseas in the same position as if they had instead transferred their superannuation to New Zealand when they first became tax-resident and paid tax on investment gains as they accrued in a KiwiSaver or bank account, for example. This would also put them in a similar tax position to someone who pays tax on an annual basis under the FIF rules on an overseas-based financial asset. Given certain assumptions (including a 5% post-tax interest rate in the foreign scheme), the schedule method has been designed so that a person should conceptually be indifferent from a tax perspective between keeping their superannuation overseas and transferring it to New Zealand. Further discussion of the policy rationale behind the schedule method can be found in the annex to the issues paper.[3]

A person's assessable income (or assessable withdrawal amount) under the schedule method is calculated using the following formula provided in new section CF 3(10):

> (super withdrawal – contributions left) × schedule year fraction

The terms in the formula are defined in new section CF 3(11).

The term "super withdrawal" is the amount of the foreign superannuation withdrawal (the lump sum).

The "contributions left" item in the formula is a deduction for contributions made for or on behalf of a person while the person is a New Zealand tax resident, if the contributions satisfy certain conditions. The schedule method may otherwise treat some of the New Zealand contributions as gains would result in over-taxation.

New section CF 3(19) provides that all of the following conditions must be met:

- at the time the contribution is made, the person must be a New Zealand resident under section YD 1 and treated as a New Zealand resident under all applicable double tax agreements;
- the contribution is made by the person, or the person's employer, or for the benefit of the person;
- the contribution must be required under the rules of the foreign superannuation scheme (that is, voluntary contributions cannot be deducted); and
- employer contributions must be subject to employer superannuation contribution tax or fringe benefit tax.

Additional conditions set out in section CF 3(11)(b) provide that a given contribution may only be deducted once under the schedule method, and for a given lump sum, the amount of contributions deducted may not exceed the value of the lump sum in calculating the assessable withdrawal amount. Section CF 3(11)(b) also provides that only recognised contributions made during the assessable period before the distribution time can be deducted.

Contributions that can be deducted are restricted in this manner because the schedule rates already include an implicit allowance for contributions. For example, for the year one schedule rate, 4.76% of the withdrawal is treated as taxable New Zealand-sourced gains and the remainder is treated as non-taxable. The non-taxable portion includes contributions as well as gains derived while non-resident.

The reason for having restrictions on the types of contributions that are deductible is to ensure that contributions are not effectively deducted more than once – first, by being deducted as "contributions left" in the formula and, secondly, by then being allocated out using the schedule year fractions.

The appropriate "schedule year fraction" to use is identified by calculating the number of income years that *begin* in the person's assessable period, before the person receives the lump sum. This is the number of income years which begin after the person becomes a New Zealand tax resident and after their four-year exemption period ends. This means that when a person has an exemption period, the number of income years beginning in a person's assessable period is less than the number of years that they have been New Zealand-resident.

The effect of counting a person's years of residence from the end of the exemption period is to treat them as being non-resident during the exemption period. Gains which accrue during those four years are not clawed back and are therefore not taxed under the schedule method.

[3] *Taxation of foreign superannuation*, released on 24 July 2012 available at **www.taxpolicy.ird.govt.nz**

Example 9

After a period spent working overseas, Dan returned to New Zealand with an interest in a foreign superannuation scheme and acquired a permanent place of abode on 28 June 2012. Dan's exemption period begins on 28 June 2012 and ends on 30 June 2016. Dan's assessable period starts on 1 July 2016.

He withdraws a lump sum of $50,000 on 27 January 2020. There are three income years that begin in Dan's assessable period: the years beginning 1 April 2017 (2018 income year), 1 April 2018 (2019 income year), and 1 April 2019 (2020 income year).

Dan is therefore required to use the schedule year fraction for year three. The corresponding schedule year fraction is 14.06%, so his assessable income is $7,030 (being $50,000 × 14.06%).

Dan includes $7,030 as income in his 2020 income tax return. His marginal tax rate is applied to this amount, rather than the full amount of the lump-sum withdrawal.

If the number of income years beginning in a person's assessable period is zero when a person receives a lump sum (that is, they receive the lump sum during the part-year in which their assessable period starts but before the start of the next income year), the person should use the schedule year fraction associated with year one.

Example 10

Melanie's assessable period begins on 1 October 2014. She withdraws a lump sum of $50,000 on 5 February 2015, which means that an income year has not yet started during her assessable period.

Melanie is required to use the schedule year fraction for year one because the withdrawal was made between 1 October 2014 and 31 March 2015. The corresponding schedule fraction is 4.76%, so her assessable income is $2,380 (being $50,000 × 4.76%). Assuming Melanie's tax rate is 33% (which is the top personal marginal tax rate for the 2014–15 income year), she is liable to pay $785.40 of tax on her $50,000 lump-sum withdrawal.

Example 11

Ruby migrated to New Zealand with an interest in a foreign superannuation scheme and became a New Zealand tax resident on 25 November 2008 when she obtained a permanent place of abode. Her exemption period is 25 November 2008 to 30 November 2012 and her assessable period begins on 1 December 2012.

On 6 May 2018, Ruby transfers her foreign superannuation scheme into a New Zealand scheme and the transfer equates to $100,000.

Ruby has been treated as New Zealand-resident under all applicable double tax agreements since early 2009.

The rules of Ruby's foreign superannuation scheme require that she continues to contribute a certain amount to the scheme each year. The amount she is required to contribute during her exemption period amounts to $2,000. The amount she is required to contribute during her assessable period before the transfer is $3,000. Ruby decides to contribute an additional $500 to the scheme during her assessable period, which was not required by the scheme.

Ruby uses the schedule method to calculate how much of her transfer she needs to include in her 2019 income tax return.

Ruby's assessable period in relation to the transfer is 1 December 2012 to 6 May 2018. The number of income years beginning in her assessable period is six, so Ruby must use the schedule year fraction of 27.47%.

The $2,000 of contributions made during her exemption period are not deductible as one of the requirements for a contribution to be deductible is that they are made during the assessable period before the distribution time. The $3,000 of contributions are deductible as they meet the requirements in sections CF 3(11)(b) and CF 3(19) that they were made during Ruby's assessable period, they were required by the rules of the scheme, they were made by Ruby, and Ruby was treated as a New Zealand tax resident under all applicable double tax agreements when they were made. The additional $500 she contributed is not deductible as it was a voluntary contribution.

Ruby calculates her assessable withdrawal amount as follows:

($100,000 – $3,000) × 27.47% = $26,645.90

Ruby includes $26,645.90 as income in her 2019 income tax return and pays tax at her marginal tax rate on this amount.

New schedule 33 to the Income Tax Act 2007 provides the full schedule of rates per income year beginning in the person's assessable period:

Schedule year	Schedule year fraction
1	4.76%
2	9.45%
3	14.06%
4	18.60%
5	23.07%
6	27.47%
7	31.80%
8	36.06%
9	40.26%
10	44.39%
11	48.45%
12	52.45%
13	56.39%
14	60.27%
15	64.08%
16	67.84%
17	71.53%
18	75.17%
19	78.75%
20	82.28%
21	85.74%
22	89.16%
23	92.58%
24	95.83%
25	99.08%
26+	100%

Formula method

New sections CF 3(9)(b), CF 3(12), (13), (14), (15), (16), (17), (18), (19) and a new definition for "foreign defined contribution scheme" inserted into section YA 1 provide for the formula method.

The formula method is an alternative to the schedule method for people with foreign defined contribution schemes, if they meet other certain requirements and choose to use the formula method. This method taxes the actual investment gains that have accrued to a person's foreign superannuation scheme while the person has been a New Zealand tax resident (excluding the gains that accrued during the person's four-year exemption period).

To use this approach, new section CF 3(9)(b) provides that in addition to the requirement that the scheme must be a foreign defined contribution scheme, all of the following conditions must be met:

- the person has the information required to use the formula method;
- the person must not have received a distribution from the scheme before 1 April 2014, other than a pension or an annuity;
- the person has not used the schedule method in relation to that scheme; and
- if the person has acquired the interest from another person in a transaction referred to in new section CF 3(21)(d), that other person did not use the schedule method.

As set out in section CF 3(9)(b), a person is not permitted to use the formula method for an interest in a foreign superannuation scheme if they have already used the schedule method for that interest. However, a person is able to use the schedule method, if they have previously used the formula method for a given interest.

To use the formula method, a person is required to obtain the market value of the foreign superannuation interest at the time the exemption period ends, as well as information about contributions made and other necessary information. Requirements relating to the quality of information also apply.

Detailed procedure

The necessary calculations for the formula method begin with new section CF 3(12):

> distributed gain = (super withdrawal × calculated gains fraction) − other gains

The definition of each of these terms is provided in section CF 3(13) and (14).

"Super withdrawal" is the amount of the foreign superannuation withdrawal for which the person is using the formula method to calculate their assessable income.

"Other gains" is the total amount of "distributed gain" calculated under this formula for *previous* foreign superannuation withdrawals received in the assessable period *before* this particular lump sum.

If this is the first lump sum for the person in relation to that foreign superannuation interest, then "other gains" is equal to zero. This is because no other lump sums have been received during the person's assessable period before the time the current lump sum (for which the person is using the formula method) was distributed.

If, for example, a person is calculating the assessable withdrawal amount in relation to a third lump sum that the person has received from their foreign superannuation scheme, the "other gains" term consists of what they previously calculated for "distributed gain" in respect of the first and second lump sums.

The "other gains" term acts as a wash-up calculation to ensure that a person is not over- or under-taxed in relation to their foreign superannuation interest.

The "calculated gains fraction" is the greater of zero and the result given by the formula in section CF 3(14) as follows:

$$\text{calculated gains fraction} = \frac{\text{predistribution} + \text{withdrawals} - \text{value} - \text{contributions}}{\text{predistribution}}$$

Where the formula for the "calculated gains fraction" provides a negative result, the person must enter zero for the "calculated gains fraction" term in the formula for the "distributed gain" in section CF 3(12). The result is that losses cannot be offset against other income in the person's income tax return.

The terms in the "calculated gains fraction" formula are defined in new section CF 3(15).

"Predistribution" is the value of the person's interest in the scheme immediately before they made their foreign superannuation withdrawal.

"Withdrawals" is the total amount of previous foreign superannuation withdrawals the person has received from their foreign superannuation scheme made during their assessable period *before* the time the current lump sum (for which the person is currently using the formula method to calculate their assessable withdrawal amount) was distributed. This term is zero if the person has received no other lump sums from the foreign superannuation scheme. If, for example, the person is calculating the "calculated gains fraction" in respect of their third lump sum, "withdrawals" would consist of the value of their first and second lump sums.

"Value" is the opening value of the person's interest in the scheme at the beginning of their assessable period. If the person has an exemption period, "value" is the value of their foreign superannuation interest at the end of their four-year exemption period, not at the time of migration. This is to ensure that gains made by the scheme during the person's exemption period and the pre-migration value are not taxed. If a person does not have an exemption period in relation to their foreign superannuation interest, "value" is the value of the person's scheme at the time they first became a New Zealand tax resident while holding the interest.

"Contributions" is the total amount of recognised contributions under section CF 3(19) made to the scheme during the person's assessable period before the distribution time. This term provides a deduction for contributions made for or on behalf of a person while the person is a New Zealand tax resident, if the contributions satisfy certain conditions. The formula method may otherwise treat some of the New Zealand contributions as gains and would result in over-taxation.

Section CF 3(19) provides that all of the following conditions must be met:

- at the time the contribution is made, the person must be a New Zealand resident under section YD 1 and is treated as a New Zealand resident under all applicable double tax agreements;
- the contribution is made by the person, or the person's employer, or for the benefit of the person;
- the contribution must be required under the rules of the foreign superannuation scheme (that is, voluntary contributions cannot be deducted); and
- employer contributions must be subject to employer superannuation contribution tax or fringe benefit tax.

Once a person has calculated their "calculated gains fraction" and their "distributed gain" in relation to their lump sum, they are then required to calculate their assessable withdrawal amount by using the formulas in new section CF 3(16) to (18). These formulas are used to calculate the appropriate amount of "interest" to be charged on the amount of taxable New Zealand gains to account for the deferral benefit that the person obtains by not paying tax on accrual. This "interest" is calculated at the same rate as the average growth of the person's superannuation interest over the number of years of New Zealand tax residence.

$$\text{assessable withdrawal amount} = [\text{gain} \times (\text{grow rate} - 1) \times \text{tax rate} \times (\text{assessable years} - 1)] + \text{gain}$$

The terms in the formulas are defined in new section CF 3(18).

"Gain" is the amount of distributed gain that a person has calculated in section CF 3(12) in relation to the current lump sum for which they are using the formula method to calculate their assessable withdrawal amount.

"Tax rate" is the tax rate referred to in row 1 of table 1 in schedule 6 of the Income Tax Act 2007. This is the top prescribed investor rate (PIR) for taxing investments in multi-rate portfolio investment entities (PIEs).

The term "assessable years" refers to the number of tax years beginning in the person's assessable period. Where a tax year has not yet begun during a person's assessable period before the distribution time, the person must use "1" for this term.

The term "grow rate" is given by the formula in new section CF 3(17):

$$\text{grow rate} = \left(\frac{\text{accrued total}}{\text{value}}\right)^{\frac{1}{\text{assessable years}}}$$

The term "accrued total" means:

- the sum of:
  - the value of the interest in the foreign superannuation scheme immediately before the distribution time; and
  - the total amount of previous foreign superannuation withdrawals made during the assessable period from the scheme *before* the time that the current lump sum was distributed. This term is zero if the person has received no other lump sums during their assessable period from the scheme. This is the same as what is used for "withdrawals" in section CF 3 (14);
- which is then reduced by:
  - the value of recognised contributions under section CF 3(19) made to the interest in the scheme during the person's assessable period before the distribution time.

The conditions that must be met in order for a contribution to be a recognised contribution are provided in new section CF 3(19) and have been discussed in further detail in reference to the formula for the "calculated gains fraction" in section CF 3(14).

"Value" is the value of the person's interest in the scheme at the beginning of their assessable period. If the person has an exemption period, "value" is the value of their foreign superannuation interest immediately following the end of their four-year exemption period. This is to ensure that the pre-migration value and the gains made by the scheme during the person's exemption period are not taxed. If a person does not have an exemption period in relation to their foreign superannuation interest, then "value" is the value of the person's scheme at the time they first became New Zealand tax resident while holding the interest. This is the same as what is used for "value" in section CF 3(14).

The term "assessable years" refers to the number of tax years beginning in the person's assessable period. Where a tax year has not yet begun during a person's assessable period before the distribution time, the person must use "1" for this term. This is the same as the term "assessable years" in relation to section CF 3(16).

The final result given by section CF 3(16) is the person's assessable withdrawal amount which is to be included as income in the person's income tax return. The remainder of the lump sum that exceeds this amount is exempt income, as provided by new section CF 3(4)(b).

Summary of procedure

In addition to the detailed description of the procedure for the formula method, a summary of the procedure to calculate the assessable withdrawal amount under the formula method is shown below:

1. Calculate the "**calculated gains fraction**" in section CF 3(14) using:
   - the value of the scheme immediately before the foreign superannuation withdrawal ("predistribution");
   - the total value of previous foreign superannuation withdrawals made during the assessable period *before* the distribution of the current foreign superannuation withdrawal ("withdrawals");
   - the value of the scheme at the beginning of the assessable period ("value");
   - the total value of recognised contributions made to the scheme in the assessable period before the distribution of the current foreign superannuation withdrawal ("contributions").
2. Calculate the "**distributed gain**" in section CF 3(12) using:
   - the result for "**calculated gains fraction**" as calculated in **step 1**;
   - the amount of the foreign superannuation withdrawal ("super withdrawal");
   - the total value of distributed gains calculated in section CF 3(12) for *previous* foreign superannuation withdrawals from the scheme in the assessable period before the distribution of the current foreign superannuation withdrawal ("other gains").
3. Calculate the "**grow rate**" in section CF 3(17) using:
   - the value of the scheme at the beginning of the assessable period ("value");
   - the sum of the value of the scheme immediately before the foreign superannuation withdrawal and previous foreign superannuation withdrawals made during the assessable period before the distribution of the current foreign superannuation withdrawal, reduced by the total value of recognised contributions made to the scheme in the assessable period before the distribution of the current foreign superannuation withdrawal ("accrued total");
   - the number of tax years beginning in the assessable period and before the distribution time (or 1 if the result is zero) ("assessable years").

4. Calculate the "**assessable withdrawal amount**" in section CF 3(16) using:
   - the result for "**distributed gain**" as calculated in **step 2** ("gain");
   - the result for "**grow rate**" as calculated in **step 3**;
   - the number of tax years beginning in the assessable period and before the distribution time (or 1 if the result is zero) ("assessable years");
   - the tax rate referred to in schedule 6, table 1, row 1 (Prescribed rates: PIE investments and retirement scheme contributions) ("tax rate").

Example 12

Graham migrates to New Zealand with an interest in a foreign superannuation scheme and becomes a New Zealand tax resident on 17 April 2011. His exemption period is 17 April 2011 to 30 April 2015.

During Graham's exemption period, he withdraws a lump-sum amount of NZ$50,000 from his scheme on 20 November 2014.

Graham's interest in his foreign superannuation scheme is worth NZ$100,000 when his assessable period begins on 1 May 2015.

Graham withdraws a lump-sum amount of NZ$60,000 from his scheme on 23 June 2025. His scheme is worth NZ$180,000 immediately before the lump-sum withdrawal.

On 9 November 2030, Graham's foreign superannuation interest is worth NZ$150,000 and he transfers the full amount into a New Zealand superannuation scheme.

Graham has made no contributions to the scheme while he has been New Zealand-resident.

The withdrawal on 23 June 2025 and transfer on 9 November 2030 fall within the definition of "foreign superannuation withdrawal" and are received during Graham's assessable period, so Graham must calculate his tax liability under section CF 3. However, the withdrawal on 20 November 2014 is exempt income as it is received during his exemption period.

23 June 2025 withdrawal

To calculate his "assessable withdrawal amount" in relation to his withdrawal made on 23 June 2025, Graham must first calculate his "distributed gain" and "calculated gains fraction".

For the "calculated gains fraction", Graham uses $180,000 for the "predistribution" term as this is what his interest in his foreign superannuation scheme was worth immediately before he made the withdrawal.

For the "value" term, he uses $100,000 as this was the value of Graham's interest in the scheme at the beginning of his assessable period.

Graham has made no contributions and has not yet received any other foreign superannuation withdrawals during his assessable period, so both "contributions" and "withdrawals" are zero. Graham does not include the withdrawal he received during his exemption period on 20 November 2014 in "withdrawals", because it was not received during his assessable period.

His "calculated gains fraction" under new section CF 3(14) is therefore:

$$\frac{\$180{,}000 + \$0 - \$100{,}000 - \$0}{\$180{,}000} = \frac{4}{9}$$

Graham then uses this to calculate his "distributed gain" under section CF 3(12) in relation to the $60,000 lump sum:

$$\left(\$60{,}000 \times \frac{4}{9}\right) - 0 = \$26{,}666.67$$

The "other gains" term is zero because Graham has not received any other lump sums that were taxed under the formula method.

Now that Graham has his "distributed gain", he uses this to calculate his "assessable withdrawal amount".

First, Graham calculates his "grow rate" under section CF 3(17).

To do this he must first identify his "accrued total". His "accrued total" is $180,000 because his scheme was worth $180,000 immediately before the lump sum was withdrawn. He has not received any other foreign superannuation withdrawals during his assessable period, nor has he made any contributions to the scheme.

Graham uses $100,000 for the "value" term (the value of his interest at the beginning of his assessable period).

Ten tax years have begun in his assessable period so far, so the number of "assessable years" is ten.

Graham's "grow rate" is:

$$\left(\frac{\$180{,}000}{\$100{,}000}\right)^{\frac{1}{10}} = 1.060540482$$

In calculating his "assessable withdrawal amount", Graham is required to use the top prescribed investor rate[4] and makes use of the "distributed gain" amount he calculated earlier. As above, his number of "assessable years" is ten. Graham's "assessable withdrawal amount" is:

$$(\$26{,}666.67 \times 0.060540482 \times 0.28 \times 9) + \$26{,}666.67 = \$30{,}734.99$$

Graham includes $30,734.99 as assessable income in his IR 3 return for the 2025–26 tax year (the year in which

[4] This is the rate in row 1 of table 1 in schedule 6 of the Income Tax Act 2007, which is 28% on the date of enactment of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014.

he received the lump sum). The remaining $29,265.01 of the $60,000 withdrawal is exempt income.

Graham pays tax based on $30,734.99 of included income, rather than on the full amount of his foreign superannuation withdrawal of $60,000.

9 November 2030 transfer

Graham's transfer of the remainder of his interest in his foreign superannuation scheme into a New Zealand scheme is a taxable event. Graham continues to use the formula method for this second foreign superannuation withdrawal.

As before, the "value" term is still $100,000 but "predistribution" is now $150,000. Graham has still not made any contributions to his foreign superannuation scheme, so "contributions" is still zero. Graham includes $60,000 in the "withdrawals" term to account for his lump-sum withdrawal made on 23 June 2025.

Graham's "calculated gains fraction" under section CF 3(14) is therefore:

$$\frac{\$150{,}000 + \$60{,}000 - \$100{,}000 - \$0}{\$150{,}000} = \frac{11}{15}$$

Graham uses this to calculate his "distributed gain" under section CF 3(12) as follows:

$$\left(\$150{,}000 \times \frac{11}{15}\right) - 26{,}666.67 = \$83{,}333.33$$

Graham then calculates his "assessable withdrawal amount" using the formulas in section CF 3(16) and (17).

Graham's "accrued total" is the value of his fund immediately before the transfer plus the value of his first withdrawal ($150,000 + $60,000). Graham uses $100,000 for the term "value". At the time of the transfer on 9 November 2030, 15 tax years have begun during Graham's assessable period, so Graham uses 15 for the term "assessable years".

Graham's "grow rate" is:

$$\left(\frac{\$150{,}000 + \$60{,}000}{\$100{,}000}\right)^{\frac{1}{15}} = 1.05070618$$

Using the results for the "grow rate" and "distributed gain", and assuming that the top prescribed investor rate is 28%[4], Graham's "assessable withdrawal amount" is:

($83,333.33 x 0.05070618 x 0.28 x14) + $83,333.33
= $99,897.35

Graham therefore includes $99,897.35 as assessable income in his IR3 return for the 2030–31 tax year. Graham pays tax on that amount, rather than on the full value of the transfer of $150,000.

Optional KiwiSaver withdrawal facility

Under section CF 3(2)(b), a transfer from a foreign superannuation scheme into a New Zealand superannuation scheme is a taxable event. In some cases, the transfer may be into a locked-in superannuation scheme, such as KiwiSaver. This could lead to cashflow difficulties for the person if they are unable to access any of the transferred amount to pay the resulting tax liability.

To address this issue, new clause 14C has been inserted into schedule 1 of the KiwiSaver Act 2006 to provide an optional withdrawal mechanism for people who have transferred their foreign superannuation scheme into a KiwiSaver scheme and need to pay their tax liability arising from the transfer.

Subclause 14C(1) provides that a person may withdraw an amount to pay their tax liability arising from a transfer under the Income Tax Act 2007, but not interest and penalties. While this withdrawal facility is available from 1 April 2014, it may be used in respect of a transfer that was made before 1 April 2014 as long as there is a tax liability that arises under the Income Tax Act 2007 (and other requirements have been met).

The reference to the Income Tax Act 2007 is also read as a reference to the Income Tax Act 2004 and Income Tax Act 1994 under existing section ZA 3(1) of the Income Tax Act 2007. This means the optional withdrawal facility available under new clause 14C of the KiwiSaver Act 2006 is available when the tax liability on the lump-sum transfer arises under the Income Tax Act 2004 or Income Tax Act 1994 due to the date of the transfer.

The maximum amount that may be withdrawn is provided in subclause 14C(2) and is the lesser of the person's tax liability arising on the transfer of the foreign superannuation interest into KiwiSaver and their terminal tax liability for the tax year in which the transfer is assessed as income. This means when the terminal tax liability for the year is less than the tax liability on the transfer (for example, this could occur when a person has losses in relation to other income), a person is only permitted to withdraw up to the amount of their terminal tax liability.

In addition, the amount withdrawn may not exceed the value of the person's accumulated funds in the KiwiSaver scheme less the value of the Crown contribution. This condition is provided by subclause 14C(3).

Subclause 14C(1) also provides that a person may withdraw an amount to pay their student loan repayment obligation arising under the Student Loan Scheme Act 2011, but only the portion of the repayment obligation that arises as a result of the transfer of the foreign superannuation interest into KiwiSaver being assessed as taxable income.

Example 13

On 26 June 2013, Hamish transfers his foreign superannuation interest into a KiwiSaver scheme. He calculates his tax liability on the transfer and includes $20,000 as assessable income in his 2013–14 income tax return. This is in addition to Hamish's other income of $60,000 for the 2013–14 year.

The student loan repayment threshold for the 2013–14 year is $19,084 and the repayment rate is 12%.

Hamish's student loan repayment obligation for the year is $7,309.92 (($80,000 – $19,084) × 12%). He is permitted to use the KiwiSaver withdrawal facility for up to $2,400 of that amount ($20,000 × 12%), which relates to the amount of his increased student loan repayment obligation arising from the transfer.

A number of requirements must be met in order to use the withdrawal facility. These conditions are provided for in new subclause 14C(4).

Subclause 14C(4) requires that the application to the KiwiSaver provider to withdraw funds under clause 14C must be made within 24 months from the end of the month that the tax liability and/or student loan repayment obligation arising from the transfer of the foreign superannuation interest into the KiwiSaver scheme is assessed.

The form of the application is determined by the trustees or manager of the KiwiSaver scheme as provided by subclause 14C(4). Under subclause 14C(4), a person's application must include any supporting documents and information that are required by the trustees or manager of the KiwiSaver scheme.

In addition, new subclause 14C(4) requires that a person's application must include a completed statutory declaration giving the details of the transfer of the person's foreign superannuation interest into the KiwiSaver scheme and the resulting liability for tax arising under the Income Tax Act 2007.

New subclause 14C(5) provides that the trustees or manager of the KiwiSaver scheme must inform the Commissioner of Inland Revenue of any withdrawals made under clause 14C and must provide details of the withdrawal. In addition, payment of the withdrawal must be made to the Commissioner if the KiwiSaver provider's systems allow the release of funds to any person other than the KiwiSaver member (for example, a solicitor).

Use of the new withdrawal facility is optional, so it is important for individuals to consider whether making a withdrawal under subclause 14C would trigger any obligations or conditions imposed upon the transfer of their foreign superannuation interest into KiwiSaver. This may include, for example, penalties imposed on withdrawals made within a certain period of time following migration under the rules of the scheme, or under the other country's law.

Example 14

Andrea transfers her interest in a foreign superannuation scheme worth $100,000 into a KiwiSaver scheme on 30 January 2015. Andrea calculates that her assessable withdrawal amount in relation to the transfer is $4,760, which she includes in her 2014–15 income tax return.

Assuming that Andrea's marginal tax rate is 33%, her tax liability arising from the transfer is $1,570.80.

Andrea has overpaid tax in relation to her other income derived in the 2014–15 year. Andrea's terminal tax liability for the 2014–15 income year is $1,200.

Andrea does not have a student loan.

She makes an application under clause 14C of the KiwiSaver Act 2006 to the manager of her KiwiSaver scheme on 6 October 2015. Her withdrawal is limited to $1,200 as this is the lesser amount of her terminal tax liability and her liability for tax arising from her transfer. Andrea's application is for $1,200.

She provides a signed statutory declaration and the documents required by the manager.

The KiwiSaver manager approves the withdrawal and pays $1,200 to the Commissioner of Inland Revenue. The manager also provides details of Andrea's withdrawal to the Commissioner.

Use of the foreign investment fund rules

From 1 April 2014, the foreign investment fund (FIF) rules generally no longer apply to interests in foreign superannuation schemes except in the following two circumstances:

- when the interest in the foreign superannuation scheme was first acquired while a person is a New Zealand tax resident under section YD 1; or
- when a person treated their interest in a foreign superannuation scheme as an attributing interest in a FIF in an income tax return filed before 20 May 2013 and the person treats the interest as an attributing interest in a FIF in income tax returns in all subsequent income years.

This is reflected in the definition of "FIF superannuation interest" which has been inserted into section YA 1 of the Income Tax Act 2007.

Interests in foreign superannuation schemes first acquired while New Zealand tax-resident

The FIF rules continue to apply when a person first acquires their interest in a foreign superannuation scheme while already New Zealand-resident under section YD 1 of the Income Tax Act 2007. This is provided for in paragraph (a) of the definition of new term "FIF superannuation interest" in section YA 1 and applies irrespective of whether the interest was acquired before or after 1 April 2014.

A person is considered to be a New Zealand tax resident under section YD, 1 if they have a permanent place of abode in New Zealand. If a person does not have a permanent place of abode in New Zealand, they are considered to be a New Zealand tax resident if they are personally present in New Zealand for more than 183 days in a 12-month period.

As discussed in section "Taxable lump-sum withdrawals or transfers", a person could be considered to be a tax resident of New Zealand and another country under the domestic law of each country. If the person "tie-breaks" to the other country under the DTA and is treated as not being a New Zealand resident for the purposes of the DTA, they are still considered to be a New Zealand tax resident under section YD 1 of the Income Tax Act 2007.

This means an individual who first acquires their interest in a foreign superannuation scheme while New Zealand tax-resident must account for income in relation to their interest on an annual basis. Any distributions received from the scheme are considered under the FIF rules and are not treated as income of the individual at the time they are derived. This is a standard feature of the FIF rules.

There is an exception to this rule in the situation when a New Zealand resident acquires the interest in a transaction that meets the criteria set out in section CF 3(21)(d). Section CF 3(21)(d) refers to a transfer of an interest in a foreign superannuation scheme from a New Zealand tax resident to:

- a New Zealand-resident surviving spouse, civil union partner or de factor partner of the original owner following their death; or,
- a New Zealand-resident former spouse, civil union partner or de facto partner of the original owner under a relationship agreement arising from the end of the marriage, civil union or de facto relationship.

If the criteria in section CF 3(21)(d) are met, the individual is not required to account for income in relation to the foreign superannuation interest under the FIF rules, but is instead required to account for tax on receipt. Section CF 3(1)(b)(ii) provides that in this situation, the individual is taxed on any lump sums under the new rules in section CF 3. Pensions received from that scheme are taxed in full at the person's marginal tax rate.

The purpose of this carve-out from the definition of "FIF superannuation interest" is to ensure that an interest in a foreign superannuation scheme is correctly taxed at the correct point in time, when a transfer of the interest from one person to another satisfies the criteria for rollover relief provided in section CF 3(3). Where rollover relief is provided to the transferor under section CF 3(3) (and an exception from the FIF rules is given to the transferee in the definition of FIF superannuation interest), section CF 3(21)(d) is integral in correctly calculating the transferee's assessable period under section CF 3(8).

There is another exception to the acquired-while-tax-resident rule, when a person transfers their interest in a foreign superannuation scheme into another foreign superannuation scheme while New Zealand tax-resident and that first interest was not a FIF superannuation interest.

Consider a person who acquired an interest in a foreign superannuation scheme while non-resident before they migrated to New Zealand. Once they are a New Zealand tax resident they transfer their interest to a different foreign superannuation scheme provider (this may occur, for example, when a person disposes of their interest to purchase an annuity with a different provider, or if a person transfers from one foreign scheme to another foreign superannuation scheme to obtain better returns). As noted in section "Transfers between two non-Australian foreign schemes (rollover relief)", this transfer is not taxed under section CF 3.

However, the person is taxed under section CF 3 when a lump sum is received from that second scheme, rather than being subject to the FIF rules in relation to the interest in that second scheme. This is provided for in section CF 3(1)(b)(ii). Section CF 3(21)(b) provides that in such a case, the assessable period begins when the person first became New Zealand tax-resident while owning the interest in the original foreign superannuation scheme or when their exemption period for that original interest ended.

Example 3 in section "Transfers between two non-Australian foreign schemes (rollover relief)" is relevant here.

Example 15

Glenn is a New Zealand tax resident. Glenn decides to diversify his investment portfolio and on 26 February 2011, he invests $100,000 in a foreign superannuation scheme. His interest is an attributing interest in a FIF and Glenn accounts for FIF income and losses in relation to his interest in subsequent income tax returns. For income years beginning from 1 April 2014, Glenn continues to account for FIF income and losses in relation to his foreign superannuation interest, because he first acquired his interest in the foreign superannuation scheme while a New Zealand tax resident.

Example 16

Peter acquired an interest in a foreign superannuation scheme while already a New Zealand tax resident in 2010. The interest is an attributing interest in a FIF, but Peter has not been returning FIF income or losses in relation to his interest. From 1 April 2014, Peter's interest in the foreign superannuation scheme is still an attributing interest in a FIF. Peter learns that he should be returning FIF income and losses in his income tax returns and begins to do so from the 2014–15 income year. Peter remains liable for omitted FIF income in relation to income years ending before 1 April 2014.

Example 17

Zoe is a New Zealand tax resident who goes to the United Kingdom to work for one year. While she is in the UK, she retains a permanent place of abode in New Zealand and remains a New Zealand tax resident. She also becomes a UK tax resident during that one-year period.

While working in the UK, Zoe acquires an interest in a UK pension scheme.

When she returns to New Zealand after her year abroad, she has a FIF superannuation interest and is required to account for income under the FIF rules, because she remained a New Zealand tax resident while she was away.

Grandparenting of the foreign investment fund rules in limited circumstances

In addition to the provision that interests in foreign superannuation schemes acquired while New Zealand-resident are taxable under the FIF regime, the FIF rules remain available (but not mandatory) for a certain group of people who acquired their interest in a foreign superannuation scheme while non-resident but have already returned FIF income or losses in an income tax return filed before 20 May 2013.

This provision, known as "grandparenting", is provided in paragraph (b) of the definition of new term "FIF superannuation interest" in section YA 1.

Grandparenting applies on an interest-by-interest basis. That is, when a person has interests in multiple foreign superannuation schemes, it is possible that the person may be grandparented in relation to one or several of those interests, or none at all.

For a given interest in a foreign superannuation scheme in a given income year (the "current year"), the criteria that must be met for the interest to be a FIF superannuation interest are described below. The reference to "current year" means that from 1 April 2014, a person needs to evaluate whether they satisfy the criteria every income year.

First, the person must have acquired (or is treated as having acquired) the interest in the foreign superannuation scheme while non-resident. Where an interest is acquired while the person is already New Zealand tax resident, the interest is already an attributing interest in a FIF under paragraph (a) of the definition of FIF superannuation interest in section YA 1.

In addition, the interest must be an attributing interest in a FIF in an income year ending before 1 April 2014 (known as the "qualifying year"). For that "qualifying year", the person must have treated the interest as an attributing interest in their income tax return and that income tax return must be filed before 20 May 2013.

It is possible that because of the $50,000 de minimis thresholds in sections CQ 5(1)(d) and DN 6(1)(d), a person did not have FIF income or losses to include in their income tax return, even if their interest in a foreign superannuation scheme was an attributing interest in a FIF before 1 April 2014. In this case, the person is not considered to have treated the interest as an attributing interest in their income tax return for the qualifying year.

The person must also continue to hold that interest from the end of the "qualifying year" until the beginning of the "current year" (known as the "qualifying period"). For all of the income years in the "qualifying period", the person must treat the interest as an attributing interest in a FIF in their income tax returns.

The effect is that when a person has satisfied the grandparenting criteria for a superannuation interest, the person is not required to account for tax on a distribution from the scheme received during the "current year".

When a person who correctly treated their interest as an attributing interest in an income tax return filed before 20 May 2013 for an income year ending before 1 April 2014 and fails to treat it as an attributing interest in an income tax return for one or more income years in the "qualifying period", the interest is no longer a FIF superannuation interest. Whether this failure is deliberate is irrelevant. When an interest ceases to be a FIF superannuation interest, the person is taxed on receipt of any distributions from the interest and no credit is given for any tax paid on income arising under the FIF rules in relation to that foreign superannuation interest. In particular, any lump sums received from 1 April 2014 are taxed under the new rules in section CF 3.

The term "treated by the person as an attributing interest in a return of income" also covers situations where a loss arises under the FIF rules, but that loss is reduced to nil in accordance with section EX 51 on a portfolio basis and the income arising under the FIF rules is nil.

Example 18

Thomas acquired an interest in a foreign superannuation scheme before he migrated to New Zealand in August 2006. Thomas has just entered the workforce, so his interest in the scheme is small and has always remained well below $50,000. Thomas has no other foreign investments.

Before 1 April 2014, Thomas' interest is an attributing interest in a FIF. However, Thomas was a transitional resident under section HR 8 for the period August 2006 to August 2010 and was not required to account for income under the FIF rules during that period.

From August 2010, Thomas' interest was an attributing interest in a FIF, but due to the de minimis threshold in sections CQ 5(1)(d) and DN 6(1)(d), he had no FIF income or losses. This means that Thomas did not treat his interest as an attributing interest in an income tax return for an income year ending before 1 April 2014.

Therefore, from 1 April 2014, Thomas is not able to use the FIF rules in relation to his foreign superannuation interest.

Optional treatment of lump sums derived between 1 January 2000 and 31 March 2014 when tax obligations were not previously met

New section CZ 21B of the Income Tax Act 2007, section CF 3 of the Income Tax Act 2004, and section CC 4 of the Income Tax Act 1994 provide an optional method relating to the taxation of lump-sum transfers and withdrawals made from foreign superannuation schemes by 31 March 2014. This optional method is available in addition to the tax rules governing foreign superannuation interests before 1 April 2014.

A person who has made a lump-sum withdrawal or transfer from their foreign superannuation scheme between 1 January 2000 and 31 March 2014 (or applies for the withdrawal or transfer of such an amount by 31 March 2014) has the option to pay tax on 15 percent of the lump-sum amount.

The phrase "applies for the withdrawal of such an amount" in new section CZ 21B means the person has done all that is necessary of them to apply to withdraw or transfer their funds by 31 March 2014 and generally that any delay in receiving the funds is outside of their control.

Section CZ 21B(1) requires that the person has not included the lump sum as income in their income tax return for the income year during which the lump sum is derived, and has not been assessed for income included in that lump sum by 31 March 2014. The 15 percent concession is only available if the person has not complied with their tax obligations in relation to their foreign superannuation interest, either on receipt of a lump sum under the ordinary tax rules or on an annual basis under the FIF rules in the income years leading up to the distribution of the lump sum.

If the 15 percent option is not used, a person remains liable for tax under the law that applied to their foreign superannuation interest at the time they made the withdrawal – this may be tax on accrual under the FIF rules, or tax on receipt under the ordinary tax rules. The original due date for payment of tax still applies if there is a positive amount of income under reassessment. This means that any relevant penalties and use-of-money interest apply from the income year in which the transfer or withdrawal occurred if the person is subject to tax on receipt, or from the appropriate years in which the person should have returned income under the FIF rules.

People who have complied with the tax law that existed at the time they received their lump sum and paid any associated tax are not able to reassess their position using the 15 percent option. In addition, people who have complied with the tax law in relation to a lump-sum withdrawal or transfer and have correctly calculated that they have zero tax to pay (for example, under the transitional resident rules) are not required to do anything further.

Unlike the restriction in section CF 3 to interests in foreign superannuation schemes acquired while non-tax resident, there is no such restriction for the 15 percent option. A person who acquired an interest in a foreign superannuation scheme while resident under section YD 1 of the Income Tax Act 2007 can use the 15 percent option provided they meet the requirements of section CZ 21B(1).

Section CZ 21B(1)(d) provides that to use this option, a person must include 15 percent of the lump-sum amount as income in their 2013–14 or 2014–15 income tax return. Tax is then calculated on this amount at the person's marginal tax rate. The remainder of the lump sum is not assessable.

Section CZ 21B(2) provides that the person is treated as having derived that 15 percent amount in the income year in which it is included in the person's income tax return, which means the portion that is included in the person's income tax return for 2013–14 or 2014–15 may affect that person's obligations and entitlements for that income year, such as child support, student loans, and Working for Families tax credits.

The 15 percent option may be used after the 2014–15 income year in respect of a pre-1 April 2014 lump sum, but the person's 2014–15 income tax return must be reassessed. In this case, any relevant penalties and use-of-money interest apply from the 2014–15 income year.

Section CZ 21B(4)(b) and (c) provide that using the 15 percent option satisfies the tax liability of a person in relation to their foreign superannuation interest by overriding the law that applied before 1 April 2014 in relation to the taxation of the person's lump-sum distribution and of the person's interest in the foreign superannuation scheme. The effect is to override any non-compliance in relation to the person's foreign superannuation interest irrespective of whether the person was non-compliant with the ordinary tax rules or the FIF rules.

In the situation when a person applies to their foreign superannuation provider to release or transfer their interest by 31 March 2014, but the lump sum is not received until on or after 1 April 2014, the interaction between new sections CF 3 and CZ 21B means that a person may choose between using the 15 percent option to satisfy their tax liability and the rules in new section CF 3. Section CZ 21B(4)(a) provides that if a person in this situation chooses to use the 15 percent option, their tax liability arising under section CF 3 is overridden. If the person should have complied with the FIF rules before 1 April 2014 but did not, section CZ 21B(4)(c) simultaneously overrides their previous FIF obligations in relation to the foreign superannuation interest.

Example 19

Judy transferred $150,000 from her foreign superannuation scheme to a New Zealand scheme in February 2004. She did not include this income in her IR3 return for the 2003–04 income year, and did not pay tax in relation to her interest under the FIF rules.

She decides to use the 15 percent option for her lump-sum transfer. She declares $22,500 (being 15 percent of $150,000) as income in her IR3 return for the 2014–15 income year.

Judy will be liable for any penalties or use-of-money interest in relation to her 2014–15 tax return, not her 2004–05 tax return.

Example 20

Catherine is a new migrant and became a New Zealand tax resident on 30 January 2002. Catherine transferred $150,000 from her foreign superannuation scheme to a New Zealand scheme in February 2004. She did not include this income in her IR3 return for the 2003–04 income year.

She decides to use the law as it applied at the time that she made the withdrawal to calculate the tax on her lump-sum transfer. In her situation, her interest was not an interest in a FIF, and the majority of her $150,000 was a return of capital, and only $2,000 of the amount is income. She has her 2003–04 IR3 return amended to include the $2,000.

Catherine will be liable for penalties and use-of-money interest from the 2003–04 income year.

Example 21

Albert migrated to New Zealand in 2008 with an interest in a New Zealand superannuation scheme. He became a New Zealand tax resident on 17 March 2008 and qualified as a transitional resident under section HR 8 of the Income Tax Act 2007.

Under section HR 8, Albert is a transitional resident from 17 March 2008 until 31 March 2012. Certain foreign-sourced income derived during this time is exempt from New Zealand tax.

Albert withdrew his foreign superannuation interest worth $100,000 on 1 September 2010. The $100,000 is received while Albert is a transitional resident, so he does not include it as income in his 2010–11 income tax return.

As Albert *correctly* calculated that he had no New Zealand tax to pay, he is not required to do anything further.

LISTED INDUSTRIAL MINERAL MINING

Subpart CU, section CZ 28, subpart DU, sections EJ 20B to EJ 20E, FM 31(2)(b), GB 20, IA 7, ID 1, IS 1, IS 2, IS 6, subpart LU and section YA 1 of the Income Tax Act 2007

The concessionary rules that previously applied to "specified mineral" miners (now known as "listed industrial minerals") have largely been repealed and replaced with rules that more closely align the tax treatment of these miners with that of taxpayers more generally, while accommodating some of the more unique aspects of the mineral mining industry.

Key features

The key features of the new rules relate to the deductibility of expenditure. The rules separate a mine's life into various phases and allow deductions based on the phase in which the expenditure occurs. In essence, the rules treat mines as large revenue account projects and seek to ensure that the allocation of income and deductions is broadly in line with orthodox tax principles.

Concessionary rules that allow the losses of mining companies to survive a breach in shareholder continuity have been retained. However, these concessions are buttressed by rules that limit the ability of mining companies to form consolidated groups and offset mining losses.

A refundable credit has been created to recognise that certain types of expenditure are likely to result in deductions being available only after the income-earning activity of a miner has ceased.

Application date

The changes apply from the 2014–15 income year.

DETAILED ANALYSIS

Who the rules apply to

The rules will apply to all "mineral miners". Because the new rules are less concessionary, it is expected that miners will adopt different structures to carry out their operations. The definition of "mineral miner" in section CU 6 therefore applies to all forms of legal entity:

- whose only or main source of income is the mining of a listed industrial mineral in New Zealand; or
- whose only or main activity is:
  - exploring, searching or mining for a listed industrial mineral in New Zealand; or
  - performing development work for exploring, searching or mining for a listed industrial mineral in New Zealand; or
- who proposes that their only or main activity is as set out in the previous point.

The relevant sources of income or activities are unchanged from the previous rules. To ensure consistency, the new rules also largely retain the previous definitions of "mining operations" and "associated mining operations" in section CU 7. The definition of "listed industrial minerals" in section CU 8 is identical to the previous definition of "specified minerals".

A miner does not include a person that engages in the relevant activity only as a service for reward, unless the reward is wholly or mainly dependent on the production of minerals or wholly or mainly arises through participation in profits from the mining operations. This is to exclude "ordinary" contractors who are not in some sort of profit-sharing arrangement as part of the mining activities.

Section CU 5 clarifies that if mining is carried out through a partnership, each partner is treated as having a share or interest to the extent of their interest in the income in the partnership. The rules related to income and deductibility of expenditure apply according to those shares.

Income

Under these rules, a mineral miner can derive income from four main sources:

- Under section CU 1, amounts derived from their "mining operations" or "associated mining operations".
- Under section CU 2, amounts derived from the disposal of land. The land in question must be acquired for the purposes of current or intended mining operations and must either:
  - constitute a mining permit area, or be adjacent to it; or
  - be part of a mining permit area, or be adjacent to it.

  This is intended to ensure that only land directly relevant to the mining activity is captured by the new rules, rather than other land interests that a mineral miner may have (such as an office building in a nearby town).
- Under section CU 3, consideration derived from disposing of a mineral mining asset. "Mineral mining asset" is defined in section CU 9 to mean a mining or prospecting right, an exploration permit, a prospecting permit or a mining permit or any share or interest in any of these assets.
- Under section CU 4, amounts recovered under a special "claw-back" rule that applies if deductions are taken when, in hindsight, those deductions should not have been taken immediately, but spread over the life of the mine. For this rule to apply, the following criteria must be met:

NEW LEGISLATION

- The miner must incur "exploration expenditure" (discussed below), for which they are allowed a deduction under section DU 1(1)(b).
- The income year in question must be after the 2013–14 income year (to avoid retrospective application of the claw-back rule).
- The expenditure must have been incurred in a year for which the miner is required to keep records under section 22 of the Tax Administration Act 1994 (to avoid imposing additional compliance costs on a miner by making them keep records for longer than they would otherwise need to for tax purposes).
- The expenditure results in, produces or generates an asset for the miner that they then use for, or in relation to, the commercial production of minerals.

The previous specified mineral rules allowed a mineral miner to provision for future anticipated expenditure – a concessionary feature that has not been carried over into the new rules. This means miners that have these provisions will need to add them back as income in the 2014–15 income year, being the year the new rules take effect. This may result in some miners having an unexpectedly large income tax liability in that year. To ease any cashflow concerns that may arise, section CZ 28 allows a miner to allocate this income equally over the 2014–15 and 2015–16 income years.

Deductions

The special deduction rules are set out in subpart DU. These rules break mining activity down into its main phases and allow deductions broadly in accordance with orthodox tax principles.

The main phases, and types of expenditure, are:

- Prospecting expenditure
- Exploration expenditure
- Development expenditure
- Operational expenditure
- Rehabilitation expenditure
- Land expenditure.

The definitions of these types of expenditure are mutually exclusive, so expenditure can only fall into one category.

Also excluded is "residual expenditure", for which deductions are allowed under ordinary principles. Residual expenditure" is expenditure:

- for which the miner is allowed a deduction under section DB 33 (Scientific research);
- on an application fee payable to the Crown for a permit;
- on insurance premiums or royalties paid under the Petroleum Act 1937 or the Crown Mineral Act 1991, land tax under the Land Tax Act 1976, or rates;
- on a lease of land or buildings;
- on a financial arrangement to which the old financial arrangement rules apply; or
- on interest.

Prospecting expenditure

Under section DU 1, mining prospecting expenditure is always deductible. "Mining prospecting expenditure" is defined in section DU 9 as expenditure that a miner incurs directly in relation to the acquisition of a prospecting right under the Crown Minerals Act or "mining prospecting information". It also includes prospecting activities undertaken through various methods, but does not include land, plant or machinery costs, which must be treated under ordinary principles.

Exploration expenditure

Mining exploration expenditure is also immediately deductible under section DU 1. However, this is subject to the "claw-back" rule in section CU 4, discussed above. Expenditure clawed back under that rule is subject to the spreading rules that apply to development expenditure, discussed below.

"Mining exploration expenditure" is defined in section DU 10 to mean expenditure incurred in searching or exploring in New Zealand for a listed industrial mineral. It includes expenditure incurred directly in relation to:

- acquiring an exploration right or permit under the Crown Minerals Act;
- geological mapping and geophysical surveys;
- systematic searches for areas containing minerals; or
- searching by drilling or other techniques.

Again, expenditure on land, plant and machinery is excluded.

Development expenditure

"Mining development expenditure" is defined in section DU 11. This type of expenditure is generally capitalised and then deducted over the life of the mine. This treatment approximates the depreciation rules that generally apply to capital assets. For these purposes "development expenditure" includes exploration expenditure that has been clawed back under section CU 4.

Definition

"Mining development expenditure" is defined as expenditure that a miner incurs in preparing a permit area for mining and expenditure on operations carried on by a miner on a permit area for the purposes of deriving income and consists of:

- mining;
- performing work directly related to mining; or
- undertaking earthworks necessary for the working of the mine.

The definition also specifically includes the following:

- acquiring a mining right or permit under the Crown Minerals Act;
- obtaining resource consents;
- establishing mine infrastructure (including plant and machinery, production equipment or facilities, or storage facilities); and
- providing communication equipment, fuel, light, power or water in relation to their mining operations in a permit area.

This definition is deliberately broad to capture all expenditure that is conceptually part of the creation of the capital asset – in this case a mine. However, it has the potential to overreach and capture expenditure that is properly operational in nature. This is particularly so for expenditure incurred after commercial production of the mine has begun. The definition therefore specifically excludes the following:

- "operational expenditure" (discussed below); and
- other expenditure that is incurred on property after the start of commercial production and that has an estimated useful life that does not depend on the remaining assumed life of the mine. An example might be a digger acquired after commercial production has begun to shift rock for mining purposes. That digger could, if the mine closed, be used for other purposes. Its useful life as a digger is not dependent on the particular mine in question. It is therefore not "development expenditure" and can be depreciated at the appropriate rate for that type of digger.

The definition of "operational expenditure" in section DU 11(4) expands and clarifies this second limb of excluded "development expenditure". "Operational expenditure" means expenditure that meets the following criteria:

- it is incurred in operations by the miner in a permit area;
- it is incurred after the start of commercial production; and
- it does not create an asset that has an estimated useful life of longer than one year.

This is designed to clarify that "running costs" of the mine, such as administrative costs incurred after the start of production, are not required to be capitalised. They can instead be treated in accordance with ordinary taxation principles.

Spreading methods

Sections DU 6 and DU 7 set out the two spreading methods that may be available to a miner in respect of their development expenditure. One is time based and the other operates on a "reserve depletion" basis (sometimes referred to as a "unit of production" basis).

Under either method deductions are denied except to the extent allowed under the spreading rules (sections DU 6(2) and DU 7(2)).

Reserve depletion

The reserve depletion method is available only to miners that either:

- use IFRS rules to prepare their financial statements; or
- keep records that are sufficient for the Commissioner to verify their calculations.

The miner must also make an irrevocable election in the first year of commercial production from a permit area to apply the reserve depletion method (sections DU 7(1)(d) and EJ 20E(2)). To transition into the new rules, section EJ 20E(7) allows an existing miner to make this irrevocable election in the 2014–15 income year.

Deductions under the reserve depletion method are only available after the miner starts to use the permit area to derive income (section DU 7(1)(b)). The deductions are then spread according to the rules set out in section EJ 20E – in particular, the formula set out in subsection (3).

That formula is:

$$(\text{reserve expenditure} - \text{previous expenditure}) \times \frac{\text{reserve depletion for the year}}{\text{proven and probable reserves}}$$

"Reserve expenditure" is the total development expenditure for the current and previous income years (in effect, all development expenditure).

"Previous expenditure" is the expenditure that has been allocated to earlier income years.

"Reserve depletion for the year" is the amount of mineral produced in the year.

"Proven and probable reserves" are the proven and probable reserves set out in the reserve statement for the area, provided the reserve statement is prepared in accordance with a classification recognised under the Crown Minerals (Mineral other than Petroleum) Regulations 2007.

For the purposes of "reserve depletion" and "proven and probable reserves" the amount must be set out using an appropriate unit of measure (as set out in the reserve statement) and used consistently.

A simple example of how the formula might work is shown below.

Example

Miner A is in year 3 of commercial production of a permit area and its total development expenditure to date has been $50 million. In the previous two years, Miner A has deducted $10 million under the reserve depletion method. The latest reserve statement estimates that 1,000 proven and probable units of the mineral remain in the permit area. In year 3, Miner A produces 250 units.

Using the formula, Miner A will be allowed a deduction in year 3 of:

$$(\$50\text{m} - \$10\text{m}) \times \frac{250}{1{,}000}$$

$$\$40 \times 0.25 = \$10\text{m}$$

To recognise that sometimes expenses might be allocated on the basis of a "mine" rather than a permit area, section EJ 20E(6) allows a miner to allocate expenditure to a mine – but only if the miner:

- uses International Financial Reporting Standards (IFRS) rules to prepare their financial statements; and
- allocation to a mine is permitted for the purposes of those statements.

Time basis

The time basis of allocating development expenditure is the default method for miners that either do not qualify to elect into the reserve depletion method (for example, if they do not keep the requisite records) or they do meet the criteria but fail to, or chose not to, elect.

As with the reserve depletion method, deductions under this method are only available after the miner starts to use the permit area to derive income (section DU 6(1)(b)). The spreading rule is set out in section EJ 20B to EJ 20D.

The calculation formula is set out in section EJ 20B(2) as:

rate × value

"Rate" is, at the choice of the miner:

- the straight-line rate set out in schedule 12, column 2 that is nearest to the rate calculated under section EJ 20D(2) (discussed below); or
- the diminishing value rate set out in schedule 12, column 1 that corresponds with the straight-line rate in the point above.

"Value" is the adjusted tax value or diminished value of the expenditure (as appropriate).

Whether the miner is using the straight line or diminishing value method, the following formula in section EJ 20D is needed to determine the appropriate rate.

$$\frac{100\%}{\text{assumed life}}$$

The assumed life is the lesser of:

- the period that the miner uses for accounting purposes as the amortisation period for the area or, if the miner is not required to use an amortisation period for their accounts, the commercial production period for the area that miner reasonably estimates; and
- 25 years from the later of the date that commercial production starts or the date that the expenditure is incurred.

This rule effectively puts a 25-year cap on the amortisation period for development expenditure under this method.

For these purposes, the expected life of the mine must be reassessed at the end of each year, to determine whether the previous estimate is still accurate.

Section EJ 20C sets out the length of the spreading period. It starts on the later of the first day in the income year that commercial production commences and the first day of the income year that the expenditure is incurred. It finishes on the last day of the income year in which the expiry of the assumed life of the mine occurs.

A simple example of how this rule works is shown below.

Example

Miner B is in year 1 of commercial production and has incurred $50,000 in development expenditure on the permit area. Miner B is not required to use an amortisation period for its accounts. Using the information at its disposal, Miner B considers that it will be commercially producing minerals from the site for 3 years. Miner B wants to use a straight-line depreciation method.

Using the formula:

$$\frac{100\%}{\text{assumed life}}$$

Miner B must calculate the depreciation rate in schedule 12 using the rate closest to 33.33%. The closest rate in the schedule is 30%.

Using the formula in EJ 20B: rate × value

Miner B's deduction in year 1 is: 30% × $50,000 = $15,000

Again, this method allows a miner to allocate expenditure to a mine, rather than a permit area if the criteria described in the "reserve depletion" section above are met (section EJ 20B(b)).

Tax credit

A tax credit may be available in some instances for "trapped" development expenditure (which may arise using either spreading method) – see the section on tax credits, below.

Operational expenditure

As set out above, "operational expenditure" is essentially an exclusion from the "mining development expenditure" definition. There are no specific rules related to such expenditure, so general principles apply to determine its deductibility or otherwise.

Rehabilitation expenditure

"Rehabilitation expenditure" is deductible in the year it is incurred (section DU 2).

The term is defined in section DU 12 to mean expenditure incurred in New Zealand directly in relation to rehabilitation of land in a permit area, carried out as a result of:

- permit requirements;
- the requirements of access arrangements under the Crown Minerals Act 1991 or regulations made under that Act;
- a miner's obligation under the Resource Management Act 1991 or regulations under that Act;
- a concession under the Conservation Act 1987; or
- an authority under the Historic Places Act 1993.

The definition also clarifies that rehabilitation expenditure can be incurred either during or after the operational phase of mining.

Tax credit

To recognise the fact that rehabilitation expenditure (though deductible) may only be incurred in years after the miner's income-earning activities have ceased, a tax credit may be available in some instances. The section on tax credits later in this report sets out the criteria.

Land expenditure

As mentioned in the section on income from land sales and section CU 2 above, a miner's income includes amounts derived from the disposal of land. However, that section only applies if the land in question was acquired for the purposes of current or intended mining operations and either:

- constitutes a mining permit area, or is adjacent to it; or
- is part of a mining permit area, or is adjacent to it.

Section DU 3 contains the corresponding deduction provision. It broadly applies to the same categories of land, to provide symmetry between the income and deduction rules. It does not cover land expenditure for which the miner has a deduction before disposing of the land. This is most likely to occur if the miner has a deduction under one of the other provisions of the Act that allow for land acquisition costs to be deductible.

Land expenditure covered by section DU 3 is deductible in the year the land or interest in land is disposed of. This broadly provides for land to be treated as revenue account property, with a deduction available if a loss is made on disposal and any gains form part of the miner's income.

Tax credit

Land interests may be one of the last things a miner disposes of. To recognise that any losses incurred on sale may therefore be incurred after the income-earning activity has ceased, a tax credit may be available. The section on tax credits later in this report sets out the criteria.

Mining asset expenditure

Mining asset expenditure is separately provided for in the legislation, although it is not as easily categorised as a "phase" in the same way as the expenditure types described above. As mentioned above, section CU 3 treats consideration derived from disposing of a mineral mining asset as income of the miner.

Section DU 4 sets out how the acquisition cost is treated. If a mining permit for the relevant permit area has not been obtained, the purchaser is allowed an immediate deduction for the expenditure. This reflects the fact that any expenses incurred by the seller at that point were probably deductible as well, either as prospecting or exploration expenditure. If a mining permit has been obtained, the purchaser must treat the expenditure as mining development expenditure, so it is deductible over the life of the mine. The fact that a mining permit has been obtained indicates that the decision has been made to attempt commercial production, so the "development" phase will have started.

Section DU 4(3) clarifies that "expenditure incurred" on a mining asset does not include the cost of applying for a mining right or permit – it is only the purchase of those assets after they have been granted.

Farm-out arrangements

A "farm-out arrangement" is defined in section YA 1 and has been modified so it applies to a mineral mining context. In simple terms, a farm-out arrangement is one where a person (the farm-in party) agrees to incur expenditure in doing work in a permit area and, in return, the existing permit holder (the farm-out party) agrees to surrender part of their interest in that permit.

Section DU 5 clarifies that expenditure by the farm-in party is to be treated as if it were the applicable class of mining expenditure. If, for example, the expenditure was classified as development expenditure, the farm-in party would only be allowed a deduction for that amount over the life of the relevant mine using the appropriate spreading method. As the existing rights holder is not getting any money from the farm-out arrangement, the expenditure of the farm-in party is excluded income to the farm-out party under section CX 43 (which overrides section CU 3 in these circumstances).

This can be contrasted with the situation when the existing permit holder sells an interest in the permit outright – in which case section CU 3 will apply to treat the proceeds as income.

Anti-avoidance rules

Section GB 20 contained the existing specific anti-avoidance rules that applied to the petroleum mining sector. Because the phases of both mineral and petroleum mining are broadly comparable, and these new rules more closely align the tax treatment of these sectors, the anti-avoidance rules have been expanded to cover the activities of mineral miners too.

Tax credits

As mentioned above, the new rules provide instances where miners may be entitled to deductions, but will be unable to use them because their income-earning activity has ceased. This can occur, for example, when a miner incurs rehabilitation expenditure. To recognise the undesirability of this type of "black-hole" expenditure, subpart LU creates a refundable credit that will be available if the following criteria are met (section LU 1):

- the expenditure is of a certain type (set out below); and
- the mineral miner has a net mining loss for the permit area for the income year that is greater than the net income of the mineral miner for the income year from all other sources. For these purposes, the net mining loss is calculated as if the miner's only income was derived from the permit area. The net income from other sources is calculated as if there were no income from the permit area. This avoids double counting of the relevant income. The difference between these figures is called the "excess amount".

The types of expenditure are:

- rehabilitation expenditure;
- a loss on the disposal of mining land;
- development expenditure for which a deduction has not been available and the relevant permit has been relinquished, revoked, surrendered or has expired and the miner has no existing privilege for the permit area.

The amount of the credit reflects the fact that the credit is intended as the economic equivalent of a loss carry-back rule. It is calculated using the following formula:

expenditure or loss × tax rate

"Expenditure or loss" means the "excess amount" referred to above, but only to the extent that it includes one of the relevant expenditure types. This means the "excess amount" is an effective cap on the amount but may not always be able to be used. For example, if there is an excess amount of $100,000 but the relevant categories of expenditure only amounted to $50,000, it is the $50,000 figure that would be the basis of the calculation. Equally, if the excess amount was $100,000 but the relevant categories of expenditure amounted to $150,000, it is the $100,000 that would be used for the calculation.

"Tax rate" is the relevant basic rate of income tax set out in schedule 1, part A of the Income Tax Act 2007.

Cap on credit

To reflect its equivalence to a loss carry-back rule, section LU 1(4) provides that the credit is capped at the lesser of:

- the result of the formula; and
- the total amount of income tax paid by the miner in all previous tax years to the extent that it relates to the permit area.

Trustees and individuals

If a simple tax rate to calculate the tax credit was used (for example, the company rate), this may result in inappropriately high or low credits being available to miners that are individuals or trustees of a trust.

For individuals, the amount of tax paid in previous years is calculated on a year-by-year basis and aggregated as if their only income from previous years was mining income from the permit area.

For trustees, the amount of tax paid in previous years is calculated on a year-by-year basis and aggregated:

- first, by reference to the amount of income tax paid as an agent of a beneficiary under section HC 32; and
- second, by reference to the amount of tax paid as trustee income.

The following examples illustrate these rules.

Example: Individual

Dave is a "mineral miner" who is also employed as an accountant. In each of years 1, 2 and 3, Dave earned taxable income of $90,000 in total from his mining activities and $70,000 from his job. At the end of year 3, Dave's mining activity ceases and in year 3 Dave incurs $250,000 of rehabilitation expenditure and derives no other income.

Because the $250,000 is rehabilitation expenditure, Dave is entitled to a tax credit, calculated by looking back at the total tax paid in the previous years. The first year to consider is year 3. Dave derived $90,000 in taxable income from mining that year (his salary income from his accounting job is not counted for these purposes and the $90,000 is treated as the first income he earned in that year). Dave's tax liability on that $90,000 was $20,620.

Dave still has $160,000 of rehabilitation expenditure that has not been offset, so that is carried back to year 2. Dave's $90,000 of taxable mining income from that year again produced a tax liability of $20,620.

Finally, Dave carries back the remaining $70,000 to year 1. The tax on his first $70,000 in that year is $14,020.

Dave's total tax credit on his $250,000 rehabilitation expenditure is $20,620 + $20,620 + $14,020 = $55,260.

Example: Trust

The trustee of the Golden Trust is a "mineral miner". The trust has three beneficiaries: Rex, Nick and Daisy. In year 1, the trust earned $80,000 taxable mining income from the relevant permit area. It distributed $20,000 to each of the beneficiaries as beneficiary income (and paid tax on that income as agent for the trustees under section HC 32) and retained $20,000 as trustee income. The beneficiaries are in the following situations for the year:

- Rex has carried forward losses of $20,000;
- Nick has no income other than that received from the trust;
- Daisy is employed on an annual salary of $50,000.

At the end of year 1, the trust's mining activity ceases and in year 2 it incurs $80,000 of rehabilitation expenditure and derives no other income.

Because the expenditure is rehabilitation expenditure, the trustee is entitled to a tax credit. The beneficiary income from year 1 is required to be counted first. For each $20,000 distribution, the tax liability was as follows:

- Rex paid no tax because the distribution simply absorbed his carry-forward losses;
- Ben paid tax on $20,000 at $2,520;
- Daisy earned a total of $70,000 but this distribution is treated as her first income, meaning her tax liability on the $20,000 is also treated as being $2,520.

This makes a total credit from the $60,000 distributed of $5,040. There is still $20,000 of rehabilitation expenditure required to be offset at the trustee tax rate, making an additional credit of $6,600.

The trustee's total tax credit is therefore $5,040 + 6,600 = $11,640.

Relationship with other rules

Section LU 1(8) clarifies that a loss that is able to generate a credit does not form part of a tax loss component or net mining loss for the miner. This is to avoid the loss being double counted (that is, used to generate a credit and then used again to offset other income).

Continuity and loss-offset rules

The previous concession that allowed losses in a company that is a mineral miner to survive a breach in shareholder continuity has been retained (section IA 7(7)). In a set of rules which are not as generous as they were, this concession could still pose a revenue risk which could result in inappropriate loss trading. To mitigate this risk, the existing rules that prevent mining companies from forming a consolidated group with companies that are not mineral miners (in section FM 31) have also been retained, as have the specific loss-offset rules in subpart IS. Sections IS 3 and 4 have been repealed because the ability to offset mining income against losses by holding companies was largely only relevant in the concessionary rules, when losses could be relatively easily accumulated in holding companies. Given there is no restriction on the activities that a holding company can undertake, there is a risk that allowing this offsetting to continue (coupled with the ability of losses to survive a continuity breach) could result in mining losses being inappropriately offset against income from other sources.

OTHER POLICY MATTERS

ANNUAL INCOME TAX RATES FOR 2013–14 TAX YEAR

The annual income tax rates for the 2013–14 tax year are the rates set out in schedule 1 of the Income Tax Act 2007, and are the same that applied for the 2012–13 tax year.

Application date

The provision applies for the 2013–14 tax year.

FURTHER CANTERBURY EARTHQUAKE-RELATED AMENDMENTS

Sections CZ 25, CZ 26, EE 1, EE 52, EZ 23B, EZ 23BB, EZ 70 to EZ 74 and FZ 7 of the Income Tax Act 2007

Amendments have been made to ensure existing Canterbury earthquake tax measures work as intended, in the context of the rebuilding activity now taking place in Canterbury.

Background

As a result of the Canterbury earthquakes, a number of changes to tax law were made in 2011 and 2012. These measures included deferring recognition of depreciation recovered in respect of certain assets (rollover relief), and rules to smooth the timing of income recognition for insurance proceeds received for damaged assets.

The policy objective behind the earthquake-related measures is to ensure the tax rules do not over-tax insurance proceeds or unnecessarily bring forward future tax liabilities for taxpayers affected by the earthquakes. A further objective has been to ensure that the tax rules do not produce unfair results and that they assist recovery and rebuilding in the Canterbury region.

Amendments have been made in response to further tax issues identified as the Canterbury recovery plans have developed and the rebuild has commenced. These largely relate to ensuring that the existing tax measures work as intended in the context of the rebuilding activity taking place in Canterbury, rather than with providing additional "special relief" measures.

Key features

There are two main amendments. The first extends the previous 2015–16 income year time limit for existing Canterbury-earthquake amendments by three years, to the end of the 2018–19 income year. The second amendment extends the existing rule providing tax relief to taxpayers for unexpected depreciation claw-back arising from earthquake-damaged assets to taxpayers who reinvest jointly with others to acquire replacement property.

A number of remedial amendments have also been made to the taxation of insurance proceeds, the revenue account property rollover relief (which is similar to depreciation rollover relief, but applies to buildings and land held on revenue account), and the special exemption for certain land disposals.

Detailed analysis

Insurance proceeds received for repairable assets

Section EE 52 specifies the amount of depreciation recovery income that a person has when they receive insurance proceeds for damage to a depreciable asset. An amendment has been made to section EE 52, to clarify that if damaged property is disposed of before the insurance proceeds are received, the proceeds will be treated as being derived immediately before the disposal. This is to remedy a gap in the earlier legislation. If a person receives insurance proceeds for a damaged building and the building is then sold, the owner is taxed on the insurance proceeds. However, before the amendment, if the damaged building was sold before the insurance proceeds were received by the owner, the proceeds were not taxable.

Application date

The amendment applies from 25 June 2013, the date the Supplementary Order Paper on further Canterbury earthquake tax measures was released.

Extension of time limit for Canterbury earthquake-related amendments

Amendments have been made to extend the 2015–16 income year time limit for Canterbury earthquake-related provisions by three years to the end of the 2018–19 income year. The following provisions are affected by this extension:

- rollover relief for depreciation recovery income arising from insured damaged assets (section EZ 23B);
- rollover relief for buildings and land on revenue account (section CZ 25);
- timing rules for smoothing income and deductions/ disposal losses when insurance proceeds are received for depreciable assets (sections EZ 23F and 23G repealed and re-enacted as sections EZ 73 and EZ 74) ;
- the provision regarding assets that are uneconomic to repair (section EZ 23C repealed and re-enacted as section EZ 70);
- the provision capping depreciation recovery income arising under section EE 52 (section EZ 23D repealed and re-enacted as section EZ 71);
- the amendment to the "available for use" depreciation rule (section EZ 23E repealed and re-enacted as section EZ 72);

- the provision allowing deduction of expenses when income-earning activity was temporarily interrupted (section DZ 20); and
- the provision allowing adjustment to assets under thin-capitalisation rules (section FZ 7).

Application date

The amendments apply until the end of the 2018–19 income year.

Extension of relief from depreciation claw-back to persons who reinvest jointly

Many income-producing depreciable assets are insured. In these cases, the tax rules deem the assets to be sold for the value of any insurance proceeds received. If the insurance proceeds exceed an item's tax book value, any excess depreciation deductions allowed while the asset was in use are clawed back as income under section EE 48 (referred to as "depreciation recovery income").

A rule was introduced in 2011 (section EZ 23B) to allow the deferral of the claw-back of depreciation that ordinarily arises when insurance proceeds are received for items of depreciable property that have been irreparably damaged in a Canterbury earthquake. It works by rolling over the depreciation recovery income to reduce the acquisition cost of replacement depreciable property. The purpose of the rollover relief is to defer any unanticipated tax liability resulting from the destruction of insured depreciable assets in the earthquakes and to assist the rebuilding in Canterbury. The relief rule is designed on the basis that the person who owns the damaged asset is the same person who acquires replacement property.

An amendment has been made (section EZ 23BB) to extend relief from depreciation claw-back to taxpayers who reinvest jointly with other investors to acquire replacement property – this is because reinvestment in Canterbury is occurring through multiple owners pooling together to invest in large building complexes. Unlike section EZ 23B, the new rule does not involve rolling depreciation recovery income into the cost base of replacement property.

Under section EZ 23BB (1), relief is available when a person:

- receives insurance proceeds for a depreciable asset (that is not depreciable intangible property or property for which the pool method is used);
- that is damaged in a Canterbury earthquake, as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011, and is irreparable (section EE 47(4)) or uneconomic to repair (section EZ 23C or section EZ 70);
- has depreciation recovery income under section EE 48;
- is not linked with replacement property under section EZ 23B;
- has a voting interest in a company that will acquire replacement property or is the settlor of a trust which holds a voting interest in such a company; and
- gives written notice to the Commissioner meeting the requirements of section EZ 23BB (10).

The replacement property must also meet certain criteria (subsection (6)), namely:

- It must be of the same class or type as the damaged property with which it is linked.
- It must be located in greater Christchurch, as that term is defined in section 4 of the Canterbury Earthquake Recovery Act, if the item is a building or commercial fit-out.

If the person meets these criteria, they should be able to defer recognising their depreciation recovery income until the earliest income year that:

- the replacement property is sold by the joint investment company; or
- they exit the joint investment company that they have a share in by reducing their voting interests in the entity or entering into liquidation or bankruptcy.

In addition, depreciation recovery income must be recognised if the income year is the 2018–19 income year and the joint investment company has not acquired the replacement property linked to the damaged property by the end of the income year.

The person's entitlement to defer their depreciation recovery income is related to their level of investment in replacement property, for consistency with the existing depreciation rollover relief provision (subsections (4) and (5)). This means the amount of depreciation recovery income that a person can defer is limited to their share of the cost of a replacement asset as a proportion of the original cost of their destroyed asset. The person's share of the cost of the replacement (referred to as the "fractional interest value") is determined using the formula:

$$\text{person's fractional interest} \times \text{replacement expenditure}$$

The person's fractional interest is either the person's voting interest in the joint investment company or, if the voting interests are held through a trust, the fraction calculated by multiplying the voting interest in the owning company held by the trustee of a trust of which the person is a settlor by the proportion of the trust corpus that has been settled by the person (subsections (12) and (13)).

For example, a person has depreciation recovery income of $4 million for a destroyed building which originally cost $5 million. The person reinvests with three other investors into a company which acquires a replacement building at a cost of $30 million by the end of the 2018–19 income year. The person owns a 10% share of the company. Therefore, their share of the cost (fractional interest value) is 10% of $30 million, that is, $3 million. The amount of depreciation recovery income they can obtain relief for is determined under subsection (4) as:

(a) zero, if the cost of the damaged property equals or is less than the total fractional interest values for other replacement interests acquired by the person before the replacement interest; or

(b) the amount calculated using the formula:

$$\frac{\text{limited replacement cost} \times \text{excess}}{\text{affected cost}}$$

"Limited replacement cost" is the lesser of:

(i) the fractional interest value determined under subsection (12); and

(ii) the amount by which the cost of the damaged property exceeds the total amount of the fractional interest values of other replacement interests acquired by the person before the replacement interest.

"Excess" is the excess recovery for the affected class.

"Affected cost" is the total cost for the person of the damaged property.

Therefore, in the example above, the amount under subsection (4) is:

$3m × $5m ÷ $4m = $2.4m

$2.4 million is treated as "suspended recovery income" and a reduction in the amount of depreciation recovery income under subsection (3). If the person's share of the replacement asset cost is equal to or more than the cost of their destroyed asset, they would be entitled to treat the full amount of depreciation recovery income as suspended recovery income.

In the case where a person has purchased two or more replacement interests concurrently, an ordering rule applies, requiring the taxpayer to choose the order in which the interests are treated as being acquired (subsection (14)). A similar ordering rule has been introduced in section EZ 23B (subsection (11C)). This amendment has been made to ensure the formula applies correctly when two or more replacement items/interests are purchased at the same time.

Notice requirements

A person who wishes to elect to apply section EZ 23BB is required to give written notice in each year they choose to apply the new rule by the date on which the return of income is filed for that income year (subsection 10). Notice can also be given under section EZ 23B for previous years.

Subsection (11) specifies that a notice must provide details of:

(i) the items of damaged property and whether it is a building or grandparented structure, commercial fit-out or other depreciable property;

(ii) replacement property that the damaged property was linked with under section EZ 23B in a previous income year;

(iii) the person's voting interest in the company acquiring the replacement property or, where a trust is used to hold an interest in a joint investment company, the proportion of the trust corpus that the person has settled on the trust;

(iv) the amount of expenditure by the joint investment company in the income year on replacement property;

(v) the amount of suspended recovery income at the end of the current year; and

(vi) the amount of depreciation recovery income for the damaged property at the end of the current year.

Interaction with other provisions

A person who has elected into section EZ 23B for a previous income year and has not yet begun incurring expenditure on acquiring replacement property that they wish to link with their damaged property is eligible to elect to use section EZ 23BB (refer to section EZ 23B (11B)). Therefore, both persons who have never elected into section EZ 23B and taxpayers who have elected into section EZ 23B for a previous income year are able to apply section EZ 23BB. A person cannot link replacement property to the same affected property under both provisions concurrently.

Both sections EZ 23B and EZ 23BB override subpart EE.

Application date

The amendment applies from 4 September 2010.

Revenue account property rollover relief

Revenue account property (RAP) rollover relief was introduced in 2011. It is similar to the rollover relief for depreciable assets, but applies to relation to buildings and assets held on revenue account.

The purpose of the RAP rollover relief is to delay the tax that would arise on the disposal of the original RAP, until the eventual sale of the replacement RAP. The tax obligation is not removed altogether though; when the replacement RAP is eventually sold, the profit will be taxed at the time of sale.

RAP rollover relief allows for equivalently valued RAP to be purchased with the receipts from the original RAP by deferring the payment of the associated tax.

The three main situations and outcomes can be summarised as:

(i) The cost of replacement RAP is *less than* the disposal proceeds and *less than* the cost of the original RAP.

In this situation no rollover relief will be due, because any liability arising on the sale of the original RAP can be met without affecting the ability to purchase replacement RAP.

(ii) The cost of replacement RAP is *equal to* or *more than* the disposal proceeds, and *more than* the cost of the original RAP.

In this situation all the proceeds are put towards the replacement RAP. Rollover relief can be claimed in full, and there is no pro-rata. The full amount of taxable income will be rolled over, and the go-forward value of the replacement RAP will be reduced accordingly.

(iii) The cost of replacement RAP is *less than* the insurance proceeds but more than the cost of the original RAP.

If not all of the amount received from disposal of the original RAP is used to purchase replacement RAP, there is a pro rata approach to determine the amount that is to be rolled over, and that amount of the proceeds that are taxable immediately. This is achieved through the formula in section CZ 25.

Amendments have been made to this formula to clarify and simplify this pro-rata calculation.

Example of pro-rata formula

Income from disposal of original RAP	\$7m
Cost of original RAP (deductions)	(\$3m)
Excess recovery (section CZ 25(2))	\$4m
Cost of new replacement RAP	\$5m

The disposal income from the original RAP of \$7m exceeds the cost of the new RAP.

Therefore a pro-rata approach is needed to determine how much of the \$4m profit (excess recovery) from this disposal will be taxed immediately, and how much will be rolled over (suspended) and reduce the tax cost of the replacement RAP going forward.

For the purposes of determining the amount of the suspended recovery income, and the value of the replacement property going forward, the expenditure on the replacement RAP (\$5m) is reduced by an amount calculated as follows:

replacement RAP cost ÷ deductions for original RAP × excess of insurance proceeds over replacement RAP

= \$5m ÷ \$3m × \$2m = \$3.3m

The replacement RAP's cost base is reduced (\$5m – \$3.3m) to \$1.7m.

The amount of the suspended recovery income immediately before the expenditure on the replacement RAP (\$4m) is reduced by the same amount (\$4m – \$3.3m).

This leaves income taxable immediately of \$0.67m.

In addition, the section has been amended to apply to disposal proceeds received from Crown acquisitions under sections 54 and 55 of the Canterbury Earthquake Recovery Act 2011 (compulsory acquisitions) as well as acquisitions under section 53 of that Act.

Application date

These amendments apply from 4 September 2010.

Disposal of buildings and land within 10 years of acquisition

Subpart CB of the Income Tax Act 2007 contains various provisions to ensure that the proceeds from land purchased with the intention or purpose of sale are taxable. Broadly speaking, a seller may also derive income from the disposal of land if it is disposed of within 10 years of purchase or within 10 years of improvements being made to the land, and the seller is, or is associated with, a person in the business of dealing in, developing or building on land.

Section CZ 26 contains an exemption to some of these rules in situations involving a Crown purchase of land made under the Canterbury Earthquake Recovery Act 2011. This means a person who accepts the Crown's offer of purchase will not be considered to derive income from the disposal of land. The exemption recognises that the particular circumstances of Christchurch may mean that it is not possible, nor in some cases desirable, for the owner to retain their property for the requisite 10-year period following acquisition or other event that triggers the 10-year rule.

Three key amendments have been made to the scope of this exemption.

The first amendment is to clarify that the exemption applies to Crown acquisitions under sections 54 and 55 of the Canterbury Earthquake Recovery Act 2011 (compulsory acquisitions) as well as acquisitions under section 53 of that Act.

The second amendment extends the exemption to income arising under section CB14. This section deals with income arising on disposal of land within 10 years of changes in zoning, planning permissions etc. when the profit from disposal is attributable to an increase in the value of the land caused by such changes.

The exemption did not originally apply to this type of income, because it was not considered relevant given the circumstances in Christchurch. However it is considered that changes to the re-zoning rules under recovery plans may mean that this section might apply to a small number of taxpayers, so the exemption has been extended accordingly.

The third amendment corrects a drafting error, and removes the exemption for income arising under section CB 11, which applies in situations when the owner has entered into a scheme to do non-minor development. The exemption does not apply to income under in this situation, because, once section CB 11 applies it is not time-limited to 10 years in relation to the date of disposal.

Application dates

The first two amendments apply from 4 September 2010.

The third amendment applies from 27 February 2014, being the date of Royal assent. This is to protect taxpayers who may already have used the exemption in relation to income arising under section CB 11.

WORKING FOR FAMILIES TAX CREDITS

Sections GB 44, MA 8, MB 1, MB 4, MB 7, MB 8, MB 9, MC 6, MD 1, MD 2, MD 11, MD 12, MD 13 and MD 16 of the Income Tax Act 2007

Amendments have been made to clarify and improve the Working for Families (WFF) tax credit provisions to ensure they operate as intended. The amendments are consistent with the policy behind previous amendments, including the broadening of the definition of "family scheme income" to prevent people structuring their income to inflate their entitlements.

Key features

There are a number of specific changes to the WFF tax credit provisions as follows:

- Sections MD 1, MD 2 and MD 16 have been amended to ensure that the formula for calculating the family credit abatement produces the correct result in all cases, when it relates to a family that receives a parental tax credit in a lump sum for a child born within 56 days of the end of the tax year.
- Section MB 4 provides that income attributable to shares in a close company held by dependent children will be included in family scheme income. This addresses a situation where a person could reduce their income by allocating shares in a close company to their dependent children. It also clarifies how dividends from close companies are treated and aligns the provision's wording with section MB 7.
- Section MB 7 ensures that, when calculating family scheme income, the attribution of trust income takes into account only settlors who were alive in the income year. It also aligns the provision's wording and structure with section MB 4 on how company income is attributed to a trustee.
- Sections MA 8 and MB 1 clarify that family scheme income is based on a person's net income and is further adjusted as provided by subpart MB.
- Section GB 44, the anti-avoidance provision, has been clarified to ensure that all arrangements that have a purpose of favourably affecting an entitlement to WWF tax credits are covered by the provision.
- Section MD 12 clarifies the days when a person is entitled to a parental tax credit by reference to the criteria in section MD 11.
- The reference to "fortnightly instalments" has been removed from section MD 13 and regulation 8 of the Health Entitlement Cards Regulations 1993, as instalments can be paid weekly as well as fortnightly.
- Reference to a market value circumstance in determining a proportion of shareholding in a company has been removed from sections MB 4, MB 7, MB 8 and MB 9.
- Sections in the Tax Administration Act 1994 and the Health Entitlement Cards Regulations 1993 have been updated to refer to "family scheme income" rather than "net income", to reflect the changes in sections MA 8 and MB 1.
- The list of defined terms in section MC 6 has been updated.

Background

WFF tax credits are provided to the principal caregiver of dependent children based, among other things, on their level of family scheme income for a tax year. The tax credits are abated when family scheme income exceeds $36,350 and are abated at the rate of 21.25 cents per dollar. The tax credits can be received as a lump sum at the end of the tax year or in weekly or fortnightly instalments throughout the year.

The WFF tax credits are:

- Family tax credit – for principal caregivers of dependent children.

- In-work tax credit – for principal caregivers of dependent children who are not receiving an income-tested benefit and who meet the full-time earner requirements.
- Parental tax credit – for principal caregivers of a newborn child who are not receiving a social assistance payment and not receiving paid parental leave.
- Minimum family tax credit – for principal caregivers of dependent children who meet the full-time earner requirement and do not receive income from certain sources such as an income-tested benefit.

The provisions have been amended a number of times over the last decade including as part of the rewrite of the Income Tax Act. The names of WFF tax credits and some criteria were amended in 2004. The parental tax credit abatement formula was introduced in 2007 (with effect from 1 April 2008). The definition of family scheme income was broadened as part of Budget 2010, with effect from 1 April 2011. This included a new provision for attributing the income of a trust and trust-owned companies to the settlors of a trust.

Detailed analysis

Calculation of parental tax credit and abatement

The parental tax credit is a payment covering the first eight weeks (56 days) after a child is born (the parental entitlement period). Section MD 11 indicates that a person is entitled to the parental tax credit if they meet the requirements in section MC 2, and for any day within the parental entitlement period they or their spouse are not in receipt of a social assistance payment. They must also not receive paid parental leave for that child. Section MD 12 calculates the amount of parental tax credit and has been amended to clarify that the number of days a person qualifies for a parental tax credit is based on the days a person meets the entitlement criteria in section MD 11.

The maximum amount a person is entitled to is then abated by family scheme income using the main abatement formula in section MD 13.

If a principal caregiver has a child born within the last 56 days of the tax year, and receives the parental tax credit as a lump sum in the tax year the child is born, there is an additional abatement calculation reflecting the fact that part of the parental entitlement period falls in the next tax year. For example, for a child born on 1 March, the main abatement formula would calculate abatement for the month of March only but the parental tax credit is based on entitlement for the period 1 March to 25 April. The formula in section MD 16 is required to calculate abatement for the period 1 April to 25 April in this situation.

The formula in section MD 16 has been replaced to clarify how it operates when calculating an additional abatement. It also improves how the formula works in very unusual circumstances. The formula calculates additional abatement for the parental tax credit based on the rate of abatement that applied on the last day of the last entitlement period in the tax year the child was born. If there was no entitlement period in the tax year the child was born, the rate of abatement is based on the first day of the first entitlement period in the following tax year.

Family scheme income of major shareholders in close companies

Section MB 4 has been replaced with an expanded formula and additional definitions. The previous formula determined the amount that was included in family scheme income when a person was a major shareholder in a close company on the last day of the company's balance date for financial purposes. The amount was based on the proportion of the company's income for the accounting year that reflects the person's proportional holding of company shares, and reduced to reflect dividends paid.

A major shareholder is someone who owns or controls, directly or indirectly, at least 10 percent of the shares in a close company. While a major shareholder includes a person who controls, including indirectly, at least 10 percent of the shares, the formula in section MB 4 only refers to shares held by the person. When shares are held by a dependent child of a principal caregiver or dependent child of their spouse, the previous formula would attribute the relative share of the income of the company to the dependent child. Section MB 11 includes resident passive income derived by a dependent child in family scheme income, including dividends received from a close company, but not attributed income under section MB 4.

The replacement formula continues to apply only when a person is a major shareholder in a close company on the last day of the company's income year. (The company's balance date is replaced with the company's income year to reflect current drafting styles and wording in section MB 7.) A person who is a major shareholder in a close company will be unable to reduce their attributed income under section MB 4 by transferring ownership of the shares to their dependent child, or dependent child of their spouse, while still retaining control of the shares.

The income attributed under section MB 4 is the greater of zero or the amount given by the formula. This clarifies that the result under section MB 4 cannot be a negative amount (in situations when dividends exceed attributed income).

The formula allocates the amount of company income, less total dividends paid by the company, to shareholders based on their proportional holding. Dividends are deducted from the amount of company income as dividends received are already included in family scheme income through section MB 1 (net income of a person) or section MB 11 (resident passive income of a dependent child). Similarly, dividends paid to other shareholders would reduce the amount of income retained in the company and therefore the income potentially available to the principal caregiver.

The proportion of shares for a person is based on the number of shares held directly and the number of shares attributed to them. Attributed shares are shares held by a dependent child of the person or the person's spouse, and they are shared among the relevant number of major shareholders connected to the dependent child. Reference to shareholding is to the percentage of voting interest. Reference to a market value interest under a market value circumstance has been removed from section MB 4, as well as sections MB 7, MB 8 and MB 9.

Family scheme income of settlors of a trust

Section MB 7 attributes income when a person is a settlor of a trust. Under this section the income of the trust (and trust-owned companies) is allocated in equal portions to the settlors of the trust when calculating family scheme income. A settlor is a person who, at any time, transfers value to the trust or for the benefit of the trust (with some exceptions). Under the previous rules, settlors could include people who had gifted property to the trust and since died. The formula has been amended so that the attribution of income takes into account only settlors who are alive during the income year. This includes people who were alive for only part of the income year, including the person for whom family scheme income is being calculated.

Section MB 7 has been amended to align with the wording and structure of section MB 4 in relation to the attribution of company income to the shareholding trustee. This includes clarifying that income is the greater of zero or the amount of the formula, reference to shareholding by voting interest and the revised structure of the formula in section MB 7(5).

Arrangements involving tax credits for families

Previously, section GB 44 referred to a person (a claimant) entering into an arrangement and the Commissioner's ability to reduce the claimant's tax credit. It was unclear from the wording whether the section would cover an arrangement entered into by a spouse of a principal caregiver, if the principal caregiver was not a party to the arrangement, yet benefited from an increased entitlement to WFF tax credits. For example, a spouse is a major shareholder in a close company and the principal caregiver is not, and the spouse enters into an arrangement with the company to reduce the amount of family scheme income attributed to them in that year. The amended drafting of the section is more closely aligned with the style of other anti-avoidance provisions.

Definition of "family scheme income"

Both the change in section MA 8 and the change in section MB 1(1) highlight that a person's entitlement to a WFF tax credit is based on a person's family scheme income. Furthermore, family scheme income is based on a person's net income (calculated under section BC 4) and adjusted as provided by subpart MB. This replaces the previous wording in section MB 1(1) which referred to entitlement being based on "the net income (the family scheme income)". The previous wording was unclear and the amendment is intended to clarify that family scheme income includes net income. Changes have also been made to sections in the Tax Administration Act and the Health Entitlement Cards Regulations 1993 to refer to "family scheme income" rather than "net income".

Application dates

The amendments will generally apply for the 2014–15 and later tax years, with some applying from the date of Royal assent, being 27 February 2014.

BELOW MARKET INTEREST RATE LOANS UNDER IFRS

Sections EW 15D and EZ 69 of the Income Tax Act 2007

In some situations, the International Financial Reporting Standards (IFRS) accounting rules require a special treatment for interest-free and reduced-interest loans. This can involve the recognition of a one-off adjustment to the value of the loan and notional payments or receipts of interest. These adjustments do not reflect actual payments made between parties, but rather are bookkeeping adjustments with no economic substance.

Amendments to section EW 15D clarify that these bookkeeping adjustments do not have a tax effect. The amendment confirms that positive adjustments are not taxable and negative adjustments are not deductible.

The amendments apply only to loans that begin with below market interest rates. They will not affect the treatment of loans that subsequently pay below market interest (for example, because of movements in market interest rates). Loans that pay no explicit interest but involve increasing repayment amounts as a substitute for interest (for example, deep-discount bonds) are also not affected by the amendment.

New section EZ 64 is a transitional provision that requires a taxpayer who has been claiming deductions for these bookkeeping adjustments or paying tax on them to perform a change of spreading method adjustment in their 2014–15 income year. This adjustment will, in effect, reverse the taxpayer's earlier deductions or tax payments.

Example

A Co, an IFRS and accrual-basis taxpayer, receives a two-year interest-free loan of $100,000 from an unrelated party.

Under IFRS, A Co will be required to adjust the book value of the loan when it is first received based on its present value. For simplicity, say this adjustment moves the loan's value to $90,000. The $10,000 difference will be credited to its income statement. IFRS also requires A Co to increase the loan's value each year through a debit in its income statement so its book value returns to $100,000 on termination. Again for simplicity, say this debit is $5,000 each year.

The new rules mean that the $10,000 difference credited to the income statement is not income and the $5,000 debited to the income statement is not expenditure under section EW 15D.

Application date

The changes apply from the beginning of the 2014–15 income year.

OVER-CREDITING OF IMPUTATION CREDITS IN EXCESS OF FIF TAXATION

Sections CV 19 and LE 8B of the Income Tax Act 2007

Amendments have been made to the Income Tax Act 2007 to address a mismatch arising under the tax rules in relation to imputed dividends paid by Australian companies under the trans-Tasman imputation rules. This mismatch arose because imputation credits are calculated on the basis of the dividend paid but income tax arises only on the foreign investment fund (FIF) income.

New section LE 8B limits the amount of the tax credit to the shareholder receiving the imputed dividend to the amount of imputation credits they would have if the imputation credits were calculated on the basis of the shareholder's FIF income from that company.

Background

The trans-Tasman imputation rules permit an Australian company to operate an imputation credit account (ICA). An Australian ICA company that has paid New Zealand tax can attach imputation credits to dividends paid to New Zealand shareholders. Wholly owned Australian and New Zealand companies can also form a trans-Tasman imputation group. New Zealand tax paid by a member of the group will generate imputation credits that can be distributed to a New Zealand shareholder. The amount of imputation credits that a particular shareholder receives is determined with reference to the actual dividend paid by the company. In the domestic context, this works as intended.

However, an issue arises when a New Zealand resident shareholder receives a dividend with imputation credits attached that is paid from a closely held Australian company. The New Zealand resident's investment in that company will generally be an attributing interest under the FIF rules. Under the FIF rules, a New Zealand resident is taxed only on the deemed FIF income; the actual dividend is disregarded (refer to section EX 59(2)).

A mismatch therefore arises, with imputation credits being calculated on the actual dividend paid but income tax arising only on the FIF income. If the dividend is of greater value than the amount of FIF income, the shareholder will receive excess imputation credits under section LE 1(4B), which they can use against the tax on their other income, such as salary and wage income. This is inconsistent with the policy intent.

Key features

New section LE 8B limits the amount of the tax credit to the shareholder receiving an imputed dividend from an Australian company to the amount of imputation credits they would have if the imputation credits were calculated on the basis of the resident's FIF income from that company. The section applies only if the dividend amount exceeds the amount of FIF income.

The amount of imputation credits is calculated using the formula: imputation ratio × FIF income, where the imputation ratio is that given under section OB 60, with a maximum imputation ratio of 0.28/0.72, as specified in section OB 60(5).

In addition, a new section CV 19 has been added to ensure that the shareholder's tax liability is calculated correctly in relation to the FIF income and imputation credits by providing that a person's income includes the amount of imputation credits under new section LE 8B. In the absence of section CV 19, a shareholder subject to section LE 8B would be under-taxed on their FIF income.

Example

A New Zealand-resident trustee shareholder in an unlisted Australian company receives a $500,000 dividend with $200,000 of imputation credits attached. The shareholder is treated as having an attributing interest in a FIF. Under the FIF rules, the person is taxed on $11,000 of FIF income and the dividend is disregarded.

Applying new section LE 8B, the shareholder is allowed a credit for the lesser of the imputation credits actually received ($200,000) and the imputation ratio × FIF income.

The imputation ratio under section OB 60(3) is: credit attached ÷ net dividend paid = $200,000 ÷ $500,000 = 0.4.

As 0.4 is greater than the maximum permitted ratio under section OB 60(5) of 0.28 ÷ 0.72, the shareholder is treated as having the maximum imputation ratio as set out in section OB 60(5):

Imputation ratio × FIF income = 0.28 ÷ 0.72 × $11,000 = $4278. Accordingly, the shareholder's tax credit is limited to $4,278.

Therefore, the shareholder is taxed as follows:

FIF income	$11,000
Imputation credits*	$4,278
Taxable amount	**$15,278**
Tax (@ 33%)	$5,042
Less imputation credits	$4,278
Tax payable	$764

*Per section CV 19

Application date

The amendments apply from 1 April 2014.

RECIPIENTS OF CHARITABLE OR OTHER PUBLIC BENEFIT GIFTS

Schedule 32 of the Income Tax Act 2007

The following organisations have been granted donee status from the 2014–15 income year:

- Kailakuri Health Care Project – New Zealand Link
- Marama Global – Education
- Marama Global – Health.

Background

New Zealand-based charities who apply some or all of their funds for overseas purposes and who want donors to receive tax benefits in connection with any donations received, are required to be named as a donee organisation on the list of recipient of charitable or other public benefit gifts in schedule 32 of the Income Tax Act 2007.

Donee status entitles individual donors to a tax credit of 33⅓ percent of the monetary amount donated to these organisations, up to the level of their taxable income. Companies and Māori authorities are eligible for a deduction for monetary donations up to the level of their net income.

Application date

The change applies from the 2014–15 and later income years.

FINANCIAL REPORTING FOR COMPANIES AND OTHER TAXPAYERS

Sections 17, 21B, 21C and 22 of the Taxation Administration Act 1994

The Tax Administration Act 1994 has been amended as part of the Government's reform of the financial reporting regulatory framework for companies. The amendments to the Tax Administration Act 1994 imposes, unless otherwise exempted, a general requirement for companies to prepare financial reports that meet certain minimum requirements as prescribed by Order in Council.

These changes (collectively referred to here as "the new sections") are a small part of much wider reforms to financial reporting and auditing that are currently being put in place.

Details of an associated Order in Council made under the new sections are published in the appropriate section of this *Tax Information Bulletin*.

Background

From 1 April 2014, under the rewritten Financial Reporting Act 2013, most companies will have no obligation to prepare financial reports. The new sections require all companies, unless specifically exempted, to continue to prepare financial reports, but under the auspices of Inland Revenue. Further, these financial reports will, at a minimum, be special purpose reports.

Key features

New sections 21B and 21C of the Tax Administration Act 1994 set up a framework that:

- requires companies that do not prepare general purpose financial reports to prepare special purpose financial reports unless they are specifically exempted;
- can be used to require non-corporate taxpayers to prepare financial statements; and
- allows the minimum requirements to be specified.

Supporting amendments have been made to sections 17 and 22 of the Tax Administration Act 1994.

New section 21B of the Tax Administration Act 1994 provides that companies must prepare financial reports unless they are:

- by way of other legislation required to prepare financial reports; or
- they are specifically exempted by way of Order in Council.

This section also provides that other classes of taxpayer may be required to prepare financial reports by way of Order in Council. The minimum requirements to which the financial reports should be prepared must be specified in the relevant Order in Council.

New section 21C of the Tax Administration Act 1994 provides the mechanism that authorises the Orders in Council. In particular, before recommending the making of an Order, the Minister of Revenue must consult with professional accounting bodies.

Consequentially, section 17(2) of the Tax Administration Act 1994 which requires companies to produce financial reports on request has been repealed as it is redundant, and section 22 of the Tax Administration Act 1994 which concerns the keeping of records has been amended to include reference to the financial reports.

Application date

The new sections apply from 27 February 2014, the date the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 received Royal assent. In practice, as discussed elsewhere in this *Tax Information Bulletin*, the effective date is years commencing 1 April 2014 and later.

BAD DEBT DEDUCTIONS FOR HOLDERS OF DEBT – COMPLIANCE CHANGE

Section DB 31 of the Income Tax Act 2007

The law has been amended to make it easier for taxpayers to take bad debt deductions in certain situations. These are when the taxpayer would ordinarily be entitled to them on the cessation of a financial arrangement, but for technical compliance issues. The amount of deductions that can be taken has not changed. For instance, there is no intended change to the tax treatment of capitalised interest (interest which has been added to the original capital). This interest has always been, and continues to be, treated as being paid to the investor and reinvested.

Background

One function of the bad debt write-off rules is to ensure that taxpayers are not taxed on amounts which may have been derived and included in assessable income, but are never actually received. If deductions for bad debts were not allowed, taxpayers would pay too much income tax because they would be assessed on income which substantively was not received.

There is a required process for taking bad debt deductions for debts owing under a financial arrangement. Generally, they must be written off as a bad debt before the financial arrangement ends (for instance, by liquidation). This means that if a creditor fails to take a bad debt deduction before that time, the deduction cannot be taken later.

Previously, where a debtor went into liquidation or bankruptcy the creditor could take a bad debt deduction only if the debt was written off as bad in the same income year, and before the liquidation or bankruptcy took place. This requirement was considered unnecessarily onerous for certain creditors (for example, "mum and dad" investors in failed finance companies who had returned income from the debt but never received the income). It meant they would need up-to-date knowledge of the financial state of the debtor in order to take the bad debt deduction in time. In some situations, creditors are not informed of upcoming liquidations or bankruptcies unless they regularly check the companies register or public listings for updates on the financial status of the debtor.

The same strict write-off criteria applied to creditors when the debtor company entered into a composition with them. A composition with creditors is a deed or agreement where the debtor is released from making all remaining payments (for example, when the creditor agrees to accept 70 cents for every dollar owed by the debtor). Where a debtor has entered into a composition with its creditors, the creditors could take a bad debt deduction only if the debt was written off as bad in the same income year and before the composition took place. Again, the write-off requirement was considered unnecessarily onerous for creditors because the timeframe to write off the debt can be short (the period between being informed of the financial difficulties of the debtor and the composition itself).

Creditors, in both the above situations, who failed to write off the bad debt in time would have a tax obligation in respect of accrual income they never received, or income from the base price adjustment that was never written off. This result was considered unfair and resulted in unnecessary complexity.

Key features

The law has been amended so that deductions can be taken for bad debts, not only after they have been written off as bad, but in two additional situations:

- if the debt has been remitted by law (new section DB 31(1)(a)(ii)); and
- if a debtor company has entered into a composition with its creditors in relation to the debt (new section DB 31(1) (a)(iii)).

Detailed analysis

The concern with the previous rules was that taxpayers who were holders of financial arrangements could only take bad debt deductions when the debt had been correctly written off as bad. There are no legislative criteria for writing off a debt as bad, however it must be written off in accordance with the accounting and record-keeping systems maintained by the taxpayer. Whether or not a debt is bad is a question of fact and depends on the prospects of recovery. A debt is adjudged as "bad" when a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid.

Under the previous rules, a taxpayer was required to write off a debt as bad before the financial arrangement came to an end and a base price adjustment[5] (BPA) was performed. If the taxpayer failed to do so they would not be able to take a bad debt deduction later. This would not be the right policy outcome if the person had derived income under the BPA calculation or in a prior income year.

Under the new rules, bad debt deductions are also allowed in two additional situations – first, if the debt has been remitted by law (section DB 31(1)(a)(ii)), and secondly, if a debtor company has entered into a composition with its creditors in relation to the debt (section DB 31(1)(a)(iii)). Deductions in these situations must be taken in the year that the BPA is performed.

The requirement that the debt be "bad" before any deduction can be taken is unchanged. However, the requirement to write off a debt as bad before the financial arrangement comes to an end and a BPA is performed is considered unnecessary in the two situations listed above. In these situations it is clear that the debt is bad, and it is not always possible for the creditor to write off the debt as bad.

The other legislative criteria for taking deductions have not changed. Bad debt deductions can be claimed for income amounts (under section DB 31(2)) and amounts owing (under section DB 31(3)), provided the criteria in those subsections are met. For instance, one criteria is that deductions under section DB 31(3) can only be taken if the person carries on a business for the purpose of deriving assessable income that includes dealing in or holding financial arrangements that are the same as, or similar to, the financial arrangement.

As noted above, the amount of deductions that can be taken has not changed. This means, for example, that there is no change to the tax treatment of capitalised interest (interest which has been paid by being added to the original capital). This interest has always been, and continues to be, treated as being paid to the investor and reinvested. Cash basis and accruals taxpayers will have derived the interest for tax. They may be allowed a bad debt deduction under section DB 31(3) as a dealer or holder of financial arrangements for the amount if it becomes a bad debt.

For clarification, bad debt deductions can be claimed in the two situations, outlined under "Key features" above, by taxpayers who are on an accruals basis and those who are on a cash basis.

The law has been amended to allow deductions where certain BPA events occur (under section EW 29(10) and (11) but with certain limitations). The remaining BPA events have intentionally been excluded. This means that when a financial arrangement comes to an end due to one of the other BPA events in section EW 29, the write-off requirements in section DB 31(1)(a)(i) must be met before a bad debt deduction can be taken. The rationale for this is that when one of the other BPA events takes place, it is not necessarily clear that a debt is bad, so requiring that the debt be written off will ensure that bad debt deductions can only be taken where the debt is actually bad. Subparagraph DB 31(1)(a)(i) is previously what was paragraph DB 31(1)(a) before the law change. It should be noted that the requirements for writing off a bad debt have not changed under subsection (i) as a result of the restructured section.

Remissions of law

Remissions by law under section DB 31(1)(a)(ii) are when the debtor is released from making all remaining payments under the Insolvency Act 2006 (excluding Part 5, subparts 1 and 2 of that Act), or under the Companies Act 1993, or under the laws of a country or territory other than New Zealand. Remissions that take place under Part 5, subparts 1 and 2 of the Insolvency Act 2006 relate to compositions during bankruptcy and proposals. These are excluded from the new rules because creditors of individuals who enter into proposals or compositions during bankruptcy are considered to have sufficient notice of the upcoming bad debt and be sufficiently aware of the write-off rules. In comparison, compositions by debtor companies can affect a wider range of people (such as "mum and dad" investors in finance companies) who are less likely to have the knowledge to write off the debt as bad in time.

[5] A wash-up calculation that is performed when the financial arrangement comes to an end.

Compositions with creditors

Under section DB 31(1)(a)(iii), bad debt deductions can be taken when a debtor company enters into a composition with its creditors, and when the creditors are required to perform a BPA. This change does not extend to non-company debtors, and is consistent with the exclusions to bankruptcy as described under the "remissions of law" section above.

Example 1

On 1 April 2010, Mr Smith invests $5,000 in a finance company for five years with $500 interest payable per year. He is a cash basis holder and does not carry on a business of dealing in or holding financial arrangements. The debt is repayable in full on 31 March 2015. Mr Smith receives interest payments for the first three years and returns those amounts as income on a cash basis. In September 2013 the finance company faces financial difficulty and Mr Smith does not receive any further funds from the company i.e., the $5,000 investment and interest of $1,000 for the last two years. The company is liquidated in November 2014. On liquidation of the finance company, Mr Smith must perform a base price adjustment (BPA). Assume that the interest from year 5 is owing in full at the time the BPA is performed.

Mr Smith's BPA will be:

BPA: Consideration – income + expenditure + amount remitted

= (1,500 – 5,000) – 1,500 + 0 + 6,000

= 1,000

The positive BPA result is treated as income of Mr Smith in the 2015 income year under sections EW 31(3) and CC 3.

Tax treatment under the previous rules

To ensure Mr Smith is taxed only on his economic income, he must have taken a bad debt deduction for the $1,000 before the liquidation process was complete. If he failed to do so, he would have had to pay tax on income which was not economically received.

Tax treatment under the new rules

Mr Smith will be able to take a bad debt deduction for $1,000 under section DB 31(2) (and allowed by section DB 31(1)(a)(ii)) in the year that the BPA is performed – the 2015 income year – even if the debt is not written off as bad.

Note that under both the previous and new rules, if the interest in years 1 to 3 had been compounded instead of being paid out to Mr Smith, for tax purposes this interest is treated as having been paid and reinvested. This means that upon reinvestment the amount is treated as being part of the principal amount. If the entire debt (including this compounded interest) later goes bad, the ordinary tax rules will apply – that is, the investor would only be able to take a bad debt deduction for the compounded amount if they hold or deal in the same or similar financial arrangements, and the requirements of subsection DB 31(3) are met.

Example 2

On 1 April 2010, Mrs Jones invests $10,000 in a finance company for five years with $800 interest payable per year. The debt is repayable in full on 31 March 2015. Mrs Jones is an accruals taxpayer and does not carry on a business of dealing in or holding financial arrangements. She receives an interest payment for the first year, but does not receive any interest repayments after that. As an accruals taxpayer she must return $800 interest per year irrespective of whether it is in fact received. In July 2014 the finance company faces financial difficulty and is liquidated in November 2014. Mrs Jones does not receive any further funds from the company. On liquidation of the finance company Mrs Jones must perform a base price adjustment (BPA). Assume that the interest from year 5 is owing in full at the time the BPA is performed.

Mrs Jones' BPA will be:

BPA: Consideration – income + expenditure + amount remitted

= (800 – 10,000) – 3,200 + 0 + 13,200

= 800

Note the 3,200 income figure represents income returned in earlier years 1 to 4, and the 13,200 amount remitted figure represents all amounts remitted ($10,000 + interest not received in years 2 to 5).

The positive BPA result is treated as income of Mrs Jones in the 2015 income year under sections EW 31(3) and CC 3. This amount represents the interest income from the final year and because it was not received a deduction should be allowed to offset the income. In addition, Mrs Jones returned accrual income in years 2, 3 and 4 that was never received and for which a deduction should be allowed.

Tax treatment under the previous rules

Under the previous rules, to ensure Mrs Jones is taxed only on her economic income, she must have taken a bad debt deduction for years 2, 3 and 4's accrual income only in the year in which they were written off, and she must have taken a bad debt deduction for the $800 BPA income before the liquidation process was complete. If she failed to do so, she would have had to ultimately pay tax on income which was not economically received.

Tax treatment under the new rules

Under the new rules, Mrs Jones will be able to take a bad debt deduction for $3,200 ($800 BPA income and $2,400 accrual income from earlier years returned but never received) under section DB 31(2). This deduction will be taken in the year that the BPA is performed (the 2015 income year) even if the debt is not written off as bad.

Note: If Mrs Jones carried on a business of dealing in or holding financial arrangements, under the new rules she could either take a bad debt deduction for the entire $13,200 under amended section DB 31(3), or $10,000 under section DB 31(3) and $3,200 under section DB 31(2).

Application date

The changes apply to the 2008–09 and later income years.

BAD DEBT DEDUCTIONS FOR HOLDERS OF DEBT – BASE MAINTENANCE CHANGE

Sections CZ 27 and DB 31 of the Income Tax Act 2007

The law has been amended to align the tax rules with the policy settings for taking bad debt deductions, by limiting bad debt deductions that can be taken by dealers and holders of debt to the economic cost of the debt.

Background

Under the previous rules, taxpayers who dealt in or held the same or similar financial arrangements could theoretically take bad debt deductions for amounts owing even when they did not suffer an economic loss. This was not consistent with the policy intent.

For example, if a taxpayer purchased a debt at a discount, under the previous rules they may have been able to take a bad debt deduction for the full face value of the debt even though they only suffered an economic loss equal to the discounted purchase price. While the base price adjustment[6] (BPA) would square up any excess deductions taken, the purchaser would still benefit from a timing advantage (and potentially a permanent advantage if a BPA was never performed). This timing advantage arose because the bad debt deduction for an amount greater than the purchase price could be taken well before income from the BPA is recognised, presenting a risk to the revenue base.

Key features

The tax rules have been amended so that when a creditor's business includes dealing in or holding the same or similar financial arrangements, they can only take bad debt deductions for their economic loss – that is, they can only take bad debt deductions for amounts owing up to the consideration they have provided and any income they have returned for tax purposes. This change is achieved by subsection DB 31(4B).

Two further amendments support this underlying change:

- *Limited recourse arrangements* – When a taxpayer is party to a debt that a limited recourse arrangement relates to, they will only be able to take a bad debt deduction for the money at risk. This is an anti-avoidance measure to ensure that section DB 31(4B) cannot be circumvented by funding the acquisition of a financial arrangement by using a limited recourse arrangement.
- *Claw-back for prior bad debt deductions* – New section CZ 27 is a claw-back rule that requires taxpayers who have taken bad debt deductions greater than their economic loss to return the excess deductions as income in their return for the 2014–15 year. This rule will ensure taxpayers are in the correct tax position, consistent with the policy intent. There is no concern for financial arrangements that have ended before the 2014–15 year, as the BPA would have been performed and squared-up any excess deductions taken.

Detailed analysis

The change that ensures bad debt deductions are limited to their economic cost is achieved by new subsection DB 31(4B).

Some submissions made at the select committee stage of the bill questioned if the correct economic result will be achieved under the new rules when the consideration paid for a debt is less than the face value. The policy intent is that a bad debt deduction should not exceed the economic cost of the debt to the taxpayer. However, it is recognised that the operation of the BPA for the debt may result in assessable income for taxpayers for which a deduction is required. The policy intent is that under the amended legislation, bad debt deductions for these income amounts are taken under subsection DB 31(2), and bad debt deductions for other amounts not received are taken under subsection DB 31(3) (limited by subsection DB 31(4B), to the consideration paid for acquiring the debt). This is illustrated by the example below:

[6] A wash-up calculation performed when the financial arrangement comes to an end; shortened to "BPA".

Example 1: Application of section DB 31(3) and (4B)

A debt with a face value of $5m is acquired for $1m by Company G who is a dealer in the same or similar financial arrangements. Company G does not receive any income from the debtor and the entire $5m debt is eventually remitted by law. Company G has suffered an economic loss of $1m.

On remission, Company G performs a BPA as follows:

BPA: consideration – income + expenditure + amount remitted

= (0 – $1m) – $0 + $0 + $5m

= $4m income

Under the new rules, bad debt deductions are intended to be taken as follows:

- $1m under subsection DB 31(3) (limited by section DB 31(4B)) – being a deduction for the amount not received by a dealer in financial arrangements, but limited to the consideration paid for acquiring the debt; and
- $4m under subsection DB 31(2) – being a deduction for an income amount (the BPA income) not received.

Limited recourse arrangements – an anti-avoidance measure

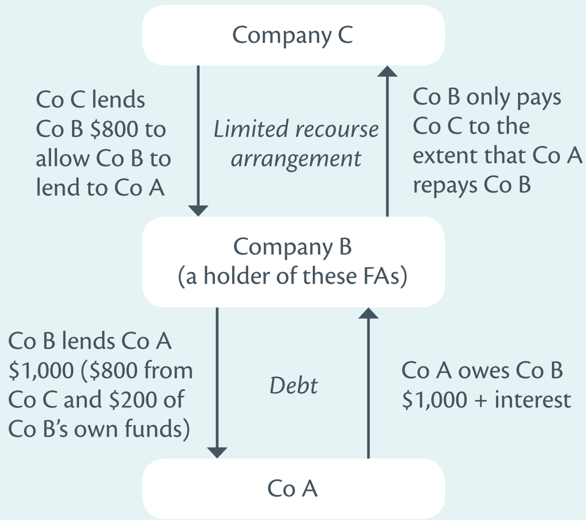
New subsections DB 31(4C)–(4E) are provisions that are intended to ensure dealers and holders can only take bad debt deductions for the money at risk.

The definition of "limited recourse arrangement" is contained in subsection DB 31(5B) and is intended to capture arrangements that are used to fund the underlying financial arrangement (for which a bad debt deduction is being sought). To illustrate, an example of a limited recourse arrangement is set out below:

Example 2: Limited recourse arrangement

Co B (a holder of the same or similar financial arrangements) lends money to Co A. Under this debt arrangement, Co B lends Co A $1,000 repayable in 5 years with $100 interest payable per year. Co B only funds $200 of the amount lent and borrows the remaining $800 from Co C. Under the arrangement with Co C, Co B is only required to repay the $800 and interest to Co C to the extent that Co A pays these amounts to Co B.

Amounts received from Co A will be split on a proportional 80:20 basis (Co C:Co B). Assume Co B is an accruals-basis taxpayer.



In the absence of rules for limited recourse arrangements, if Co A failed to repay the $1,000 to Co B, even with new subsection DB 31(4B), it would be possible for Co B to take a bad debt deduction for the full $1,000 even though it has only suffered an economic loss of $200. The new limited recourse arrangement rules are intended to ensure that prior to the BPA for the limited recourse arrangement Co B can only take a bad debt deduction up to $200 (under section DB 31(4C)). If Co B was able to take a deduction for more than $200, it would receive an unintended advantage.

Limited recourse arrangements may take a variety of forms and the drafting is intentionally broad to capture a wide range of possible arrangements.

Subsection DB 31(4C) is intended to ensure that, prior to the BPA of the limited recourse arrangement, dealers and holders of the same/similar financial arrangements can only take bad debt deductions under section DB 31(3) for the money at risk. Subsections DB 31(4D) and (4E) are intended to ensure that when a BPA for the limited recourse arrangement is performed, dealers and holders of the same/similar financial arrangements are allowed a deduction for amounts owing under the debt for which deductions have not been taken under subsections DB 31(2) or (3).[7]

[7] As currently drafted, the application of subsections DB 31(4C)–(4E) may not give the intended result and legislative amendments are expected to be made in a later tax bill. Amendments may need to be made so that dealers and holders of the same or similar financial arrangements are allowed a deduction for amounts owing under the debt in the year the BPA for the limited recourse arrangement is performed, other than amounts for which deductions have been taken under subsections DB 31(2) or (3). The application date of any amendment is likely to be 20 May 2013 (the same application date for the other base maintenance changes).

Example 3: All interest received when due, $80 received during the liquidation of Co A, accruals-basis taxpayer

In example 2, assume that Co A paid Co B all interest amounts when they fell due. Co A was put into liquidation and only $80 of the remaining $1,000 repayable was received during the liquidation of Co A. On a proportional 80:20 basis (Co C:Co B) Co B uses the amounts received from Co A to pay Co C under the limited recourse arrangement. This means Co C receives a total of $400 from interest payments, and Co B retains the remaining $100. Co C also receives $64 of the other $80 received, and Co B retains the remaining $16. In this case Co B has suffered a cash loss of $84 from both arrangements overall. It is assumed that the BPAs for both arrangements take place in the same year.

Debt

From Co B's perspective, the cashflow under the debt is a loss of $420 ($580 received – $1,000 lent). Co B's overall tax position should reflect this.

The BPA for the debt (between Co A and Co B) is:

BPA: Consideration – income + expenditure + amount remitted

= (580 – 1,000) – 400 + 0 + 920

= 100

Tax position:

The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest received in the last year.

Co B was required to return $400 interest income received from Co A in years 1 to 4.

To align the tax position with the cashflow position (the loss of $420), a deduction of $920 is required.

In this example it is assumed that deductions were not taken under section DB 31(3) (limited by section DB 31(4C)) in a year prior to the BPA being performed. However, a deduction can be taken under subsection DB 31(3) (limited by subsection DB 31(4C)) for $120 in the year of the BPA. This is calculated as $920 (being the amount owing) – $800 (being the consideration paid to Co B under the limited recourse arrangement).

The law, as enacted, allows a deduction to be taken under section DB 31(4D) for $336 when the BPA for the limited recourse arrangement is performed. This is calculated as consideration paid to Co B under the limited recourse arrangement (800) – consideration paid by Co B under the limited recourse arrangement (400 interest + 64 other amounts). This is not the intended policy result.[8]

Limited recourse arrangement

From Co B's perspective, the cashflow under the limited recourse arrangement is a gain of $336 ($800 received – $464 paid). Co B's overall tax position should reflect this.

The BPA for the limited recourse arrangement (between Co B and Co C) is:

BPA: Consideration – income + expenditure + amount remitted

= (800 – 464) – 0 + 320 + 0

= 656

Tax position:

The BPA performed under the limited recourse arrangement will result in $656 of income for Co B.

Deductions of $320 for interest paid to Co A in prior years would be allowed under section DB 7 ($80 each year for years 1 to 4).

This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($656 income – $320 deductions) aligns with the cashflow ($336 gain).

We note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Example 4: No interest received when due, $80 received during the liquidation of Co A, accruals-basis taxpayer

This example further illustrates the intended application of the new rules including new section DB 31(4D).

In example 2, assume that Co A did not pay Co B any of the interest amounts when they fell due. Also assume that Co A was put into liquidation and Co B received $80 during the liquidation of Co A. On a proportional 80:20 basis (Co C:Co B) Co B uses the amount received from Co A to pay Co C under the limited recourse arrangement. In this case Co B has suffered a cash loss of $184 from both arrangements overall. It is assumed that the BPAs for both instruments take place in the same year.

Debt

From Co B's perspective, the cashflow under the debt is a loss of $920 ($80 received – $1,000 lent). Co B's overall tax position should reflect this.

[8] If the law is amended as outlined in footnote 7, it is anticipated that in the year the BPA for the limited recourse arrangement is performed, Co B should be allowed to take a deduction for amounts owing under the debt other than amounts for which deductions have not been taken under subsections DB 31(2) or (3).

Total amounts owing under the debt – section DB 31(2) deductions – section DB 31(3) deductions

= 920 – 0 – 120

= 800

The BPA for the debt (between Co A and Co B) is:

BPA: Consideration – income + expenditure + amount remitted

= (80 – 1,000) – 400 + 0 + 1,420

= 100

Tax position:

The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest income not received in year 5 and a deduction can be taken under subsection DB 31(2).

Co B was required to return $400 interest income for interest payable by Co A in previous years. The $80 that was received during the liquidation of Co A is attributed to the earliest amount of unpaid interest (in year 1). A deduction for the interest amounts that were returned but not received in years 1 to 4 (that is, $320) can be taken under subsection DB 31(2).

To align the tax position with the cashflow position (the loss of $920), a further deduction of $1,000 is required.

In this example it is assumed that deductions were not taken under section DB 31(3) (limited by section DB 31(4C)) in a year prior to the BPA being performed. However, a deduction can be taken under section DB 31(3) (limited by section DB 31(4C)) for $620 in the year of the BPA. This is calculated as $1,420 (being the amount owing) – $800 (being the consideration paid to Co B under the limited recourse arrangement).

The law, as enacted, allows a deduction to be taken under section DB 31(4D) for $736 when the BPA for the limited recourse arrangement is performed. This is calculated as $800 (being the consideration paid to Co B under the limited recourse arrangement) – $64 (being the consideration paid by Co B under the limited recourse arrangement). As covered in footnote 7, this is not the intended policy result.[9]

Limited recourse arrangement

From Co B's perspective, the cashflow under the limited recourse arrangement is a gain of $736 ($800 received – $64 paid). Co B's overall tax position should reflect this.

The BPA for the limited recourse arrangement (between Co B and Co C) is:

BPA: Consideration – income + expenditure + amount remitted

= (800 – 64) – 0 + 320 + 0

= 1,056

Tax position:

The BPA performed under the limited recourse arrangement will result in $1,056 of income for Co B.

Deductions of $320 for interest paid to Co A in prior years would be allowed under section DB 7 ($80 each year for years 1 to 4).

This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($1,056 income – $320 deductions) aligns with the cashflow ($736 gain).

We note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Claw-back for prior bad debt deductions

The new rules have been introduced to align the law with the policy intent. It was never intended that bad debt deductions be taken for more than the economic loss. New section CZ 27 has therefore been introduced to rectify this by clawing back any excess bad debt deductions taken in prior years.

The rules apply to a taxpayer who has taken an excess bad debt deduction before 20 May 2013. An excess bad debt deduction is one that would not have been allowed under new subsections DB 31(4B), (4C) and (5B). If a taxpayer took an excess bad debt deduction under a financial arrangement before 20 May 2013, and if that financial arrangement is still in existence in the 2014–15 income year, the taxpayer is treated as receiving an amount of income equal to the amount of the excess bad debt deduction.

The claw-back rule in section CZ 27 only applies if a BPA has not already been calculated in the 2014–15 or earlier income year. This is because the BPA will have captured excess deductions, and result in an income amount for the taxpayer.

There is a "savings" provision for taxpayers who, on 20 May 2013, were already involved in the disputes process in relation to the prior bad debt deduction. For these taxpayers, section CZ 27 will not apply.

Application dates

The changes apply from 20 May 2013, the date of introduction of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill.

The claw-back rule requires taxpayers who have taken excess deductions to return those amounts as income

[9] If the law is amended as proposed in footnote 7, it is expected that at the time the BPA of the limited recourse arrangement is performed, Co B should be allowed to take a deduction for amounts owing under the debt other than amounts for which deductions have not been taken under subsections DB 31(2) or (3).

Total amounts owing under the debt – section DB 31(2) deductions – section DB 31(3) deductions

= 1,420 – 500 – 620

= 300

NEW LEGISLATION

in the 2014–15 year. The effect of this rule is that it is retrospective for financial arrangements that are in existence in the 2014–15 year, subject to a "savings" provision for taxpayers who are involved in assessments that are subject to the tax disputes process.

CHILD SUPPORT

Sections 2, 9, 12, 19A, 38, 39, 40, 43, 46, 52, 53, 62, 63 and schedule 3 of the Child Support Amendment Act 2013

Sections 3A, 276 and schedule 1 of the Child Support Act 1991

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 makes technical changes to child support and also inserts provisions to delay most changes made by the Child Support Amendment Act 2013. There are also some consequential amendments to the Child Support Act 1991.

Key features

The relevant provisions change the date at which most provisions in the Child Support Amendment Act 2013 come into force. They also make consequential amendments to the Child Support Act 1991. In particular, some provisions originally intended to come into force on 1 April 2014 will now come into force on 1 April 2015 and some changes originally intended to come into force on 1 April 2015 will now come into force on 1 April 2016. The consequential amendments to the Child Support Act 1991 are to various transitional provisions that were inserted by the Child Support Amendment Act 2013 with effect from 17 April 2013.

The other specific change to the Child Support Amendment Act 2013 is the insertion of section 19A which amends section 89F(1)(a)(i) of the Child Support Act and clarifies that a paying parent who is a hospital patient is exempt from paying child support even if they are in receipt of income from investments earned before their hospitalisation. This approach is consistent with allowing a paying parent to take care of their needs for the period they are in hospital. This amendment, and a similar amendment to the exemption for prisoners, continues to come into force from 1 April 2014.

Application dates

Part 1 of the Child Support Amendment Act 2013 applies from 1 April 2015. Part 2 applies from 1 April 2016.

REMEDIAL MATTERS

TAXATION RULES FOR INSURANCE BUSINESS

Sections CR 4, DR 3, DR 4, DW 4, ED 3, EY 5, EY 15 to EY 17, EY 19 to EY 21, subpart LR, sections OB 47, OP 44 and YA 1 of the Income Tax Act 2007

A range of technical and remedial changes have been made to the taxation rules for insurance business contained in the Income Tax Act 2007.

Key features

Deductions for life insurance claims

Section DR 4 has had two changes made to it. The first change links the deduction provision to amounts allocated to the shareholder base by section EY 20, being expenditure or loss that relates to the life-risk component of a claim. Its purpose is to align the permission in the context of non-participation policies.

The second change confirms entitlements life insurers have in respect of claiming a deduction for life insurance claims that are tied to reserves that form part of any acquired or transferred insurance business. The change overrides the application of the capital limitation to reserve amounts attaching to a block of insurance business when it is transferred.

Both changes apply from 1 July 2010 or earlier income years that include 1 July 2010 (the date the new life insurance rules came into force).

Opening value for reserves in connection with insurance business transferred to New Zealand

Further modifications have been made to the Income Tax Act 2007 to deal with the valuation of reserves when insurance business is transferred. Changes made by the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 deal with the situation when insurance business is transferred into New Zealand, more specifically with transfers affected by sections ED 3 or EY 5.

In respect of general insurance business and a life insurer's non-life business, sections DW 4 and CR 4 have been amended to specify how the opening balance of the outstanding claims reserve should be calculated by the New Zealand recipient of the insurance business. The new rule requires general insurers to actuarially determine the opening value of the outstanding claims reserve, being the insurer's incurred (but not reported) claims, reported claims and an appropriate risk margin.

For life insurance reserves, section EY 5 specifies who is required to calculate the opening balance under sections EY 24 to EY 27.

The changes apply from 1 April 2014.

Non-profit participation policies – shareholder and policyholder bases income allocations

Section EY 15 has been significantly rewritten. Central to the changes is a redraft of the formula that allocates income between a life insurer's policyholder and shareholder tax bases in sections EY 15 and EY 19.

The formula, as written in section EY 15, was unclear in its effect when allocating income to the policyholder base.

As part of the Finance and Expenditure Committee's consideration of the bill, section EY 15 was redrafted to make the operation of the section clearer, including the treatment of annuities and de minimis amounts under section EY 15(5). The life insurer may choose to exclude the de minimis life risk component of the premium from the shareholder base under section EY 19(2) and instead return the amount with investment income allocated to the policyholder base under section EY 15(5). The de minimis amount is not treated as a deposit of principal in respect of the policy as earlier described in Part II of the *Tax Information Bulletin* Vol 21, No 7. Section EY 19(1)(db) has been inserted to make it clear that investment income of annuities is taxed under the shareholder base.

Further changes have been made to sections EY 16 and EY 20 to mirror the changes in section EY 15.

The changes apply from 1 July 2010 or earlier income years that include 1 July 2010.

The change to the way the formula applies to de minimis amounts under section EY 15(5) applies from 27 February 2014.

Profit participation policies – shareholder and policyholder bases investment income allocation

Changes have been made to sections EY 17 and EY 21 in connection with the way that amounts that represent the shareholder bases' future claim on policyholder assets are described by the Income Tax Act 2007. The change responds to concerns about the imprecise description of claim on future amounts and the method for finding the value of that claim. References to "present value (net)" have been removed and replaced with the word "value" which should be actuarially determined (section EY 17(2)).

In addition, reference to "future bonus declarations" have been replaced by the phrase "portion of future profits" to recognise that the allocation of income to the shareholder base is not "a bonus declaration" as the term is used by life insurers. The changes apply from 1 July 2010 or earlier income years that include 1 July 2010.

Technical changes

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 made a range of technical changes to the taxation rules for life insurance business as set out in the table below:

Clarifications	**Reason**	**Application date**
Life insurance outside New Zealand The colon ":" in section DR 3 has been replaced with an "and".	To improve the logic and interaction of the source rule in section EY 48.	27 February 2014.
Policyholder credit account Section LR 1 has been repealed.	The operation of section LR 1 was contingent on the effect of a number of memorandum accounts that were repealed when the new life insurance rules took effect. The section no longer has any effect and has been removed.	With effect from the 2014 income year.
Incorrect cross-references Cross-references in sections EY 19(3) and EY 20(2) have been corrected.	To improve internal consistency of the Income Tax Act 2007.	27 February 2014.
Timing of debit entries to the imputation credit account A debit entry should be recorded in the insurer's imputation credit account at the time there is a breach in continuity.	The point in time when debit entries in a life insurer's imputation credit account need to be recognised has been clarified. The change to sections OB 47 and OP 44 ensure that a debit entry is not required if sections OB 41 and OP 42 apply (for example, if there has been a breach in shareholder continuity).	On and after 1 July 2010 or earlier for income years including 1 July 2010.

Application dates

Different application dates apply to the changes made. These have been specified under the relevant discussion.

TIME BAR FOR AMENDMENT OF INCOME TAX ASSESSMENT

Section 108(1) of the Tax Administration Act 1994

Section 108(1) of the Tax Administration Act 1994 has been amended to clarify that the time bar applies not only to the Commissioner amending an income tax assessment to increase the amount of tax payable, but also to the Commissioner reducing the amount of a net loss.

Background

Section 108(1) of the Tax Administration Act 1994 prevents the Commissioner amending an income tax assessment to increase the amount assessed if four years have passed since the end of the tax year in which the taxpayer provides their tax return, unless the return was fraudulent, wilfully misleading or failed to mention income of a particular nature or from a particular source.

Before the introduction of the income tax self-assessment rules in the 2002–03 income year, section 92(5) of the Tax Administration Act 1994 clarified that despite the words "so as to increase the amount assessed" in section 108(1), the time bar applied equally to prevent the Commissioner amending an assessment outside the time bar in order to reduce the amount of a net loss under a determination of loss.

Section 92(5) was repealed in its entirety as part of the introduction of the income tax self-assessment rules. A replacement provision was not enacted to confirm that a reduction in the amount of a net loss is to be treated as an increase in the amount assessed for the purposes of the time bar in section 108.

The amendment corrects this oversight with effect from the application date for the repeal of section 92(5) – the 2002–03 and later income years – so that the original policy intention is restored retrospectively.

Application date

The amendment applies for the 2002–03 and later income years.

MIXED-USE ASSET RULES

Section DG 3 of the Income Tax Act 2007

Section DG 3(4)(c), which excludes certain assets from the mixed-use asset rules, has been repealed for the 2013–14 and later income years.

Background

Section DG 3(4)(c) was intended to exclude from the operation of the mixed-use asset rules assets that undergo a change of use in an income year from purely private use to purely income-earning use (or vice-versa). It was also intended that assets that became mixed-use assets part way through an income year would be subject to a part-year rule to apportion deductions appropriately.

Section DG 3(4)(c) was intended to achieve this policy intention, but, as drafted, it applied too widely and thus excluded assets that were intended to be within the mixed-use asset rules. Because of this wide application, the provision has been repealed and an appropriate part-year provision will be considered at a later date.

Application date

The change applies for the 2013–14 and later income years.

REBATES OF FEES PAID BY A FIF

Section CW 55BAB of the Income Tax Act 2007

Section EX 59(2) treats a person with an interest in a foreign investment fund (FIF) as having no income from the interest for a period other than FIF income. Section EX 59(2B) contains an exception where the amount derived by a person from an interest in a FIF is a rebate of fees and the person was allowed a deduction for the payment of the fees.

New section CW 55BAB ensures that a person is not taxed on rebates of fees they have derived in relation to an interest they have in a FIF, if the person has not been allowed a deduction for the payment of the fees, when the person derives the rebate of fees from a third party the FIF has paid fees to. This does not apply for persons who use the comparative value method to calculate their FIF income or loss from their FIF interest. The change reflects the policy intent behind the insertion of section EX 59(2B), which was to ensure tax symmetry in relation to management fees paid to an offshore fund manager and any related rebates for a FIF investment.

Application dates

This amendment applies for rebates derived on or after 27 February 2014. Additionally, the amendment applies to persons who have derived a rebate between the beginning of the 2009–10 income year and 26 February 2014 (inclusive), if the person gives notice to the Commissioner of an election to have the new section CW 55BAB apply to rebates derived in the income year of the rebate.

CALCULATING AMOUNTS ATTRIBUTED TO INVESTORS IN A PIE

Section HM 36 of the Income Tax Act 2007

Section HM 36(2) contains a formula which a multi-rate PIE uses to calculate the PIE income (or loss) attributable to each investor. The formula in section HM 36(2) contains the item "percentage", which is defined in section HM 36(3)(a).

The definition of "percentage" in section HM 36(3)(a) has been amended to clarify that the investor's entitlement to a distribution referred to in the definition is the entitlement that accrues for the period on any given day, and not the total amount that would be distributed to the investor if a distribution was made on that day. The amendment ensures that the intended policy outcome is achieved in the case of an investor in a term fund with a fixed unit value (e.g., $1), when investors enter the fund at different times, but for the same price.

Application date

This amendment applies for the 2010–11 and later income years.

REWRITE ADVISORY PANEL REMEDIAL ITEMS

NOTICE TO LEAVE A CONSOLIDATED IMPUTATION GROUP

Sections FM 40(5) and FN 12(5) of the Income Tax Act 2007

The Panel considered, and agreed with, a submission that the Income Tax Act 2007 contains an unintended change to the effective date that a company leaves a consolidated group of companies, if its notice to leave the consolidated group of companies is invalid.

Key features

Under the provisions of the Income Tax Act 2007, a company must provide a notice to the Commissioner that it has left a consolidated group if it is no longer entitled to continue as a member of that consolidated group of companies. Sections FN 12(5) and FM 40(5) apply to invalidate this notice as an anti-avoidance rule.

The amendments to sections FM 40(5) and FN 12(5) ensure that if the notice is invalidated, the company is treated as leaving the group from the start of the tax year in which the company is no longer entitled to be within the consolidated group.

Application date

The amendment applies from the beginning of the 2008–09 income year.

WITHHOLDING OF TAX FROM SCHEDULAR PAYMENTS

Section RD 10(4) of the Income Tax Act 2007

The Panel considered, and agreed with, a submission that the effect of section RD 10(3) of the Income Tax Act 2007 differs from the outcome given by that section's corresponding provision in the Income Tax Act 2004.

Key features

The amendment corrects the unintended change and ensures that the payer of a schedular payment to a GST-registered person must withhold tax under the PAYE rules based on the GST-exclusive amount. This is because GST charged by and paid to a registered person is not treated as income.

Application date

The amendment applies from the beginning of the 2008–09 income year.

RELIEF FROM OBLIGATION TO WITHHOLD RESIDENT WITHHOLDING TAX

Section RE 4 of the Income Tax Act 2007

The Panel considered, and agreed with, a submission that the outcome given by section RE 4 of the Income Tax Act 2007 differs from the outcome given by that section's corresponding provision in the Income Tax Act 2004 on the requirement to withhold resident withholding tax from payments of dividends. This issue mainly relates to financial institutions operating through a branch in New Zealand that pay dividends to the branch's New Zealand shareholders in relation to shares issued by the foreign company.

Key features

Section RE 4 requires a person to withhold resident withholding tax from payments of dividends and interest, unless an exception applies.

The amendment correctly provides an exception from the obligation to withhold resident withholding tax. This ensures that a non-resident company carrying on a taxable activity in New Zealand through a branch is relieved from the obligation to withhold resident withholding tax from dividends paid to its New Zealand shareholders if the company is not required by generally accepted accounting practice, to express its financial statements in New Zealand dollars.

Application date

The amendment applies from the beginning of the 2008–09 income year. However, a "savings" provision applies to:

- validate the tax position of a company that has withheld resident withholding tax from dividends paid to its New Zealand shareholders (based on the previous section RE 4 in the 2007 Act); and
- ensure that self-assessments of shareholders that take into account the dividend paid from the company and the associated tax credit are not disturbed.

REFUND LIMITS FOR ICA COMPANIES

Section RM 13(3) of the Income Tax Act 2007

The Panel agreed with a submission that, for a company that has an extension of time to file its annual imputation credit account (ICA) return, the provisions of section RM 13(3) in the Income Tax Act 2007 do not correctly reflect the outcome given by the section's corresponding provision in the Income Tax Act 2004 (section MD 2(1A)).

Key features

The amendment corrects the unintended change and ensures that the amount of the refund or transfer must not exceed the balance of the company's imputation credit account on the last day of the tax year to which that imputation credit account return relates.

Application date

The amendment applies from the beginning of the 2008–09 income year.

REWRITE MINOR MAINTENANCE ITEMS

Remedial changes have been made to the Income Tax Act 2007 for a number of minor drafting matters that have been brought to the attention of the Rewrite Advisory Panel. In general, these amendments consist of corrections of cross-references, spelling, punctuation, terminology and consistency of drafting. The Rewrite Advisory Panel publishes lists of these maintenance items on its website.

Amendments to the Income Tax Act 2007 shown in the table below apply from the beginning of the 2008–09 income year (other than for section LD 3).

Section	Act	Amendment
CB 36	2007 Act	Terminology corrected
CV 2(1)	2007 Act	Correction to cross-reference
DP 11	2007 Act	Terminology corrected
FM 31	2007 Act	Clarifying eligibility to become, and to remain, a member of a consolidated group of companies
GB 32(2B)(a)(i)	2007 Act	Terminology corrected
HA 4(2)	2007 Act	Correction to cross-reference
HM 8	2007 Act	Defined terms list
HM 11	2007 Act	Defined terms list
HM 12	2007 Act	Defined terms list
HM 13	2007 Act	Defined terms list
HM 50(5)(a)	2007 Act	Correction to cross-reference
HM 55FB(1)(b)	2007 Act	Correction to cross-reference
HM 72(1)	2007 Act	Correction of punctuation

Section	Act	Amendment
LD 3*	2007 Act	Clarifying meaning of charitable and public benefit gift
After subpart LP	2007 Act 1 June 2009	Repeal redundant heading
OB 1, YA 1, ICA company	2007 Act	Clarifying definition of ICA company and Australian ICA company
After section OP 77	2007 Act	Repeal redundant heading
After section RC 35	2007 Act	Repeal redundant heading
RD 5	2007 Act	Terminology corrected
Section RZ 5D	2007 Act	Defined terms list
YA 1, FDP rules	2007 Act	Terminology corrected
YA 1 NZIAS references	2007 Act	Terminology corrected
YA 1 partnership share	2007 Act	Terminology corrected
Schedule 1, Part A, Clause 1	2007 Act	Correction of cross-reference

* The change applies from the date of Royal assent, being 27 February 2014.

ORDER IN COUNCIL

TAX ADMINISTRATION (FINANCIAL STATEMENTS) ORDER 2014

From 1 April 2014, companies including "look-through companies" that do not prepare financial reports to a higher authoritative accounting standard will be required under section 21B of the Tax Administration Act 1994, to prepare financial reports to a minimum standard as set out in the Tax Administration (Financial Statements) Order 2014 unless otherwise exempted from doing so.

Application date

The new regulation applies for income years commencing 1 April 2014 and later, with a deferral for the disclosures connected with associated persons' transactions to the 2015 tax year.

Background

The start of the Financial Reporting Act 2013 on 1 April 2014 removed for a large number of companies the obligation to prepare general purpose financial reports.

When decisions were made by the Government to reform the financial reporting regulatory framework for companies, it was also decided that these companies should continue to prepare financial reports for tax purposes, but to a lesser and minimum special-purpose level (special-purpose financial reports). For medium-sized companies that previously complied with the general-purpose financial reporting requirements, significant compliance cost savings are anticipated.

The Tax Administration Act 1994 has been amended by the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 and sets a framework so that by way of Orders in Council, the minimum financial requirements can be specified for companies and other taxpayers (when specified). A fuller description about the legislative changes made to the Tax Administration Act 1994 can be found in the commentary on the new legislation in this *Tax Information Bulletin*.

Overview of the Tax Administration (Financial Statements) Order 2014

Application of the minimum requirements to companies and look-through companies

All companies including look-through companies, except those expressly exempted, will be required to prepare special-purpose financial reports to a level specified by the regulation. The circumstances when companies are not required to prepare financial reports are discussed below.

"Company" is defined as having the same meaning as in section YA 1 of the Income Tax Act 2007, which includes bodies corporate and other entities that have a legal existence separate from that of their members. This includes subsidiaries of companies that prepare general-purpose consolidated financial reports.

The regulation also provides that the minimum requirements also apply to "look-through companies" as defined in the Income Tax Act 2007, unless they are otherwise exempt because the look-through company is inactive or its activities are small-scale. Look-through companies that prepare financial reports using a higher authoritative accounting standard are also exempted from preparing special-purpose reports.

Companies exempted from preparing financial reports

Section 21B of the Tax Administration Act 1994 removes the obligation to prepare special purpose reports if the company prepares financial statements to a higher authoritative accounting standard or is required to prepare according to a standard specified by another enactment, for example – companies that are subject to the Companies Act 1993 or Charities Act 2005.

In addition, recognising the costs connected with preparing financial reports, the regulation also exempts:

- companies, that are not part of a group of companies, whose activities are small-scale (both income and expenditure do not exceed $30,000 during an income year); and
- companies that are non-active companies.

The term "non-active companies" is defined by reference to section 43A of the Tax Administration Act 1994. An election under section 43A removes the obligation to file a return of income for certain companies when, for example, the company has derived no income or deemed income and has no deductions. An explanation of the non-active company rules can be found in *Tax Information Bulletin* Vol 6, No 12 (May 1995), page 28.

Definitions

For the most part, the definitions used in the regulation are defined in the context of the Inland Revenue Acts. An exception applies to terms used to describe accounting principles – clause 4(2) refers – and includes:

- accrual accounting
- assets
- double-entry
- expenditure

- historical cost
- income
- intangible property
- liabilities
- net assets.

The terms above are to be defined according to their accounting context.

Minimum requirements

Clause 8 and the Schedule to the regulation prescribe the minimum requirements for preparing financial statements. The minimum requirements are directed at the preparation of special-purpose financial statements. The requirements are, for the most part, principles based, although some disclosures and valuation methods are specified. The new regulation sets out the following minimum requirements for preparing financial reports under the headings:

- *Form of the financial reports* – Companies are required to prepare a balance sheet and a profit and loss statement.
- *Principles with which statements must comply* – Financial reports must be prepared using double-entry accrual accounting concepts.
- *Valuation* – Disclosed values should generally be based on tax values (values that comply with the Inland Revenue Acts). In most instances this will correspond with historical cost, but not always. Historical cost or market values can be used if this is more appropriate. For example, entertainment expenses should be recorded using historical cost, with the add-back detailed in the book-to-tax reconciliation. The valuation method used should be included in the accounting policies disclosure.
- *Statement of accounting policies* – A description of the policies used by the company in preparing the financial reports must be included.
- *Matters the statements must show* – Comparatives are required, but in years that special-purpose financial reports are first adopted they need not be restated, so long as resulting movements in shareholders' funds are disclosed.
- *How matters must be shown* – Amounts showing interest and dividends received must be grossed up for RWT and dividends should be grossed up for imputation credits, to the extent the dividend is taxable and the imputation credits can be used. However, the imputation credit gross-up can be disclosed in the book-to-tax reconciliation if the preparer of the financial reports prefers.
- *Schedule* – The schedule to the regulation sets out the matters that must be disclosed. Clause 1 prescribes matters that must be shown for income years starting from 1 April 2014. Clause 2 prescribes additional information for certain transactions with certain associated persons and applies to tax years starting from 1 April 2015. These clauses are discussed in more detail below.

The schedule

Clause 1 specifies, under three headings, a number of disclosures:

- The first heading deals with reconciliations and fixed or depreciable assets – where a difference arises between a company's accounting profit and taxable income for an income year, a reconciliation of the two figures is required. Companies are also required to prepare a detailed tax schedule of fixed assets and depreciable property.
- The second heading deals with disclosures specific to certain taxpayers. The regulation specifies particular disclosures for companies involved in forestry (the tax-carrying cost of timber) or that deal with livestock (class by class details of sales, purchases and on-hand).
- The third heading requires the financial reports to show items on forms prescribed under section 35 of the Tax Administration Act 1994. This is a reference in the IR 10 prescribed form. However, any reconciliation from the IR 10 back to the financial reports will be undertaken by Inland Revenue in the first instance. This is because it is accepted that good detailed financial reporting may be prepared on a divisional basis and this practice may mean that the financial report does not directly reconcile with the disclosures in the IR 10. A good example of this is a dairy farm's financial reports which are likely to have a milk account, cattle account and sundry income, all of which will have components of "gross income".

Clause 2 applies to tax years from 1 April 2015 and deals with matters connected with certain associated persons' transactions, within the meaning of the term "associated person" in subpart YB of the Income Tax Act 2007.

Clause 2(3)(a) requires matters connected with transactions with non-companies (for example, individuals and trusts) and non-resident companies to be disclosed if the transaction relates to:

- interest expense incurred in respect of any loan;
- amounts paid in the nature of outbound loans or other advances;
- expenses incurred for services, including wages and salaries, management fees and other payment for services;
- expenses incurred in respect of rentals or leases of land and other assets;
- expenses incurred to acquire or use intangible property including royalty payments.

Clause 2(3)(b) also requires a reconciliation of any movements in shareholders' equity and loans or other advances to (and from) the company's shareholders or other owners and persons associated with the company.

Relationship with authoritative financial reporting standards and other frameworks

The Income Tax Act 2007 makes reference in a number of places to financial reporting standards (New Zealand International Accounting Standards) when determining values for income, expenditure or loss. Examples of this include research and development expenditure and the financial arrangement rules. Preparers of financial reports may choose to use higher quality reporting standards for segments of their financial reports when appropriate so long as Inland Revenue's minimum requirements are disclosed. Also, preparers are free to use frameworks that have more detailed disclosures, such as the New Zealand Institute of Chartered Accountants' (NZICA) special-purpose framework, which is in the process of being finalised. It is anticipated that compliance with NZICA's special-purpose framework will also mean compliance with minimum requirements set out in the regulation.

Tax Administration (Financial Statements) Order 2014
LI 2014/69

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)*. You can download this publication free from our website at **www.ird.govt.nz**

PRODUCT RULING BR PRD 14/01: RESTAURANT BRANDS LIMITED

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Restaurant Brands Limited.

Taxation Laws

This Ruling applies in respect of:

- sections BD 2, DA 1 and DA 2(4) and the definition of "income from employment" in section YA 1 of the Income Tax Act 2007 for the periods from 1 April 2008;
- the definition of "taxable activity" in section 6, and the definition of "employment under any contract of service" in section 6(3)(b) of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is a recurring arrangement in terms of section 91E(1) of the Tax Administration Act 1994 involving the engagement of delivery drivers by Restaurant Brands Limited ("RBL") pursuant to the Delivery Driver Contract, and in accordance with information in the Delivery Driver Handbook, and completion of Certification S5, and the standard practice information previously provided to Inland Revenue in the ruling application (dated 10 October 2007) (collectively referred to as "the relevant documents"), to deliver RBL products to RBL customers. Further details of the Arrangement are set out in the paragraphs below.

Relationship between RBL and its delivery drivers

1. RBL prepares and sells a range of "fast food" products via its Pizza Hut business. RBL sells its products through a chain of restaurants and provides a delivery service to its customers at some of these restaurants. RBL engages the services of delivery drivers to deliver its products to its customers from its Pizza Hut stores.
2. The relationship between the Delivery Drivers (owner drivers) and Pizza Hut are governed by the following documents:
   - The "Delivery Driver Contract" dated September 2012 which includes the following:
     – An outline of delivery driver payments (clause 7);
     – A form to compile the details of the driver, bank account, vehicle and motor insurance (schedule B); and
     – The driver uniform policy (schedule C);
   - The "Delivery Driver Handbook" dated November 2010 which incorporates the following:
     – The "Contract Delivery Drivers Notice of Taxation Requirements";
     – The guideline on "Delivery Driver Duties";
     – The "CHAMPS " guidelines on dealing with a customer; and
   - The "Certification S5" which drivers are required to complete to demonstrate their skills and knowledge in the following areas:
     – Driver's Role in CHAMPS;
     – Service Standards; and
     – Driver Safety & Security; and
   - The "Standard Practice Information" provided to Inland Revenue in prior rulings application.

2a) Changes to the terms of the Delivery Driver contract and the Delivery Driver Handbook (for example, with respect to payments) are communicated to Area Managers & Store Managers by the RBL Head Office by way of an email. This is in turn communicated to the Delivery Drivers verbally with reference to the e-mail received from RBL Head Office. No physical amendment is made to the Delivery Driver Contract entered into with each respective driver. Consequently, the Delivery Driver contract and the Delivery Driver Handbook has not changed from that previously provided to the Inland Revenue.

3. In some cases, in-store employees make home deliveries for Pizza Hut stores from time to time, while also carrying out employment duties in-store. These employees are contracted with RBL under employment contracts and are not remunerated separately for the delivery services performed.

Terms of the Delivery Driver Contract

4. Under the terms of the Delivery Driver Contract the delivery driver agrees to:
   a) use only the motor vehicles detailed in the Driver/Vehicle details as provided in Schedule B to the contract in the performance of the contract (clause 3.1(d));
   b) ensure the performance of the delivery services in a safe, proper and courteous manner in accordance with the guidelines provided in the Delivery Driver Handbook as varied from time to time (clause 3.1) (attention is drawn to any delivery driver guidelines issued by RBL from time to time);
   c) be responsible for all costs and expenses of the driver's business including the costs and expenses of operating and maintaining all delivery vehicles (clause 4.1(b));
   d) immediately refer any discrepancies on delivery with regards to collection of monies and delivery records to RBL (clause 5.1(a));
   e) at the end of each delivery period provide to RBL's authorised representative:
      - a complete account and record in the format specified by RBL (clause 5.1(b)(i)); and
      - all monies collected by the delivery driver from customers of RBL during the course of that delivery period (clause 5.1(b)(ii));
   f) be responsible to account for any cheques, credit card slips or monies received on behalf of RBL as soon as possible and make good any shortfall (clause 5.1(c));
   g) be liable for, and indemnify RBL against, any liability, loss, claim or proceedings arising out of or relating to the use of the Contractor's vehicles in the provision of delivery services (clause 8.1);
   h) a minimum of Third Party Property Damage Liability Insurance in respect of the vehicle (clause 8.1(a));
   i) wear any uniforms provided by RBL and ensure their proper care and maintenance. A $30 deposit is retained out of the first payment, to be returned to the delivery driver on return of the uniform in good conditions (fair wear and tear excepted) (clause 9.1);
   j) provide a float of $20 for the purpose of making change during each delivery period (clause 9.2);
   k) return upon request, clean and in good condition uniforms and delivery pouches. Failure to do so will entitle RBL to deduct the replacement cost from any monies owing to the delivery driver (clause 9.3); and
   l) produce to RBL's authorised representative documents that are necessary in the opinion of RBL to establish that the delivery driver has complied and continues to comply with their obligations under the contract (clause 10).
5. The delivery driver is not liable to take out any insurance or be responsible for loss or damage to the products delivered (as long as the loss or damage does not result from the delivery driver's wilful default, negligence or breach of the Contract) (clause 8.3).
6. In terms of RBL's obligations under the Delivery Driver Contract:
   a) The engagement of the delivery driver does not commit RBL to a guarantee of any minimum remuneration (clause 1.2);
   b) RBL also reserves the right to engage the services of other contractors (clause 1.3);
   c) RBL agrees to pay the delivery driver:
      - for services on a per delivery basis an all-inclusive payment of $5.50 per delivery including GST if any) (clause 7);
      - within 24 days of submission and approval of an invoice for services (clause 6.1);
   d) RBL is not responsible for any vehicle damage sustained as a result of the delivery driver's negligence or omission (clause 8);
   e) Products carried by the delivery driver shall be at the risk of RBL (clause 8.3);
   f) The uniforms and delivery pouches remain the property of RBL (clause 9.3).
7. Under clause 1.2 either party may terminate the Delivery Driver Contract upon notice to the other party at the conclusion of any delivery.
8. The legal relationship between the delivery driver and RBL is described as that of "principal and independent contractor and not that of employer and employee" (clause 2.1).

Delivery Driver Payments

9. Clause 7 of the guideline on "Delivery Driver Payments" states that the delivery drivers will be reimbursed at the current delivery payment rate per delivery, at a maximum of two deliveries per round trip.
10. In the case of a mistake and redelivery is required, the delivery driver will receive another delivery payment if the mistake was through no fault of their own.

11. The following are examples of delivery driver payments/reimbursements that are available.

    The delivery drivers receive payments/ reimbursements for:

    - redeliveries that have resulted through overdue order complaints;
    - redelivery due to wrongly supplied delivery details (eg, wrong address/phone number supplied by RBL to the delivery driver);
    - delivery of hoax orders or orders cancelled after the product has left the restaurant (the product must be returned to the restaurant);
    - redelivery due to miscellaneous circumstances outside the delivery driver's control;
    - cost of phone calls made to customers or back to the restaurant from a payphone;
    - redelivery due to complaints received in relation to an incorrect pizza base/toppings or production of a pizza;
    - delivery of orders cancelled after they have left the unit;
    - drivers will only receive payments/reimbursement once there is a "Driver Activity Record" report signed by both the Driver and the Manager on Duty.

12. The delivery drivers do not receive payments/ reimbursements for:

    - three or more home deliveries per delivery round, RBL policy is a maximum of two;
    - complaints indicating driver's mishandling of the order (eg, pizza has been dropped by the delivery driver);
    - redelivery due to the delivery driver not finding the address where the original delivery details are correct (where possible delivery drivers are required to call from a pay phone to clarify the delivery details);
    - cost of cell phone calls to the customer or back to the restaurant;
    - redelivery due to missing items off the order (eg, missing garlic bread). (It is the delivery driver's responsibility to check that they have the entire order before leaving the restaurant);
    - transporting stock between stores, stock transfers are the shift manager's responsibility, and not the delivery driver's responsibility;
    - deliveries done if there is no "Driver Activity Record" report signed by the Driver and the Manager on Duty for the night worked.

13. Delivery drivers are not guaranteed any minimum per hour delivery payment.

Uniform Requirements

14. Clause 9 of the Delivery Driver Contract sets out the uniform requirements for delivery drivers to adhere to health regulations and Pizza Huts professional standards. Key points of the requirements are listed below:

    - Delivery drivers are required to wear the uniforms provided by the Company and shall ensure their proper care and maintenance;
    - A $30 deposit will be retained from the delivery drivers first payment and will be returned on the return of the uniform in good condition (fair wear and tear accepted);
    - Failure by the contractor to do so will entitle the Company to deduct the replacement or repair costs from any monies owing the Contractor at the time of termination of the Agreement, in addition to any other legal remedies that may be available to the Company.

Notice of Taxation Requirements

15. The "Contract Delivery Drivers Notice of Taxation Requirements" is a guide contained in the Delivery Driver Handbook which states that:

    - the delivery driver is not an employee of RBL;
    - the delivery driver should seek independent taxation advice to understand their rights and obligations;
    - PAYE will not be deducted from payments for deliveries;
    - the gross values of all payments received by the delivery driver for deliveries must be included in the delivery driver's annual income tax return;
    - the delivery driver must calculate and pay their earner premium at the end of the year when they file their tax return;
    - the delivery driver may be liable to pay provisional tax; and
    - the delivery driver must register for GST if the delivery driver has income of $60,000 or more.

Delivery Driver Duties

16. The guidelines on "Delivery Driver Duties" have suggestions for the manner in which deliveries are to be made, handling customer complaints, and what to do in the event of emergencies.

CHAMPS – guidelines on dealing with a customer

17. The CHAMPS guidelines on dealing with a customer includes a problem solving method and actions to take when certain scenarios arise (eg, if the order has missing items).

Certification S5 – Serving Delivery Customers

17a) The delivery drivers are required to complete and pass this certification to demonstrate their skills and knowledge in the following areas:

a) Driver's Role in CHAMPS;

b) Service Standards;

c) Driver Safety & Security.

Any questions that are incorrect are re-done by the drivers and are re-marked by the trainers until the correct answer is recorded and understood by the incumbent delivery driver. (A copy of the Certification S5 has been provided for information purposes.)

Standard Practice Information

18. The delivery drivers are not:
    - entitled to overtime or sick pay;
    - required to belong to any union;
    - able to supervise employees of RBL;
    - able to access RBL's administration or support services, however they do have access to staff toilets and product discounts;
    - advertising for work nor do they have their own client base, however there is no restriction for them doing this.
19. Also, the delivery drivers:
    - are able to decide the hours they work (provided work is expected to be available). It is standard practice that the delivery drivers make themselves available for rostered hours;
    - provide their own vehicles and associated equipment;
    - are free to work for another principal;
    - must hold an appropriate drivers' license.
20. RBL trains the delivery drivers as to the manner in which deliveries are made. The delivery drivers are instructed as to what geographical area they will work in.
21. RBL employees take orders over the phone and decide the delivery sequence of the orders. A maximum of two orders can be delivered at any one time (to ensure quality control of the product).
22. From time to time RBL may pay at its discretion the delivery drivers a minimum of two deliveries per hour during certain hours, in order to ensure minimum coverage for RBL during quiet periods.
23. Although the delivery driver may find his or her own replacement driver, in practice this does not happen and generally another delivery driver is used by RBL.
24. RBL is currently reviewing the implementation of an incentive scheme, which will apply only to certain delivery drivers for maintaining delivery standards and will not be offered to in-store drivers or employees. The incentive payments are not contractually guaranteed and are not part of an ongoing arrangement.

Relationship between RBL's employees (employed under a different contract) and delivery drivers

25. In certain cases employees of RBL may, from time to time, be required to perform delivery services. Where this is the case, the employees also do other tasks (ie, making the pizzas, cleaning, etc). In contrast, delivery drivers are contracted purely to deliver pizzas and are not asked to perform other tasks.
26. No other collateral contracts, agreements, terms or conditions, written or otherwise, have a bearing on the conclusions reached in this Ruling.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The terms of the relevant documents entered into by RBL and the delivery driver is exactly the same as those provided to the Inland Revenue in the Ruling application dated 8 December 2009, except in relation to the following clauses of the Delivery Driver Contract (dated September 2012) where the basic uniform and hygiene requirements, number of days or dollar amounts (as appropriate) may vary from time to time:
   - Clause 6, which states that RBL agrees to pay the delivery drivers within 24 days of submission of an invoice;
   - Clause 7, which states the rate per delivery as a gross amount of $5.50 per delivery;
   - Clause 9, which specifies the current uniform requirements;
   - Clause 9.1, which states that a $30 deposit will be retained out of the delivery driver's first payment, to be returned to the delivery driver on the return of the uniform in good condition;
   - Clause 9.2, which provides that a float of $20 be carried by the delivery driver.

b) RBL will provide the delivery drivers with the notice of taxation requirements at the commencement of the contract and advise the delivery drivers that as independent contractors they are required to comply with their own income tax, GST and ACC obligations.

c) The actual relationship between RBL and the delivery driver is, and will continue to be during the period this Ruling applies, in accordance with the terms of the relevant documents in all material respects.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any assumption or condition stated above, the Taxation Laws apply to the Arrangement as follows:

- For the purposes of sections BD 2, DA 1 and DA 2(4) of the Income Tax Act 2007, payments made by RBL to the delivery driver are not "income from employment" as defined in section YA 1 of the Income Tax Act 2007, so the driver is not prevented from claiming deductions under these sections by reason only that the driver earns "income from employment"; and
- For the purposes of the Goods and Services Tax Act 1985, the provision of services by the driver to RBL will not be excluded from the definition of "taxable activity" in section 6 of the Goods and Services Tax Act 1985 by section 6(3)(b) of that Act as they are not made under "contracts of service".

The period or income year for which this Ruling applies

This Ruling will apply for the period from 26 October 2013 until 26 October 2017.

This Ruling is signed by me on 25 February 2014.

Tracey Lloyd
Investigations Manager, Investigations and Advice

PRODUCT RULING BR PRD 14/02: GENESIS ENERGY LIMITED INITIAL PUBLIC OFFERING

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by the Minister of State Owned Enterprises and the Minister of Finance, in their capacity as holders of all of the issued shares in Genesis Energy Limited ("Genesis") on behalf of Her Majesty the Queen in Right of New Zealand ("the Crown").

Taxation Law

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of s CC 3.

This Ruling does not consider or rule on the tax consequences (if any) arising from the sale or disposition of any Shares acquired under the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the transfer of fully paid ordinary shares in Genesis ("the Shares", which include IPO Shares and the Loyalty Bonus Shares each as defined below) by the Crown to New Zealand Applicants pursuant to an Investment Statement and a Prospectus relating to the Initial Public Offering ("IPO") of Ordinary Shares in Genesis ("the Offer Documents").

Further details of the Arrangement are set out in the paragraphs below.

1. Genesis is a New Zealand incorporated company. Genesis commenced operations in 1999, when the Crown separated Electricity Corporation of New Zealand into three state-owned enterprises. Genesis produces electricity, using its power station assets and has a 31% interest in the Kupe oil and gas field. Genesis sells electricity, gas and LPG to retail and business customers through two retail brands.
2. All shares in Genesis are currently held by the Crown. The Crown is intending to sell up to 49% of the ordinary Shares in Genesis under the IPO.
3. The purchase price payable to the Crown for each Share under the IPO will be determined under a front-end book-build process. Application will be made to list all of the Shares in Genesis on the Australian and New Zealand stock exchanges.
4. New Zealand Applicants under the Retail Offer will acquire Shares from the Crown under the IPO ("the IPO Shares") on the date of completion of the IPO ("the Allotment Date") pursuant to the terms of the IPO. New Zealand Applicants who continue to hold those IPO shares in the same registered name for a period of 12 months will be entitled to be transferred additional Genesis shares from the Crown ("the Loyalty Bonus Shares") based upon a ratio of one Loyalty Bonus Share for every 15 IPO Shares held by that New Zealand Applicant, up to a maximum of 2,000 Loyalty Bonus Shares.
5. In submitting an application form for IPO Shares, New Zealand Applicants under the Retail Offer are automatically applying for Loyalty Bonus Shares to which they may become entitled under the terms of the Offer Document.
6. The date upon which the Loyalty Bonus Shares will be allotted to eligible New Zealand Applicants is intended to be within 5 business days from 12 months after the Allotment Date ("Measurement Date").
7. New Zealand Applicants pay the same amount per share as all other purchasers under the IPO. This amount ("the Final Price") is payable on completion of the Offer. No further consideration (in addition to the price paid by New Zealand Applicants when applying for their Shares) is payable by New Zealand Applicants who receive Loyalty Bonus Shares. There is no partial refund to New Zealand Applicants if they do not receive the Loyalty Bonus Shares.
8. The Prospectus contains the following statement:

   > For the purposes of the financial arrangement rules, the Crown confirms that the Final Price is the lowest price it would have accepted for the Shares on the basis of payment in full on the Allotment Date.

9. No promise to hold the IPO Shares for the required period of time is given by the New Zealand Applicants; they are free to dispose of their IPO Shares at any time. The recipients of the Loyalty Bonus Shares are determined solely by reference to those of the New Zealand Applicants who have held their IPO Shares until the Measurement Date. The Crown promises to transfer one Loyalty Bonus Share to a New Zealand Applicant on a future date for each

15 IPO Shares that the New Zealand Applicant held continuously until the Measurement Date, up to a maximum of 2,000 Loyalty Bonus Shares, with that value determined based on the Final Price.

10. A New Zealand Applicant is defined in the Offer Document as an applicant who provides, in conjunction with their application to acquire Shares, a New Zealand IRD number, a New Zealand bank account, a New Zealand address and a declaration that the applicant is:
    - in the case of an individual, a New Zealand citizen or permanent resident; or
    - in the case of a New Zealand incorporated company, incorporated in New Zealand and the majority of its ultimate beneficial owners are New Zealand citizens or permanent residents; or
    - in the case of a trust, established in New Zealand and the majority of its ultimate beneficiaries are New Zealand citizens or permanent residents; or
    - in the case of any other legal entity, it is incorporated or established in New Zealand and the majority of its ultimate beneficial owners, beneficiaries or members are New Zealand citizens or permanent residents.
11. The documents describing the Arrangement are the Investment Statement dated 13 March 2014 and the Prospectus dated 13 March 2014.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

(a) The New Zealand Applicants will not derive income under s CC 3 as a result of acquiring Loyalty Bonus Shares under the Genesis Energy Limited Initial Public Offering.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 13 March 2014 and ending on 13 March 2017.

This Ruling is signed by me on the 13th day of March 2014.

Fiona Heiford
Manager (Taxpayer Rulings)

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

SPECIAL DETERMINATION S25: VALUATION OF SHARES ISSUED BY BANK AND HOLDCO FOLLOWING A NON-VIABILITY TRIGGER EVENT

This determination may be cited as "Special Determination S25: Valuation of Shares Issued by Bank and HoldCo Following a Non-Viability Trigger Event".

1. Explanation (which does not form part of the determination)

1. This determination relates to a funding transaction involving the issue of Notes by the Bank to the public pursuant to a Deed Poll. The Notes will contain an exchange mechanism, in order to allow them to be recognised as Tier 2 capital for the purposes of the Reserve Bank of New Zealand and Australian Prudential Regulation Authority frameworks relating to the capital adequacy of banks.
2. At the same time that the Notes are entered into, Bank, HoldCo and Parent will enter into a Co-ordination Agreement, which will set out the steps that will occur if a Non-Viability Trigger Event occurs, requiring exchange of the Notes.
3. If a Non-Viability Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably exchanged for ordinary shares in Parent. The Co-ordination Agreement provides for a series of share subscriptions and payments from Bank to HoldCo and from HoldCo to Parent.
4. The Arrangement is the subject of private ruling BR Prv 14/06 issued on 10 March 2014, and is fully described in that ruling.
5. The share subscriptions provided for in the Co-ordination Agreement are each a financial arrangement (as defined in s EW 3) and an "agreement for the sale and purchase or property or services" (as defined in s YA 1). The Notes and the Co-ordination Agreement are, together, a wider financial arrangement.

2. Reference

This determination is made under s 90AC(1)(i) of the Tax Administration Act 1994.

3. Scope of determination

1. This determination applies to a funding transaction involving the issue of Notes by the Bank to the public pursuant to a Deed Poll. At the same time that the Notes are entered into, Bank, HoldCo and Parent will enter into a Co-ordination Agreement, which will set out the steps that will occur if a Non-Viability Trigger Event occurs, requiring exchange of the Notes.
2. If a Non-Viability Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably exchanged. In summary, the steps for the exchange of the Notes will be as follows:
   a) Each Note (subject to the exchange requirement) will be immediately transferred by the holder to HoldCo.
   b) In consideration for the holders transferring their Notes to HoldCo, Parent will allot and issue a specified "exchange number" of Parent ordinary shares to such holders for each Note assigned.
   c) Immediately following the transfer referred to in (a), the Notes will become immediately due and payable and Bank will be required to repay the Face Value of the Notes to HoldCo as assignee. Under the terms of the Co-ordination Agreement, the Face Value owed to HoldCo will be repaid by being applied on HoldCo's behalf to subscribe for ordinary shares in Bank. The number of ordinary shares in Bank to be subscribed for will be calculated in accordance with a formula in the Co-ordination Agreement.
   d) Under the Co-ordination Agreement, HoldCo will be required to pay a sum to Parent equal to the Face Value of each Note assigned to it. This amount will be automatically applied on Parent's behalf to subscribe for ordinary shares in HoldCo. The number of ordinary shares in HoldCo to be subscribed for will be calculated in accordance with a formula in the Co-ordination Agreement.

3. This determination applies in the situation that shares are issued by Bank and HoldCo following a Non-Viability Trigger Event, to determine the value of the shares for the purposes of the financial arrangement rules.

4. Principle

1. The Co-ordination Agreement and Notes are, together, a financial arrangement (as defined in s EW 3). The subscription for shares in Bank by HoldCo and the subscription for shares in HoldCo by Parent contained in the Co-ordination Agreement are both an "agreement for the sale and purchase of property and services" (as defined in s YA 1), as they are conditional agreements to acquire property.
2. The share subscriptions are not a "short-term agreement for sale and purchase" (as defined in s YA 1), as settlement will not occur within 93 days of the Co-ordination Agreement being entered into. As such, they are not excepted financial arrangements under s EW 5.
3. For the purposes of determining the consideration paid or payable under the financial arrangements rules, the value of the shares issued by Bank and HoldCo must be established under s EW 32. None of subs (3) to (5) of s EW 32 apply to the share subscriptions.
4. Under s EW 32(6), the Commissioner is required to determine the value of the property. Both parties are required to use this amount.

5. Interpretation

In this determination, unless the context otherwise requires:

"Bank" means the bank issuing the Notes;

"HoldCo" means the parent company of Bank;

"Non-Viability Trigger Event" has the meaning set out in the terms of the Deed Poll and as described in private ruling BR Prv 14/06, issued on 10 March 2014;

"Notes" means Notes issued to the public by the Bank pursuant to a Deed Poll;

"Parent" means the parent company of HoldCo.

All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.

6. Method

1. The Arrangement does not involve the advancement or deferral of income or expenditure.
2. For the purposes of s EW 32(6), the value of the shares issued by Bank is equal to the amount HoldCo paid for those shares, and the value of the shares issued by HoldCo is equal to the amount Parent paid for those shares.

7. Example

This example illustrates the application of the method set out in this determination.

Example

Following a Non-Viability Trigger Event, Notes having a face value of $100 are transferred to HoldCo by the holders of the Notes.

Bank immediately repays the face value of the Notes to HoldCo. This amount is automatically applied on HoldCo's behalf to subscribe for ordinary shares in Bank. Bank issues the number of shares to HoldCo calculated in accordance with the formula in the Co-ordination Agreement. The value of the shares, for the purposes of s EW 32, is $100.

HoldCo then pays an amount equal to the face value of the Notes to Parent. This amount is automatically applied on Parent's behalf to subscribe for ordinary shares in HoldCo. HoldCo issues the number of shares to Parent calculated in accordance with the formula in the Co-ordination Agreement. The value of the shares, for the purposes of s EW 32, is $100.

This Determination is signed by me on the 10th day of March 2014.

Fiona Heiford
Manager (Taxpayer Rulings)

DETERMINATION FDR 2014/02: USE OF FAIR DIVIDEND RATE METHOD FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager, Investigations and Advice, under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the Civic Capital Currency Offshore Fund Limited ("the Civic Capital Fund"), to which this determination applies, are attributing interests in a foreign investment fund (FIF) for certain portfolio investment entity funds ("the NZFM Funds") managed by New Zealand Funds Management Limited.

The investments held by the Civic Capital Fund through the Civic Capital Currency Master Fund Limited ("the Civic Master Fund") are predominantly financial arrangements. In addition, the NZFM Funds hedge their attributing interests in the Civic Capital Fund back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent the NZFM Funds from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

Despite Civic Capital Fund having assets predominantly comprising financial arrangements and the presence of the hedging arrangement, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument. Accordingly, I consider it is appropriate for the NZFM Funds to use the fair dividend rate method to calculate FIF income from its attributing interest in the Civic Capital Fund.

Scope of determination

This determination applies to shares held by the NZFM Funds in the Civic Capital Fund and Civic Capital Fund's investment in the Civic Master Fund.

The Civic Capital Fund:

- is organised under the laws of the Cayman Islands as a limited liability company;
- issues shares, denominated in USD, to the NZFM Funds;
- Invests in and trades in global currency markets and foreign exchange related derivatives through its investment in the Civic Master Fund.

The NZFM Funds will hedge their attributing interests in the Civic Capital Fund back to New Zealand Dollars.

It is an additional condition of this determination that the investment in the Civic Capital Fund is not part of an overall arrangement that seeks to provide NZFM Funds with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.

Interpretation

In this determination, unless the context otherwise requires:

"Civic Capital Fund" means the issuer, Civic Capital Currency Offshore Fund Limited, which is incorporated as a company under the laws of the Cayman Islands;

"Civic Capital Currency Master Fund Limited" means the master fund used for holding the investments, which is incorporated as a company under the laws of the Cayman Island;

"Fair dividend rate method" means the fair dividend method under section YA 1 of the Income Tax Act 2007.

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"the NZFM Funds" means a portfolio investment entity managed by New Zealand Funds Management Limited;

"Portfolio investment entity" means a portfolio investment entity under section YA 1 of the Income Tax Act 2007.

Determination

This determination applies to an attributing interest in a FIF, being a direct income interest in the Civic Capital Fund. This is a type of attributing interest for which the NZFM Funds may use the fair dividend rate method to calculate FIF income from the interest.

Application date

This determination applies for the 2014 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for the 2014 income year for an investor in the Civic Capital Fund unless that investor chooses for this determination to apply for that year.

Dated at Christchurch this 11th day of March 2014.

John Trezise
Investigations Manager, Investigations and Advice

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS (FOR THE 12 MONTHS ENDING 31 MARCH 2014)

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars for the 12 months ending 31 March 2014.

The Income Tax Act 2007 ("2007 Act") requires foreign currency amounts to be converted into New Zealand dollars applying one of the following methods:

- actual rate for the day for each transaction (including close of trading spot exchange rate on the day), or
- rolling 12-month average rate for a 12-month accounting period or income year (see the table **Currency rates 12 months ending 31 March 2014 – rolling 12-month average**), or
- mid-month actual rate as the basis of the rolling average for accounting periods or income years greater or lesser than 12 months (see the table **Currency rates 12 months ending 31 March 2014 – mid-month actual**).

Legislation enacted in September 2010 with effect from 1 April 2008 permits the Commissioner to set currency rates and approve methods of calculating exchange rates. The Commissioner can set rates for general use by taxpayers or for specific taxpayers. The Commissioner's ability to set rates and approve methods applies in circumstances where the 2007 Act does not contain a specific currency conversion rule (sections YF 1(5) and (6)), or in circumstances where the 2007 Act provides a rate or method for currency conversion (section YF 2).

Inland Revenue uses wholesale rates from Bloomberg for rolling 12-month average, mid-month actual and end of month. These rates are provided in three tables.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Note: All section references relate to the 2007 Act.

Actual rate for the day for each transaction

The actual rate for the day for a transaction can be used in the following circumstances:

- where the 2007 Act does not provide a specific currency conversion rule, then foreign currency amounts can be converted by applying the close of trading spot exchange rate on the date that the transaction which is required to be measured or calculated occurs (section YF 1(2))
- where a person chooses to use the actual rate for the day of the transaction when calculating their FIF income or loss when applying the comparative value method, fair dividend rate method, deemed rate of return method or the cost method (section EX 57(2)(a))
- where a person chooses to use the close of trading spot exchange rate to convert foreign income tax paid by a CFC (section LK 3(a)) or by a FIF where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(a)).

Unless the actual rate is the rate for the 15th or the last day of the month, these rates are not supplied by Inland Revenue.

The table **Currency rates 12 months ending 31 March 2014 – month end** provides exchange rates for the last day of the month. These are provided for convenience to assist taxpayers who may need exchange rates on those days.

Currency rates 12 months ending 31 March 2014 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average. This table should be used where the accounting period or income year encompasses 12 complete months.

This table can be used to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods of 12 months
- FIF income or loss calculated under the attributable FIF income method (section EX 50(3)(a)) for accounting periods of 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of 12 months
- calculating the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of 12 months.

Currency rates 12 months ending 31 March 2014 – mid-month actual table

This table sets out the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted. This table can be used as the basis of the rolling average where the accounting period or income year is less than or greater than 12 months (see Example 4). You can also use the rates from this table as the actual rate for any transactions arising on the 15th of the month.

This table can be used as the basis of the rolling average for calculating:

- FIF income or loss under the comparative value method, the fair dividend rate method, the deemed rate of return method or cost method (section EX 57(2)(b)) for accounting periods or income years of less than or greater than 12 months
- FIF income or loss calculated under the attributable FIF income method (section EX 50(3)(a)) for accounting periods of less than or greater than 12 months
- attributed CFC income or loss calculated under the CFC rules (section EX 21(4)(b)) for accounting periods of less than or greater than 12 months
- the New Zealand dollar amount of foreign income tax under the CFC rules (section LK 3(b)) or under the FIF rules where the attributable FIF income method is used (sections EX 50(8)–(9) and LK 3(b)) for accounting periods of less than or greater than 12 months.

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippine company (which is a FIF but does produce a guaranteed yield) on 6 September 2013. Its opening market value on 1 October 2013 or its closing market value on 30 September 2013 is PHP 350,000. Using the comparative value method and applying the actual rate for the day (section EX 57(2)(a)), the opening market value is converted as follows:

PHP 350,000 ÷ 35.9919 = $9,724.41

(In this example, the rate selected is the month-end rate for September 2013 for PHP. Refer to the table "Currency rates 12 months ending 31 March 2014 – month end".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 31 December 2013. Attributed CFC income for the period 1 January 2013 to 31 December 2013 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 6.3871 = $31,313.12

(In this example, the rate selected is the rolling 12-month average rate for December 2013 for HKD. Refer to the table "Currency rates 12 months ending March 2014 – rolling 12-month average".)

Example 3

A resident individual with a 31 October 2013 accounting period acquires a FIF interest in a Japanese company on 1 November 2012 for 10,500,000 yen. The interest is sold in October 2013 for 10,000,000 yen. Using the comparative value method and applying section EX 57(2)(b), these amounts are converted as:

JPY 10,500,000 ÷ 77.4843 = $135,511.32

JPY 10,000,000 ÷ 77.4843 = $129,058.40

(In this example, the rolling 12-month rate for October 2013 has been applied to both calculations. Refer to the table "Currency rates 12 months ending March 2014 – rolling 12-month average".)

Example 4

A CFC resident in Singapore was formed on 19 April 2013 and has a balance date of 30 September 2013. During the period 1 May 2013 to 30 September 2013, attributed CFC income of 500,000 Singaporean dollars was derived. For the conversion to New Zealand dollars the taxpayer chooses the method set out in section EX 21(4)(b).

1. Calculating the average monthly exchange rate for the complete months May-September 2013:

   1.0264 + 1.0074 + 0.9854 + 1.0243 + 1.0322 = 5.0757

   5.0757 ÷ 5 = 1.01514

2. Round exchange rate to four decimal places: 1.0151
3. Conversion to New Zealand currency:

   SGD 500,000 ÷ 1.0151 = $492,562.31

(In this example, the rates are from the table "Currency rates 12 months ending March 2014 – mid-month actual", from May to September 2013 inclusive for SGD.)

LEGISLATION AND DETERMINATIONS

Currency rates 12 months ending 31 March 2014 – rolling 12-month average

Currency	Code	15/04/13	15/05/13	15/06/13	15/07/13	15/08/13	15/09/13	15/10/13	15/11/13	15/12/13	15/01/14	15/02/14	15/03/14
Australia Dollar	AUD	0.7913	0.7962	0.8011	0.8078	0.8173	0.8251	0.8318	0.8407	0.8509	0.8626	0.8715	0.8840
Bahrain Dinar	BHD	0.3086	0.3103	0.3108	0.3104	0.3104	0.3099	0.3105	0.3112	0.3105	0.3103	0.3101	0.3109
Britain Pound	GBH	0.5189	0.5238	0.5248	0.5253	0.5254	0.5255	0.5267	0.5273	0.5259	0.5248	0.5210	0.5182
Canada Dollar	CAD	0.8184	0.8236	0.8247	0.8253	0.8281	0.8311	0.8367	0.8417	0.8449	0.8520	0.8577	0.8664
China Yuan	CNY	5.1375	5.1545	5.1478	5.1230	5.1062	5.0841	5.0823	5.0853	5.0632	5.0484	5.0315	5.0405
Denmark Kroner	DKK	4.7283	4.7511	4.7398	4.7084	4.6770	4.6649	4.6570	4.6474	4.6217	4.6103	4.5971	4.5856
Euporean Community Euro	EUR	0.6346	0.6375	0.6359	0.6315	0.6272	0.6255	0.6245	0.6231	0.6197	0.6182	0.6164	0.6148
Fiji Dollar	FJD	1.4656	1.4728	1.4727	1.4748	1.4815	1.4857	1.4915	1.4998	1.5048	1.5123	1.5179	1.5268
French Polynesia Franc	XPF	75.7392	76.0940	75.8996	75.3717	74.8487	74.6431	74.5183	74.3583	73.9451	73.7674	73.5543	73.3566
Hong Kong Dollar	HKD	6.3453	6.3803	6.3913	6.3813	6.3813	6.3712	6.3842	6.3999	6.3871	6.3835	6.3782	6.3955
India Rupee	INR	44.6153	44.8849	45.1276	45.3611	45.7596	46.2898	47.0033	47.6694	48.1011	48.5555	49.0343	49.6906
Indonesia Rupiah	IDR	7,851.5058	7,919.6108	7,964.7283	7,995.7692	8,060.0333	8,158.4967	8,267.9683	8,418.6533	8,571.1192	8,721.3842	8,861.2500	9,005.7317
Japan Yen	JPY	69.1612	71.0423	72.1944	73.4402	74.6783	75.9964	77.4843	78.9724	80.1873	81.2395	81.7499	82.3928
Korea Won	KOR	910.4685	913.0595	912.1790	908.9694	908.0382	904.4832	903.2629	903.7850	900.2992	900.2821	898.3579	897.9686
Kuwait Dinar	KWD	0.2306	0.2323	0.2329	0.2328	0.2329	0.2328	0.2334	0.2341	0.2337	0.2336	0.2334	0.2338
Malaysia Ringit	MYR	2.5277	2.5334	2.5352	2.5322	2.5435	2.5545	2.5678	2.5813	2.5894	2.6063	2.6177	2.6375
Norway Krone	NOK	4.7280	4.7449	4.7374	4.7271	4.7246	4.7337	4.7647	4.8009	4.8299	4.8666	4.9000	4.9280
Pakistan Rupee	PKR	78.3749	79.3225	79.7634	80.0082	80.5339	81.1460	82.0761	83.0566	83.5442	84.0235	84.4464	84.7335
Phillipines Peso	PHP	33.9327	33.9860	34.0916	34.1455	34.2675	34.3570	34.5622	34.7841	34.9375	35.2150	35.4551	35.8552
PNG Kina	PGK	1.7001	1.7155	1.7263	1.7311	1.7438	1.7576	1.7877	1.8190	1.8409	1.8638	1.8857	1.9161
Singapore Dollar	SGD	1.0142	1.0189	1.0194	1.0175	1.0189	1.0206	1.0240	1.0281	1.0284	1.0311	1.0317	1.0357
Solomon Islands Dollar*	SBD	0.5601	0.1158	0.1157	0.1155	0.1155	0.1151	0.1153	0.1154	0.1150	0.1148	0.1145	0.1145
South Africa Rand	ZAR	7.0792	7.1823	7.3010	7.3950	7.5130	7.6195	7.7165	7.8205	7.9214	8.0606	8.1929	8.3190
Sri Lanka Rupee	LKR	105.6995	106.0398	105.9503	105.5884	105.5884	105.3915	105.7771	106.1627	106.0653	106.2580	106.4549	107.0336
Sweden Krona	SEK	5.4604	5.4587	5.4303	5.3982	5.3868	5.3784	5.3780	5.3828	5.3650	5.3596	5.3634	5.3775

Currency	Code	15/04/13	15/05/13	15/06/13	15/07/13	15/08/13	15/09/13	15/10/13	15/11/13	15/12/13	15/01/14	15/02/14	15/03/14
Swiss Franc	CHF	0.7695	0.7753	0.7748	0.7714	0.7680	0.7670	0.7671	0.7671	0.7636	0.7615	0.7588	0.7562
Taiwan Dollar	TAI	24.1508	24.3122	24.3533	24.3069	24.3048	24.2903	24.3487	24.4474	24.4410	24.5061	24.5303	24.6382
Thailand Baht	THB	25.0249	25.0592	25.0421	24.9721	24.9549	24.9868	25.0759	25.1976	25.2456	25.4348	25.5861	25.8458
Tonga Pa'anga*	TOP	1.3979	1.4060	1.4098	1.4132	1.4198	1.4242	1.4320	1.4432	1.4472	1.4534	1.4604	1.4721
United States Dollar	USD	0.8180	0.8226	0.8240	0.8227	0.8228	0.8214	0.8231	0.8251	0.8234	0.8230	0.8222	0.8244
Vanuatu Vatu	VUV	76.3726	76.8003	76.8003	76.7061	77.0489	77.3013	77.6604	78.0553	78.0553	78.2115	78.5317	79.1242
West Samoan Tala*	WST	1.8391	1.8472	1.8530	1.8536	1.8649	1.8750	1.8785	1.8806	1.8801	1.8855	1.8872	1.9033

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2014 – mid-month actual

Currency	Code	15/04/13	15/05/13	15/06/13	15/07/13	15/08/13	15/09/13	15/10/13	15/11/13	15/12/13	15/01/14	15/02/14	15/03/14
Australia Dollar	AUD	0.8151	0.8326	0.8409	0.8581	0.8831	0.8795	0.8790	0.8898	0.9225	0.9354	0.9268	0.9456
Bahrain Dinar	BHD	0.3169	0.3107	0.3034	0.2944	0.3044	0.3065	0.3160	0.3146	0.3120	0.3144	0.3154	0.3217
Britain Pound	GBH	0.5499	0.5409	0.5126	0.5171	0.5162	0.5121	0.5238	0.5168	0.5068	0.5094	0.4995	0.5128
Canada Dollar	CAD	0.8621	0.8371	0.8183	0.8142	0.8320	0.8417	0.8697	0.8705	0.8721	0.9118	0.9189	0.9480
China Yuan	CNY	5.2000	5.0648	4.9341	4.7924	4.9351	4.9755	5.1176	5.0848	5.0241	5.0418	5.0678	5.2480
Denmark Kroner	DKK	4.8086	4.7653	4.4942	4.4578	4.5113	4.5604	4.6201	4.6082	4.4882	4.5732	4.5590	4.5807
Euporean Community Euro	EUR	0.6449	0.6396	0.6032	0.5978	0.6049	0.6116	0.6192	0.6175	0.6013	0.6129	0.6111	0.6134
Fiji Dollar	FJD	1.4950	1.5011	1.4706	1.4865	1.5232	1.5124	1.5312	1.5418	1.5454	1.5674	1.5620	1.5855
French Polynesia Franc	XPF	76.9556	76.3608	71.9575	71.2913	72.1401	72.9392	73.9049	73.7016	71.8109	73.1393	72.8587	73.2191
Hong Kong Dollar	HKD	6.5254	6.3959	6.2474	6.0582	6.2603	6.3052	6.5009	6.4620	6.4050	6.4662	6.4886	6.6314
India Rupee	INR	46.3020	44.9585	46.5563	46.4526	49.5886	51.6626	51.8298	52.3685	50.9931	51.4787	51.8307	52.2654
Indonesia Rupiah	IDR	8236.6600	7985.4500	7955.3300	7862.4200	8429.5200	9125.5400	9154.5100	9630.5800	9991.5300	10083.5400	*9910.3200*	9703.3800
Japan Yen	JPY	81.3500	84.2590	75.8370	77.9710	78.6120	80.7970	82.2350	83.5370	85.2550	87.1830	85.1330	86.5440
Korea Won	KOR	944.5067	920.2527	907.9036	875.7247	902.2449	883.0024	894.1792	887.3437	868.2552	888.0041	890.0500	914.1556
Kuwait Dinar	KWD	0.2396	0.2358	0.2279	0.2230	0.2295	0.2313	0.2372	0.2361	0.2335	0.2360	0.2357	0.2399
Malaysia Ringit	MYR	2.5770	2.4595	2.5094	2.4901	2.6533	2.6727	2.6511	2.6535	2.6705	2.7416	2.7688	2.8027
Norway Krone	NOK	4.8405	4.8187	4.6019	4.7331	4.7697	4.8222	5.0466	5.0943	5.1055	5.1171	5.0861	5.0997
Pakistan Rupee	PKR	82.6446	81.3008	79.3651	78.1250	82.6446	85.4701	89.2857	89.2857	88.4956	87.7193	87.7193	84.7458
Phillipines Peso	PHP	34.9873	33.7754	34.4911	33.9112	35.4663	35.6330	36.2281	36.1786	36.4348	37.5475	37.4518	38.1568
PNG Kina	PGK	1.8158	1.7590	1.7374	1.6856	1.8150	1.8731	2.0498	2.0435	2.0171	2.0228	2.0403	2.1338
Singapore Dollar	SGD	1.0417	1.0264	1.0074	0.9854	1.0243	1.0322	1.0417	1.0394	1.0355	1.0616	1.0530	1.0802
Solomon Islands Dollar*	SBD	0.1157	0.1148	0.1108	0.1103	0.1131	0.1127	0.1181	0.1151	0.1149	0.1156	0.1159	0.1174
South Africa Rand	ZAR	7.7376	7.6283	8.0063	7.7087	8.0667	8.0817	8.3671	8.4712	8.5044	9.0724	9.0716	9.1121
Sri Lanka Rupee	LKR	105.2632	103.0928	103.0928	102.0408	106.3830	107.5269	109.8901	109.8901	107.5269	108.6957	109.8901	111.1111
Sweden Krona	SEK	5.4009	5.4988	5.1737	5.2132	5.2538	5.3337	5.4478	5.5327	5.4368	5.3937	5.3882	5.4572

Currency	Code	15/04/13	15/05/13	15/06/13	15/07/13	15/08/13	15/09/13	15/10/13	15/11/13	15/12/13	15/01/14	15/02/14	15/03/14
Swiss Franc	CHF	0.7829	0.7950	0.7415	0.7405	0.7477	0.7556	0.7646	0.7628	0.7345	0.7577	0.7464	0.7446
Taiwan Dollar	TAI	25.1457	24.6983	24.0378	23.2917	24.1860	24.1534	24.6142	24.6788	24.5215	25.1000	25.3343	25.8968
Thailand Baht	THB	24.4921	24.5251	24.6155	24.2996	25.2444	25.8980	26.2158	26.3401	26.4902	27.4152	27.0529	27.5603
Tonga Pa'anga*	TOP	1.4327	1.4280	1.4162	1.4140	1.4590	1.4585	1.4857	1.4892	1.4988	1.5116	1.5234	1.5487
United States Dollar	USD	0.8407	0.8241	0.8050	0.7808	0.8073	0.8131	0.8381	0.8338	0.8263	0.8338	0.8362	0.8538
Vanuatu Vatu	VUV	78.1250	78.1250	75.7576	74.6269	78.7402	79.3651	80.6452	79.3651	78.7402	80.0000	81.9672	84.0336
West Samoan Tala*	WST	1.8497	1.8611	1.8752	1.8188	1.9504	1.9644	1.8783	1.8434	1.8686	1.9952	1.8910	2.0431

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However, these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 12 months ending 31 March 2014 – month end

Currency	Code	30/04/13	31/05/13	30/06/13	31/07/13	31/08/13	30/09/13	31/10/13	30/11/13	31/12/13	31/01/14	28/02/14	31/03/14
Australia Dollar	AUD	0.8256	0.8297	0.8472	0.8889	0.8683	0.8896	0.8739	0.8920	0.9214	0.9236	0.9392	0.9361
Bahrain Dinar	BHD	0.3225	0.2995	0.2919	0.3010	0.2913	0.3129	0.3116	0.3066	0.3098	0.3048	0.3161	0.3271
Britain Pound	GBH	0.5512	0.5226	0.5088	0.5251	0.4984	0.5126	0.5152	0.4963	0.4964	0.4916	0.5009	0.5205
Canada Dollar	CAD	0.8620	0.8238	0.8141	0.8206	0.8144	0.8554	0.8619	0.8623	0.8730	0.9000	0.9280	0.9579
China Yuan	CNY	5.2739	4.8721	4.7517	4.8927	4.7282	5.0762	5.0348	4.9542	4.9779	4.8995	5.1540	5.3946
Denmark Kroner	DKK	4.8443	4.5579	4.4411	4.4751	4.3600	4.5759	4.5363	4.4586	4.4593	4.4737	4.5330	4.7005
Euporean Community Euro	EUR	0.6502	0.6112	0.5947	0.6002	0.5844	0.6135	0.6083	0.5978	0.5983	0.5996	0.6075	0.6300
Fiji Dollar	FJD	1.5214	1.4575	1.4529	1.5175	1.4738	1.5437	1.5223	1.5209	1.5444	1.5344	1.5701	1.6026
French Polynesia Franc	XPF	77.5813	72.9179	70.9765	71.6071	69.7621	73.2856	72.6339	71.4365	71.3496	71.5265	72.4869	75.1483
Hong Kong Dollar	HKD	6.6449	6.1695	6.0024	6.1924	5.9926	6.4374	6.4071	6.2987	6.3747	6.2791	6.5105	6.7252
India Rupee	INR	46.0586	45.2293	46.2461	48.2750	51.0792	51.8103	51.0019	50.6947	50.8033	50.9305	51.9667	51.7831
Indonesia Rupiah	IDR	8322.2800	7974.2100	7810.1700	8191.2800	8692.2100	9442.9600	9321.4700	9719.3500	10001.1100	9954.6300	9765.7600	9831.7000
Japan Yen	JPY	83.3310	79.8490	76.7260	78.1530	75.8700	81.5120	81.2530	83.2200	86.5140	82.5090	85.3950	89.5020
Korea Won	KOR	941.8600	898.6228	884.2300	896.2057	857.6573	892.8974	876.8785	860.5901	865.1535	874.3314	894.2074	923.2057
Kuwait Dinar	KWD	0.2434	0.2271	0.2209	0.2271	0.2205	0.2350	0.2335	0.2298	0.2322	0.2284	0.2360	0.2443
Malaysia Ringit	MYR	2.6009	2.4790	2.4673	2.5908	2.5529	2.6982	2.6091	2.6189	2.6908	2.7249	2.7562	2.8247
Norway Krone	NOK	4.9384	4.6627	4.6979	4.7050	4.7260	4.9918	4.9095	4.9781	4.9895	5.0785	5.0335	5.1953
Pakistan Rupee	PKR	84.0336	78.1250	76.9231	81.3008	80.6452	87.7193	88.4956	88.4956	86.9565	85.4701	87.7193	85.4701
Phillipines Peso	PHP	35.2162	33.8519	33.6730	34.7008	34.6471	35.9919	35.7273	35.5473	36.4373	36.9409	37.5420	38.7820
PNG Kina	PGK	1.8709	1.7145	1.6713	1.7773	1.7369	2.0007	2.0235	1.9960	1.9922	1.9611	2.0581	2.3037
Singapore Dollar	SGD	1.0538	1.0048	0.9810	1.0148	0.9851	1.0422	1.0259	1.0202	1.0377	1.0324	1.0636	1.0893
Solomon Islands Dollar*	SBD	6.1958	5.7798	5.6285	5.7819	5.4954	5.9960	5.9897	5.8293	5.9080	5.8801	6.1004	6.3021
South Africa Rand	ZAR	7.6793	8.0163	7.6461	7.8728	7.9438	8.3229	8.3023	8.2650	8.6320	9.0010	9.0227	9.1317
Sri Lanka Rupee	LKR	108.6957	100.0000	101.0101	105.2632	103.0928	109.8901	108.6957	106.3830	107.5269	105.2632	109.8901	113.6364
Sweden Krona	SEK	5.5502	5.2594	5.1842	5.2015	5.1158	5.3357	5.3563	5.3191	5.2921	5.2976	5.3743	5.6138

Currency	Code	30/04/13	31/05/13	30/06/13	31/07/13	31/08/13	30/09/13	31/10/13	30/11/13	31/12/13	31/01/14	28/02/14	31/03/14
Swiss Franc	CHF	0.7949	0.7584	0.7312	0.7396	0.7188	0.7510	0.7493	0.7362	0.7335	0.7329	0.7383	0.7670
Taiwan Dollar	TAI	25.2221	23.7955	23.2500	23.9730	23.1222	24.5342	24.3465	24.0868	24.5121	24.5269	25.4344	26.4356
Thailand Baht	THB	25.0578	24.0980	24.0300	24.9610	24.8446	25.9287	25.7619	26.0400	26.8898	26.7018	27.2983	28.1174
Tonga Pa'anga*	TOP	1.4613	1.4154	1.3952	1.4367	1.4137	1.4779	1.4687	1.4726	1.4943	1.4839	1.5281	1.6009
United States Dollar	USD	0.8563	0.7946	0.7738	0.7985	0.7727	0.8300	0.8263	0.8124	0.8214	0.8086	0.8389	0.8663
Vanuatu Vatu	VUV	79.3651	76.9231	72.4638	77.5194	75.7576	80.0000	78.7402	77.5194	80.6452	78.1250	82.6446	81.9672
West Samoan Tala*	WST	1.8887	1.8096	1.7070	1.7615	1.8668	1.8601	1.8518	1.9165	1.8878	1.8286	2.0074	1.9200

Notes to table:

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Source: Bloomberg CMPN BGN

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, Privy Council and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

INDEMNITY COSTS AWARDED TO COMMISSIONER

Case	Ben Nevis Forestry Venture Ltd v Commissioner of Inland Revenue
Decision date	12 March 2014
Act(s)	High Court Rules
Keywords	Indemnity costs, hopeless case, presumptive bias

Summary

The Commissioner of Inland Revenue ("the Commissioner") was awarded indemnity costs on the basis that the taxpayer's claim fell within the "hopeless case" category and the Commissioner should not have been put to the expense of defending such a case.

Impact of decision

The decision confirms that the Court may award indemnity costs when a claim is clearly hopeless.

Facts

This is a costs judgment in respect of *Ben Nevis v Commissioner of Inland Revenue* [2013] NZHC 2361; [2013] 26 NZTC 21,032 which was heard on 5 June 2013.

In that hearing, Ben Nevis submitted that the original Trinity judgment from 2004 (*Accent Management v Commissioner of Inland Revenue* [2005] BCL 196; (2005) 22 NZTC 19,027) ("the 2004 judgment") was a nullity because the judge, Venning J, was presumptively biased due to an alleged tax obligation which resulted in him being "beholden to the Commissioner".

The Commissioner filed a protest to the jurisdiction of the High Court to hear this issue. The 2004 judgment was appealed to both the Court of Appeal and the Supreme Court, therefore, any challenge to the 2004 judgment could now only be heard by an appellate court.

In her judgment, Katz J agreed that the High Court no longer had jurisdiction over the 2004 judgment.

The Commissioner applied for indemnity costs to be awarded on the basis that Ben Nevis's claim was:

1. a misconduct that caused loss of time to the Court and the Commissioner;
2. commenced for an ulterior motive;
3. in wilful disregard of known facts and clearly established law, and
4. a hopeless case.

The Commissioner submitted that this should be viewed in light of the taxpayer's litigation history and the fact that indemnity costs had frequently been awarded against Ben Nevis.

The taxpayer submitted that indemnity costs would be inappropriate because the Commissioner won on a point not submitted in her original submissions and that comments in *R v Smith* [2003] 3 NZLR 617 (CA) suggested that presumptive bias on the part of judges could lead to the relevant judgment being set aside.

Decision

The Court awarded indemnity costs to the Commissioner.

Justice Katz found that it was not necessary to consider each ground relied on by the Commissioner because the taxpayer's claim was clearly hopeless. Her Honour stated that it was not even remotely arguable that the High Court had jurisdiction to set aside one of its own decisions.

It was also noted that this proceeding had the potential to require the High Court to declare Court of Appeal and Supreme Court judgments nullities and re open aspects of the Court of Appeal's recusal decision. This is beyond the power of the High Court.

Her honour rejected all of the taxpayer's claims and upheld the Commissioner's quantum of costs.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

Legal and Technical Services also contribute to the "Your opportunity to comment" section.

Policy Advice Division

The Policy Advice Division advises the government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

Litigation Management

Litigation Management manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

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If you would prefer to get the TIB from our website, please email us at **tibdatabase@ird.govt.nz** and we will take you off our mailing list.

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