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TAX INFORMATION Bulletin

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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.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz/public-consultation**

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

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IN SUMMARY

IN SUMMARY (continued)

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NEW LEGISLATION

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

Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill was introduced into Parliament on 6 April 2017. It received its first reading on 24 May 2017, its second reading on 27 February 2018 and its third reading on 27 March 2018. The new Act received Royal assent on 29 March 2018.

The new Act sets the annual rates of income tax for the 2017–18 tax year and implements measures to improve the timeliness and completeness of information Inland Revenue receives about people's employment and investment income from payers of that income. It also makes changes to the taxation of employee share schemes and extends the bright-line test that requires income tax to be paid on any gains from the sale of residential property from two years to five years. It also implements several other policy changes and contains numerous technical changes to ensure the tax rules work as intended.

The new Act amends the Income Tax Act 2007, Tax Administration Act 1994, KiwiSaver Act 2006, Student Loan Scheme Act 2011, Goods and Services Tax Act 1985, Child Support Act 1991, Accident Compensation Act 2001, Income Tax Act 2004, Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017, Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017, Health and Safety at Work Act 2015, Compensation for Live Organ Donors Act 2016, Accident Compensation (Earners' Levy) Regulations 2017 and the Anti-Money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2014, and revokes the Income Tax (Payroll Subsidy) Regulations 2006 and the Income Tax (Employment-related Remedial Payments) Regulations 2017.

Making tax simpler - Employment income information

OVERVIEW

New rules have introduced changes to the reporting of employment income information. Employment income information is the information employers are required to provide to Inland Revenue when they make a PAYE income payment to an employee.

Changes have also been made to the payroll subsidy and to a number of PAYE rules.

In addition the PAYE administrative requirements have been consolidated in the Tax Administration Act 1994. Numerous consequential amendments have been made to reflect terminology and section reference changes.

The key changes relate to the following:

- Payday reporting of employment income information
- Transitional provisions for the introduction of payday reporting
- Payroll subsidy
- Tax treatment of advance payments of holiday pay or salary and wages
- Tax treatment of a retrospective increase in salary or wages
- Application of legislated rate and threshold changes.

Application dates

The PAYE rules changes apply from 1 April 2018.

The changes to reporting are required from 1 April 2019 although they are available on a voluntary basis from 1 April 2018.

The payroll subsidy is more tightly targeted from 1 April 2019 and repealed from 1 April 2020.

PAYDAY PROVISION OF EMPLOYMENT INCOME INFORMATION

Sections 3(1), 14G, Subpart 3C, sections 24J, 36A, 36B, 36CA, 36D, 36E, 46, 47, 48, 80D, 80KT, 125, 139A, 139AA(1), 139AA(3), 139AA(4), 139AA(7), 141AA, 141ED, 142(1A), 142G, 183A, 183D, 183F, and schedule 4 of the Tax Administration Act 1994

Sections 4, 17, 22, 23, 34, 42, 60, 73, 93, 97, 98, 98A and 99 of the KiwiSaver Act 2006

Sections CE 1(3B), CE 2(7) to (9), LD 4, LD 5, RD 6, RD 7B(3), RD 10(2C), RD 13(B), RD 22, RD 23, YA 1 and schedule 2, of the Income Tax Act 2007 – other changes to the Income Tax Act are included in the subsequent section on "Consolidation of the PAYE administrative requirements".

Background

PAYE is a withholding mechanism used by employers and PAYE intermediaries to deduct income tax and ACC earners' levy from employees' salary and wages, and as appropriate from schedular payments, and pay it directly to Inland Revenue. The PAYE system is also used to collect payments and information for many income-related social policies including student loan repayments, KiwiSaver contributions and some child support payments.

The amendments introduce changes to the reporting of PAYE information. The current requirement for an employer monthly schedule (EMS) is replaced from 1 April 2019, with a requirement that an employer sends 'employment income information' to Inland Revenue within a few days of each payday. Employers can voluntarily adopt payday reporting from April 2018.

The amendments take advantage of the capabilities of modern payroll software and are intended to reduce the compliance and administrative costs associated with the PAYE system. The changes will improve the timeliness of employment income information. They will create opportunities to improve the accuracy of withholding from individual taxpayers and to improve the administration of social policy.

No changes have been made to employers' obligations to pay PAYE and other deductions to Inland Revenue. Payments will remain due on the 20th and 5th of the following month for large employers and the 20th of the following month for all other employers.

Some employers have indicated that they would like to pay their PAYE and other deductions to Inland Revenue at the same time as they pay their staff. Inland Revenue is managing the transfer of PAYE from its old computer system to the new one in several releases. Once this process is complete, which is not expected to be before 2020, it is intended that it will be easy for employers to choose to pay IRD at the same time as they pay their staff.

Key features

New subpart 3C of the Tax Administration Act 1994 contains the rules for employment income information. Section 23Cz and schedule 4 set out what 'employment income information' means.

These sections provide that an employer[1] must provide the information in schedule 4 to the Commissioner on a payday basis. The due dates and filing requirements are set out in new sections 23D to 23K and differ depending on which employer group the employer belongs to. There are three employer groups, the non-electronic group, the new group of employers and the on-line group.

Online group

The online group is the default group. Employers are included in the online group unless they have an exemption or meet the criteria for the non-electronic group or the new group. Payroll intermediaries are included in the online group. Payday filing for this group generally means within two working days of payday. There is an exception, described below, for certain 'special payments'.

Non-electronic group

An employer is included in the "non-electronic group" if:

- they have a small payroll, withholding less than $50,000 of PAYE and employers superannuation contribution tax (ESCT) in the previous tax year, and they submit their employment income information on paper; or
- They are in the new group and submit their employment income information on paper; or
- They have an exemption from the online group and submit their information on paper.

The threshold at which electronic reporting was required was previously $100,000 of PAYE and ESCT in the previous tax year. Section 23F(6) reduces the threshold to $50,000 of withholding in the previous year. This threshold may in future be changed by Order-in-Council following consultation.

[1] Except where an exception is noted references to an employer should be read as applying to a payroll intermediary.

Employers in the "non-electronic group" are generally required to provide employment income information within 10 working days of payday. These employers also have an option of providing information about each payday but treating the 15th and last day of the month as their paydays for the purpose of calculating the due dates. This option reduces the reporting requirement to twice a month and is intended to reduce compliance costs.

New group of employers

An employer is in the "new group of employers" for their first six months employing staff, regardless of how much PAYE and ESCT they withhold during that period. An employer in the new group has the same obligations as an employer in the non-electronic group. This categorisation enables the new employer to submit their employment income information on paper. However, if they choose to submit electronically, the employer is immediately included in the online group.

After the six month period the amount of PAYE and ESCT withheld determines which group a new employer is in.

Employees providing information

The requirements for employees who have an obligation to provide employment income information to the Inland Revenue are in new section 23I. These employees have ten working days after the end of the month to provide employment income information to Inland Revenue. This group includes what are known as IR56 taxpayers such as private domestic workers and employees of foreign embassies.

Rules for certain special payments

New sections 23J and 23K recognise that payday reporting of certain categories of payments would be impractical or could impose undue compliance costs. Payments made by an employer to an employee outside of the regular payment cycle may be reported on a payday basis, or reported as if they were paid on the next regular payday. To avoid problems reconciling information and payments the information cannot be included with the next regular payday if that payday falls after the end of the employer's 'payment period'.

The requirements for schedular payments, payments made to persons on shadow payrolls and employee share scheme benefit reporting allow the employer to choose between reporting these payments on a payday basis or twice monthly. In addition, further time is allowed for the value of payments made to persons on shadow payrolls and for share scheme benefits to be calculated.[2]

New employees

New section 23L and schedule 4, table 2 set out the requirements for information concerning new employees. The objective is to eliminate the need for new staff to fill out paper forms for Inland Revenue and to allow fully electronic onboarding of new employees with the relevant information being electronically transmitted to Inland Revenue.

Employers are required to provide a new employee's date of birth to Inland Revenue, if the employee has supplied it, and to provide address details. This information is required to help confirm the employee's identity and to assist Inland Revenue to maintain up-to-date contact details. This information will only be required from new employees and employers are not required to provide it for existing employees. The Commissioner has used her discretion under section 23Q to exempt payers of schedular payments from the obligation to provide this information return in respect of schedular payees. This decision has been taken to reduce compliance costs.

Error correction

New section 23N provides that regulations can be made to specify how errors in employment income information can be corrected. Before such regulations are made there must be appropriate consultation.

Penalties

Amendments to sections 139A, 139AA, and 142 and142G update the penalty provisions for late filing or non-electronic filing of employment income information. These penalties remain monthly penalties. An employer with a weekly payroll who failed to meet the due date on more than one occasion during a calendar month would incur no greater penalty that one who runs a monthly payroll and was late providing their one return. In addition, a discretion is added enabling the Commissioner not to impose penalties during the early stages of payday filing. This discretion is intended to support Inland Revenue's "right from the start" approach, and will allow the Commissioner to assign her resources to provide education and support, rather than taking a punitive approach. Penalties will, however, still be imposed if the non-compliance is serious or unreasonable.

Application date(s)

The changes come into force on 1 April 2019.

[2] These measures do not change the date on which the value of the payment or benefit is determined.

As outlined in a subsequent section, transitional provisions allow an employer to elect into payday filing before 1 April 2019. The transitional provisions are effective from 1 April 2018 and come into force for an employer when they elect to submit their information on a payday basis during the period 1 April 2018 – 1 April 2019.

Detailed analysis

Employment income information

Payday (as defined in section 3) means the day on which an employer makes a PAYE income payment to an employee. For employers instructing a bank to transfer funds to an employee the payday is the date that the employer has instructed the bank to make the funds available, early transfer of the funds, for example on the preceding evening, does not change the payday.

Example

Pia's business has a Thursday payday. On Tuesday, she instructs the bank to have the money in staff accounts on Thursday. The money typically shows up in staff accounts on Wednesday evening. For the purposes of reporting employment income information the payday is Thursday.

New section 23C defines "employment income information" as the items of information set out in schedule 4 tables 1-3. Table 1 information is required on a payday basis and includes:

- the information currently on the employer monthly schedule (EMS),
- the date of the payday, and
- the amount of ESCT for each employee. This information is currently required on the PAYE income payment form (IR345 or EDF) at an aggregated level.[3]

An amendment to section RD22(2) of the Income Tax Act 2007 repeals the requirement for a separate form to accompany payment (the PAYE income payment form, commonly known as the 'employer deduction form' or IR345). To permit payments to be processed, new section 23O(2) authorises the Commissioner to require information to accompany payment. Until all PAYE information is processed in Inland Revenue's new computer system, estimated as 2020, the existing requirement for the *PAYE income payment form (IR345)* will continue, and the due date for this information, will continue to be the date that the payment of PAYE and other deductions is paid.

Employers, who have not paid PAYE income in a pay period, will not be required to file a nil payday return. The operational details to support this are still being developed and will be made known through the Inland Revenue website when they are finalised.

Employment income information for new and departing employees

New section 23L and schedule 4, tables 2 and 3 set out the requirements for information about new and departing employees. Table 2 brings together the requirements from the *IR330 (Tax code declaration)* and *KS2 (KiwiSaver deduction form)* in a way which supports "fully electronic onboarding" of new staff and allows for an electronic interchange of details between the employer and Inland Revenue before the new employee is first paid. Paper forms will still exist and those below the electronic filing threshold may communicate the information on paper.

The objective of an early exchange of information is to ensure that the new employee is set up correctly from the beginning. While Inland Revenue will encourage employers to provide new employee information before the first payday the obligation is to provide it no later than the first time payday information is provided which relates to that employee. The items of information in schedule 4, table 2 about new employees are:

- The name of the employer
- The tax file number of the employer
- The contact address of the employer
- The full name of the employee
- The contact address of the employee
- The date of birth of the employee if supplied to the employer
- The tax file number of the employee if supplied to the employer
- The tax code supplied by the employee
- The KiwiSaver status of the employee under s22 of the KiwiSaver Act 2006 (the information additional to the above, on the existing KS1 form concerning membership and a new "not eligible" status).

[3] While this reporting requirement is listed in Schedule 4, Table 1, Row 6 at an aggregated employer level, the Commissioner is seeking the amount of ESCT payable for every employee, as applicable, as Other particulars as the Commissioner requires under Schedule 4, Table 1, Row 8.

In circumstances where an error has been made with the IRD number the provision of date of birth information will assist the department to resolve the problem without further contact with the employer.

The "if supplied" caveat on the requirement for date of birth information means that the employer must ask the new employee for it but if the employee does not supply it the employer is not obliged to take further action. Unlike an employee who does not elect a tax code, an employee who does not supply their date of birth should not automatically be placed on the non-notified tax code.

The requirement for contact address details has been extended from applying to employees who are enrolled in KiwiSaver to all new employees. The Commissioner has exercised her discretion under section 23Q to exempt payers of schedular payments from providing this information in respect of schedular payees.

The information required about a departing employee[4] in Table 3 is the date at which the employee stopped being an employee of the employer. This information is required at the time of the last payment to the employee but it can be supplied in advance.

Example

Carla is on a contract which includes a year-end bonus depending on company results. She resigns in December but under her contract retains an entitlement to a percentage of the bonus to be paid in April.

The company's practice is to leave departing employees on the payroll system until the bonuses have been paid. As Carla is still entitled to receive a PAYE income payment from the company she fits the definition of an 'employee' under the Income Tax Act 2007. Once bonuses have been paid out the company removes Carla from its payroll system and Inland Revenue is advised that she is no longer employed with them. If Carla did not actually receive a bonus, the return for the day the bonus would have been paid should show zero income for Carla and identify that day as the date of departure.

Example

Mathieu works for a company where staff are removed from the payroll as soon as their last substantive pay has been processed. Any subsequent "wash-up" pays for year-end bonuses or other issues are managed manually.

The company notifies Inland Revenue of a departing employee following the final substantive pay and could subsequently lodge the details of any subsequent wash up via an "error-correction" process rather than by adding the employee back into the payroll system. This optional approach does not change the due dates for information or payment but makes a lower cost channel available for the submission.

The advantage for an employer in promptly reporting that an employee has ceased to be employed is that it will end the relationship between the employer and employee in Inland Revenue's system much more quickly than under the current system. Thereafter Inland Revenue will no longer contact the employer about that employee.

Amendments to the KiwiSaver Act 2006

The KiwiSaver Act 2006 has been amended to update references and to repeal the definition of and references to, the KiwiSaver deduction notice.

The information previously required on a KiwiSaver deduction notice will in future be required when an employee informs their employer of their "KiwiSaver status" or updates their KiwiSaver status, for example by opting out or taking a contribution holiday. It is intended that these actions could be done electronically. Paper forms will continue to exist. A definition of KiwiSaver status is added to section 4(1)(c) of the KiwiSaver Act.

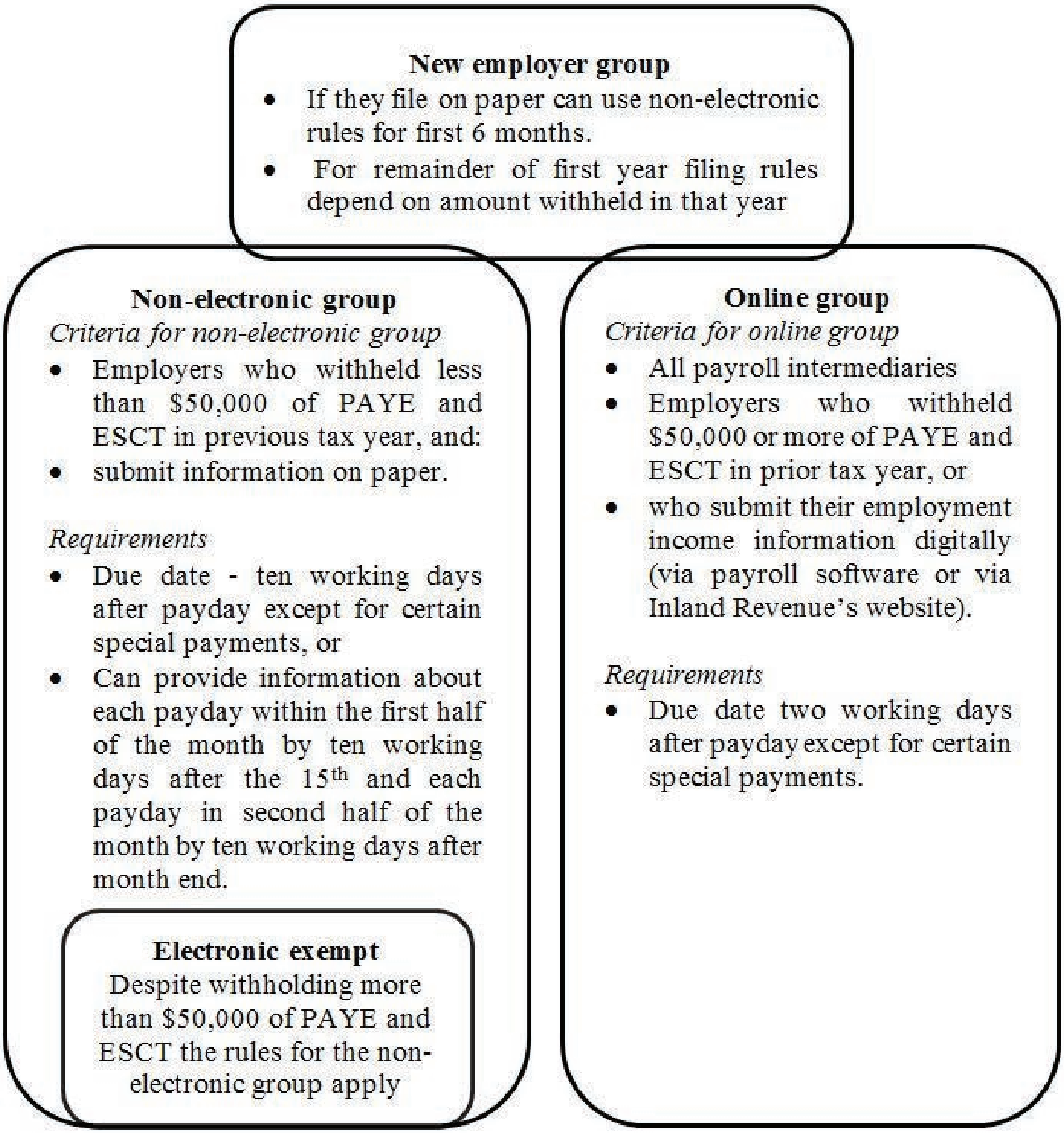
Employer groups

New sections 23D – 23H establish three employer groups, and specify the formats for employment income information and due dates. Due dates are expressed as a number of working days after payday. The new groups are graphically displayed on the next page.

For the purposes of these sections a working day is defined in section YA 1 of the Income Tax Act 2007. In addition to Saturday and Sunday the definition excludes the following from being working days: Good Friday, Easter Monday, Anzac Day, Labour Day, the Sovereign's birthday and Waitangi Day, but not provincial holidays. If Waitangi Day or Anzac Day fall on a Saturday or Sunday the following Monday is excluded. There are no working days between December 25 and January 15th (both dates inclusive) in the following year. An employer in the online group who paid staff on December 24 would therefore not be required to provide employment income information until the second working day after 15th of January.

[4] "Employee" is defined in section YA 1 of the Income Tax Act 2007 as a person who receives or is entitled to receive a PAYE income payment.

Figure 1 Graphic representation of employer groups and key requirements



New section 23I sets out the requirements for employees who are required to provide employment income information. New section 23J establishes options which relax the payday rules due dates for certain special payments. New section 23D(3) allows an employer to provide employment income information before the due dates.

Example

Fiona owns a business and always does the payroll herself. If she goes on holiday and will be away during a pay week she instructs the bank before she leaves, to enable standard payments to her staff on the normal payday. She follows the same approach over the Christmas closedown.

Because she has the information she needs in relation to the payday at the time she instructs the bank, she can file the employment income information with Inland Revenue in advance.

The existing constraint in Inland Revenue's system which prevents an employer from filing more than one EMS in a month will not apply. Under the payday regime an employer may submit information more than once on the same day. For example, if they run a weekly and a fortnightly payroll which coincide every second Tuesday.

New section 23D(4) provides that despite the requirements around employer groups an employer may ask the Commissioner for approval to deliver employment income information in another way.

Online group of employers

New section 23E establishes the online group. The online group is the default group and employers are included in the online group unless they have an exemption or meet the criteria for the non-electronic group or the new group. Payroll intermediaries are, by definition, included in the online group.

Except where they are dealing with certain 'special payments' employers in the online group must provide their employment income information in an electronic format, using an electronic means of delivery, within two working days after payday. New section 23C(2) requires the Commissioner to prescribe electronic form(s) and means of communication. It is intended that acceptable electronic forms of communication for payday reporting will include:

- completing an onscreen form
- uploading files through the IR website
- filing direct from payroll software.

Most employers who use payroll software obtain it from a commercial provider of payroll software. However, a number of employers have developed their own 'bespoke' software packages. Inland Revenue is in contact with providers of payroll software to the New Zealand market and with the employers which it knows use bespoke software. Any providers of payroll software or employers using bespoke software that are not already in contact with the Department about payday reporting should contact their relationship manager at Inland Revenue or if they do not have one, make contact through **PaydayReporting@ird.govt.nz**.

An employer who otherwise meets the criteria for the non-electronic group or the new group, or who has an exemption from electronic filing but who chooses to file electronically, is included in the online group and has two working days to submit their employment income information.

Non-electronic group of employers

The non-electronic group of employers is established by new section 23F. An employer is included in the non-electronic group if they withheld less than $50,000 of PAYE and employers superannuation contribution tax (ESCT) in the preceding tax year and they do not deliver their employment income information electronically. Inland Revenue monitors the amounts withheld and will advise employers when they exceed the $50,000 threshold. A reasonable period will be allowed for the customer to transition to electronic filing and if the employer considers that they need longer, they could apply to the Commissioner under section 23D(4) for approval to deliver their employment income information in another way.

An employer which has an exemption from the online group under new section 23G is also included in the non-electronic group. As set out below, new employers may also be included in the non-electronic group.

An employer in the non-electronic group is permitted to submit their information in a prescribed paper format and can choose to either:

- deliver the information within 10 working days of each payday, or
- to provide details for each payday but to deliver information relating to payments made or benefits provided between the 1st and the 15th of the month within 10 working days of the 15th; and for payments made and benefits provided between the 16th of the month and month end within 10 working days of month end.

Consistent with the requirements for the receipt of tax payments, for information to be received by the due date, it must actually be received on or before the due date, not simply be posted by that date.

Example

Leonie and her husband farm in partnership and employ one full time employee who they pay on a weekly basis and at certain times of year they employ casual agricultural employees. They withheld less than $50,000 of PAYE and ESCT in the previous year and they have chosen to continue to file their employment income information on paper which places them in the 'non-electronic group of employers'.

Leonie has chosen to file their employment income information twice a month. When their only employee is their full timer the return identifies what was paid and withheld for each weekly payday within the half monthly period. When they employ casual staff, the half monthly return also includes the details for each payment made to casual workers. Their employment income information is due ten working days after the 15th of the month and ten working days after month end.

If an employer who has withheld less than $50,000 of PAYE and ESCT in the previous year files their employment income information electronically they are included in the online group. However, if they wish they can revert to filing on paper, in which case the non-electronic group filing rules will apply.

Example

Mark runs a small business which withheld less than $50,000 of PAYE and ESCT in the previous tax year. He does not use payroll software and he initially filed employment income information for his one part time and two full time employees on paper because that is how he always filed his employer monthly schedules. He pays his staff weekly and took advantage of the ability to send his employment income information twice a month.

Mark uses myIR to file his GST return and would prefer to get the payday details off his desk when he sends the payment instructions to the bank rather than having to come back to the task on the 15th and at month end. Mark starts filing his employment income information through myIR using the onscreen form. Because he files electronically he now belongs to the online group and the information is due within two working days of payday.

Mark knows that for as long as his business withholds less than the threshold of $50,000 of PAYE and ESCT in the previous tax year he could however elect to go back to paper filing if he wanted to.

Inland Revenue asks to be notified in advance should customers wish to revert to paper filing. Notice will enable the 'customer group' indicator, which establishes the expectations for when employment income information will be received, to be changed.

Threshold may be amended by order-in-council

The $50,000 threshold in new section 23F(6) may be amended as set out in new section 23F(8), by Order in Council on the recommendation of the Minister of Revenue following appropriate consultation.

Exemption for certain employers in the online group

New section 23G of the Tax Administration Act 1994 allows the Commissioner of Inland Revenue to exempt an employer in the online group from the requirement to deliver their employment income information electronically. The exemption can be time limited.

Factors the Commissioner will take into account when considering whether to exempt an employer under the new provision are:

- The nature and availability of digital services to the employer, in particular whether the services are reliable;
- whether the employer is capable of using a computer; and
- whether the cost the employer would incur in delivering employment income information electronically would be unreasonable in the employer's circumstances.

The Commissioner will consult and publish guidelines on how the exemption will apply.

Example

Jack's company withholds around $60,000 of PAYE and ESCT annually. Because this is more than the threshold, the company will be in the online group. Jack has been advised by Inland Revenue that the company is required to start filing electronically. He has also been advised that if he believes he has grounds, he can apply for an exemption from electronic filing.

The company is located in a rural area where Jack also lives. Jack, who does the payroll and filing of employment income information with Inland Revenue, uses an internet connection to sometimes send business emails. However, the connection is not reliable, the speed is always slow and drops out frequently, particularly during peak internet usage times. He writes to Inland Revenue explaining his issues seeking an exemption from filing employment income information electronically.

Inland Revenue advises Jack that his company is exempt from the requirement to file employment income information electronically until the Commissioner notifies Jack that the exemption for his company is to be cancelled. The reason stated for the exemption is that the digital services available to Jack's company are not reliable for the purpose of delivering employment income information on a payday basis electronically.

New group of employers

The rules for new employers are included in new section 23H and 23F(3) – (7). For their first six months employing employees an employer can choose to file employment income information using non-electronic means (on paper) regardless of how much PAYE and ESCT they have withheld. If they file on paper they are subject to the rules of the non-electronic group. If the employer choses to file electronically they are included in the online group.

If the amount withheld reaches $50,000 during the first year the new employer may continue to file on paper for the remainder, if any, of the initial six month period. Thereafter, if the amount withheld exceeds $50,000 in the first tax year, the employer is in the online group and must file electronically within 2 working days of payday. Inland Revenue will advise the employer when the accumulated amount reaches $50,000 for the year.

Example

Mel and Sefina have established a company and bought an existing business which employs 12 full time staff. Rather than take over the antiquated business systems which the previous owner used they intend to use a modern business software package which will look after invoicing and accounting as well as payroll. They know that there are packages which can be used to meet their obligations for GST, provisional tax and employment income information.

At the time they take the business over they have not chosen their new software system and know that, regardless of how much PAYE and ESCT they withhold, they have a six month period during which they can file their employment income information on paper.

Delivery of employment income information for certain special payments

The definition of payday "the day on which an employer makes a PAYE income payment to an employee" includes "out-of-cycle" payments made to employees who are on a regular payroll as well as schedular payments and payments to employees on shadow payrolls. New section 23K(1)(a) of the Tax Administration Act 1994 allows an employer to treat the 20th day after the share scheme taxing date for an employee share scheme beneficiary as the payday.

To reduce the compliance costs associated with reporting these payments, new sections 23J and 23K provide employers with a choice. The employer can report these payments on a payday basis as set out in new sections 23E to 23H, and new section 23K(1)(a) in the case of benefits under employee share schemes, or they can choose to report them as set out in:

- schedular payments: new sections 23J(2) and 23C(4);
- a payment made to a person on a shadow payroll: new sections 23J(3) and (6) and 23C(4);
- benefits under employee share schemes: new sections 23K(1)(b) and 23C(4);
- out of cycle payments: new sections 23J(4) and (5).

New section 23J(7) provides that the provisions in section 23J do not extend to employers who are delivering their information as set out in new section 23F(3)(b). This is because these employers are only required by section 23F(3)(b) to deliver their employment income information twice a month which will reduce compliance costs in a similar way to the provisions in section 23J.

Schedular payments

Schedular payments are defined in schedule 4 of the Income Tax Act 2007 and include payments made to certain classes of contractors, company directors and commission sales people. Many businesses pay those entitled to receive schedular payments through their accounts payable rather than the payroll system. Payments may be made on a daily or irregular basis.

Sections 23J(1) and (2) allow an employer to either report schedular pays on a payday basis or twice-monthly. Twice monthly filing is defined in new section 23C(4) and allows the employer to report payments made between the 1st and 15th of the month as if they had been made on the 15th of the month. For the second half of the month the payments can be reported as if they were made on the last day of the month.

The due dates for twice monthly reporting of schedular payments depend on the employer group and are either two working days or ten working days after the 15th of the month and two or ten working days after month end.

Twice monthly reporting schedular payments

Sun	Mon	Tues	Wed	Thurs	Fri	Sat
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31 (month end)					

For any schedular payments made in the mid-grey period (1st – 15th) the reporting due date is as if the payments were made on the 15th.

Any payments made in the light-grey period can be reported as if they were paid on the 31st (month end).

Example

Curran and Co is in the online employer group. It pays sales people on a commission basis and payments are made from the accounts payable system on an almost daily basis.

They run reports on the schedular payments made and the amounts withheld, in the first half of the month, on the first working day after the 15th and the on the payments made and the amounts withheld in the second half of the month, on first business day of the following month.

Curran and Co's employment income information relating to schedular payments is electronically reported within two working days of the 15th of the month, and within two working days of month end.

Example

Sacha and his wife farm in partnership. In addition to employing two staff who are paid fortnightly, they occasionally employ contractors who are paid schedular payments. They pay contractors at the end of their period of engagement.

They do the payroll manually but the partnership files electronically, using the onscreen form, and is in the online group. If there is a regular payday between the date of the schedular payment and the end of the half monthly period for schedular payments Sacha reports the schedular payment at the same time as the next report for his employees.

If the schedular payment falls after the last regular payday in the half month Sacha knows he could wait until the end of the half monthly period, but he generally files the information relating to the schedular payment on a payday basis, at the same time he calculates the payment. If he chose he could however wait until the end of the half monthly period to electronically file the information.

A payment made to a person on a shadow payroll

Employers of internationally mobile employees working in New Zealand may have PAYE reporting and payment obligations in New Zealand even though the employees have been paid in a foreign jurisdiction. New Zealand obligations are worked out on what is referred to as a shadow payroll. New section 23J(6) defines what is meant by a payment to a person on a shadow payroll.

The process of determining the New Zealand taxable income includes obtaining employee payment information from offshore payroll providers and confirming the calculation of New Zealand taxable income of that employee. This takes time.

New section 23J(3) provides that the employer (or their New Zealand based agent) has twenty days after an amount is paid to a person before the obligation to provide employment income information arises. The employer then has the option of reporting it on a payday basis or can report it twice-monthly with the 20th day after payment being treated as the 'relevant day' (payday). Twice monthly delivery is defined in new section 23C(4) and operates as it does for schedular payments except it is the 20th day after payment (the relevant day) that dictates the reporting obligation. For the purposes of this rule, which also applies to reporting benefits under employee share schemes under new section 23K(2)(b), the 20th day is not calculated on a working day basis but in actual days.

If the relevant day falls in the first half of the month it must be reported by and employer in the online group no later than two working days after the 15th and if it falls in the second half of the month it must be reported no later than two working days after month end. Twice monthly delivery allows all payments, to employees on a shadow payroll, made by that employer in that half monthly period to be reported in the same return.

An amendment to section CE 1(3B) of the Income Tax Act 2007 provides that where an employer reports their employment income information under 23J(3) such a payment is treated as being derived by the person on the 20th day after the payment. Under this provision, the 20th day after the payment is made to the person is the date of the PAYE income payment for the purposes of section RD 4 which sets the requirements for when PAYE and other deductions must be paid to Inland Revenue.

Example

Jones and Lowe provide professional services which include acting as a tax agent for offshore employers who employ staff working on projects in New Zealand. Jones and Lowe report this information electronically and are in the online employer group for the work they do for their clients.

Jones and Lowe have established processes with their offshore clients so that they usually receive details of the amounts paid to the employees by the home country payroll, within a few days of the payment being made.

An offshore employer paid an employee working in New Zealand on Thursday 12 April and Jones and Lowe received the information the following week. Jones and Lowe have twenty days after the original payday (12 April) to calculate the New Zealand taxable income. In this example, the twentieth day is Wednesday 2 May.

Because the twentieth day falls on 2 May, in the first half of the month Jones and Lowe must report the information at the latest as if the payday was the 15th. The information would be due two working days after the 15th of the month. If the twentieth day falls in the second half of the month Jones and Lowe must report it at the latest as if the payday was the last day of the month. This information would be due two working days after month end.

The second of May is date the payment is deemed to be derived which, because the employer withholds less than $500,000 of PAYE and ESCT a year, means that PAYE on the payment is due on 20 June.

Benefits under employee share schemes

Amendments have been made to section CE 2 of the Income Tax Act 2007 which defer the date that an employee who receives a benefit under an employee share scheme is treated as deriving income in relation to the benefit by 20 days from the taxing point. The amendment names this 20th day after the share scheme taxing date for the employee share scheme beneficiary as the "ESS deferral date". This deferral applies for all employees who receive benefits under an employee share scheme that their employer is required to report to Inland Revenue about as part of employment income information.

An amendment to section RD 6 of the Income Tax Act 2007 provides that an employee share scheme benefit from which an employer has chosen to withhold tax under the PAYE rules is treated as paid on the 20th day after the taxing point for the benefit received by the employee. The date on which an employee share scheme benefit is treated as paid will be the end date of the four-week period referred to in the extra pay tax rate calculation in section RD 17, which employers will use to calculate the amount of tax they must withhold for the benefit. It also influences when the employer is required to pay the withheld tax to Inland Revenue by.

An amendment to section RD 7B of the Income Tax Act 2007, which specifies how an employer makes an election to withhold tax for an employee share scheme benefit, replaces the requirement to report the value of the benefit to Inland Revenue on their employer monthly schedule by the relevant due date with a requirement to include the value of the benefit in their employment income information under new subpart 3C of the Tax Administration Act 1994.

Replacement section RD 22(3) of the Income Tax Act 2007 requires employers to provide employment income information in relation to employee share scheme benefits to Inland Revenue under new sections 23E to 23H of the Tax Administration Act 1994 as modified by new section 23K of that Act.

A new defined term "ESS deferral date" has been inserted into section YA 1 of the Income Tax Act 2007 and section 3(1) of the Tax Administration Act 1994 which refers to the definition of that term in new section CE 2(9) of the Income Tax Act 2007.

New section 23K(1) of the Tax Administration Act 1994 sets out the two options an employer has for reporting information about employee share scheme benefits. An employer may report the information to Inland Revenue:

- on a payday basis, treating the 20th day after the taxing point for the benefit received by the employee as the payday; or
- on a twice-monthly basis as described in new section 23C(4) of that Act, treating the 20th day after the taxing point for the benefit received by the employee as the "relevant day" that dictates the reporting obligation.

New section RD 22(4) of the Income Tax Act 2007 and new section 23K(2)(a) of the Tax Administration Act 1994 specify that employers are not required to provide Inland Revenue with information on:

- employee share scheme benefits received by former employees if they have not chosen to withhold tax for the benefit; or
- benefits arising under tax-exempt employee share schemes.

New section 23K(2)(b) and new schedule 4, table 1 of the Tax Administration Act 1994 specify the particulars in relation to employee share scheme benefits that must be provided to Inland Revenue by employers who are subject to the reporting requirements.

The employee share scheme benefit-specific information that employers who are required to report employee share scheme benefit information for current employees is:

- the value of the benefit to the employee; and
- the amount of tax withheld for the benefit, if any.

Employers who are required to report employee share scheme benefit information for former employees because they have chosen under the PAYE rules to withhold tax from the benefit, must report:

- the employee's name;
- the employee's IRD number, if known by the employer;
- the value of the benefit; and
- the amount of tax withheld for the benefit.

Example

Under the new rules, if an employee received a benefit under an employee share scheme on 5 July 2019 (that is, the share scheme taxing date for the employee share scheme beneficiary is 5 July 2019) they would be treated as deriving income in relation to the benefit on 25 July 2019.

Their employer would have two options as to how they meet their obligation to provide information in relation to the benefit to Inland Revenue:

- *Option 1: reporting on a payday basis*
  If their employer chooses to report information in relation to the benefit on a payday basis, 25 July 2019 would also be the relevant payday. This would mean that their employer would be required to report information about the value of the benefit received by the employee and any tax withheld in relation to the benefit by the 2nd working day after 25 July 2019 if they are an employer in the online group, or by the 10th working day after 25 July 2019 if they are an employer in the non-electronic group (or an employer in the new group who provides their employment income information on paper).
- *Option 2: reporting on a twice-monthly basis*
  If their employer chooses to report information in relation to the benefit on a twice-monthly basis, 25 July 2019 would be treated as the "relevant day" for the purposes of new section 23C(4) of the Tax Administration Act 1994. This would mean that their employer would be required to report information about the value of the benefit received by the employee and any tax withheld in relation to the benefit by the 2nd working day after 31 July 2019 if they are an employer in the online group, or by the 10th working day after 31 July 2019 if they are an employer in the non-electronic group (or an employer in the new group who provides their employment income information on paper).

25 July 2019 would also be the relevant date for determining the due date for the payment of tax withheld in relation to the benefit (assuming that the employer elected to withhold tax in relation to the benefit). In this example, the due date for paying the tax withheld to Inland Revenue would be 5 August 2019 if the employer was above the $500,000 per annum of PAYE and ESCT threshold, or 20 August 2019 if they are below the threshold.

A payment to an employee made outside the employee's regular payment cycle

Many employers make out-of-cycle payments. These might be made to pay an employee's final pay on their last day of employment, or to correct for the omission of a payment that was not included with the previous pay run because the information was received late. Some employers will process these payments through the payroll system and they can be reported on a payday basis. Other employers will not process the payments through the payroll system until the next regular payday.

To reduce the compliance costs of out-of-cycle payments, new sections 23J(4) and (5) permit the employer to report such payments with the information for the next regular payday[5]. An exception applies where the next regular payday falls after the employer's "end date" for the payment of PAYE and other deductions to Inland Revenue Where the exception applies, the out-of-cycle payment must be reported to Inland Revenue as if it was made on the last day of the payment period[6], at the latest.

For example in the month illustrated below if information relating to any payments made between the 28th and 31st was held over beyond the end date of the 31st into a report for the next month, the information provided for the illustrated month would not reconcile with the payment made.

Under section RA15(3)(b) of the Income Tax Act 2007 most employers have an end date for the payment of PAYE at the end of the month. All amounts withheld in the month up to month end, have to be paid to Inland Revenue by the 20th of the following month. If an out of cycle payment was made after the last regular payday in the month but before month end the deductions would be paid to Inland Revenue with the other amounts deducted in the month. If the information was held over and included with the next regular payday it would appear as if it related to a payment made in that (subsequent) month. This would cause problems reconciling the amounts paid to Inland Revenue with the information provided.

Under section RA15(3)(a) of the income tax Act 2007 the largest employers have two 'end dates' in a month; the 15th of the month and month end and as illustrated in the Cork and Co example below, the exception could arise twice monthly for these employers.

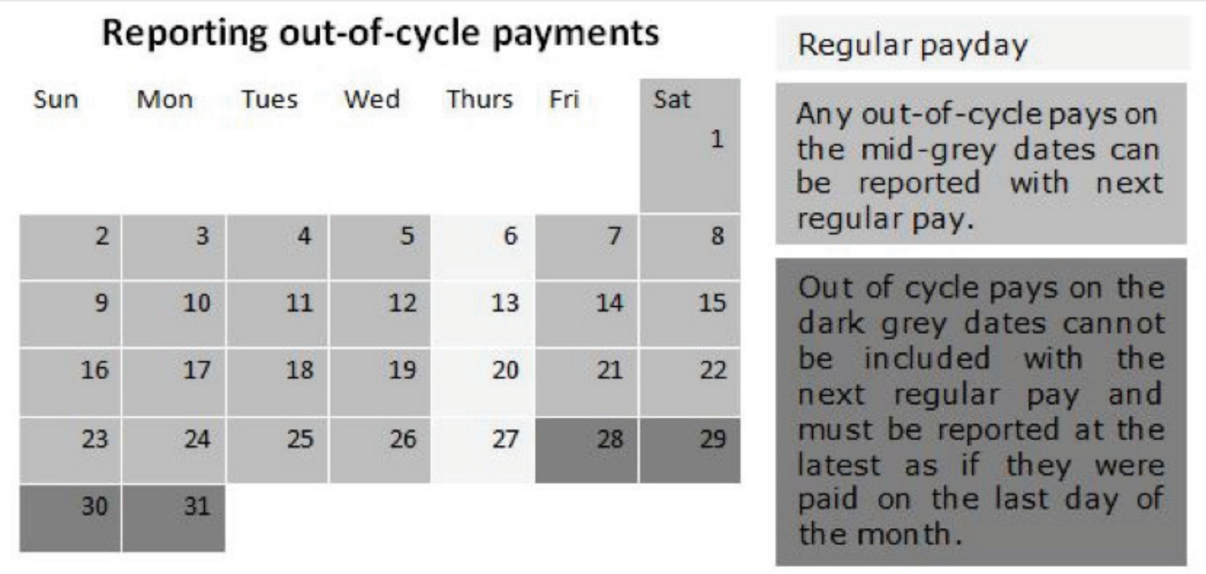
[5] An employer who does a 'regular' out of cycle pay run during the normal pay period can either report this on a payday basis or with the next normal payday report, subject to the exception noted above.

[6] The requirement that the out-of-cycle payment must be reported at the latest as if it was made on the last day of the payment period is intended to allow an employer to report all out-of-cycle payments made during the exception period in the same return.

In the Advantage All example illustrated below if information relating to any payments made between the 28th and 31st was held over beyond the end date of the 31st into a report for the next month, the information provided for the illustrated month would not reconcile with the payment made.

As noted earlier employers in the non-electronic and new employer groups, or who have an exemption from electronic filing and who are choosing to deliver their employment income information twice a month as set out in sections 23F(3)(b) and 23F(4) are not able to also take advantage of new section 23J(4). This exclusion, contained in new section 23J(7), reflects that these employers already have reduced reporting obligations and eliminates the need for these employers to apply the exception in section 23J(5).

Example



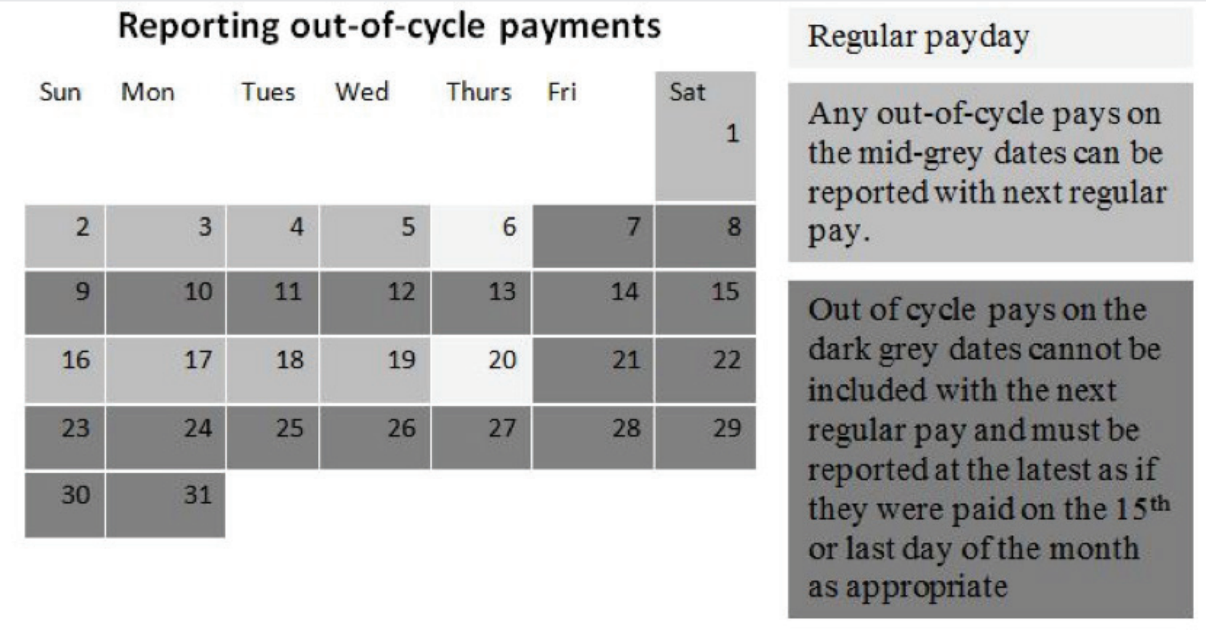
The calendar month above illustrates the obligations for Advantage All New Zealand a charity which is above the electronic filing threshold and is in the online employer group.

Advantage All has an "end date" for the payment of PAYE at the end of every month and must remit the amounts withheld during the month to Inland Revenue by the twentieth of the following month.

Advantage All can report out-of-cycle payments made on any of the mid-grey dates at the same time as the next regular payday return.

If Advantage All makes an out-of-cycle payment between the last regular payday (27th in the month illustrated above) and the end of its payment period, at month end (the dark grey dates), it must report the payments within two working days of month end.

Example



Cork and Collins Ltd are a large business which pays the PAYE and other deductions they withhold to Inland Revenue twice a month. Cork and Collins have two payment periods in a month, with end dates of the 15th and month end. Amounts withheld between 1st and 15th inclusive are paid to Inland Revenue by the 20th and amounts withheld between the 16th and month end must be paid by the 5th of the following month.

Cork and Collins are in the online employer group. The organisation runs a single fortnightly payroll and makes occasional out-of-cycle payments during other days in the month, most often to pay departing staff on their last day. In the month illustrated above payments made between the first and fifth (the mid-grey dates) could be reported with the regular payday on the 6th and payments made between the 16th and 19th could be included with the regular payday on the 20th.

If Cork and Collins made ad hoc payments between the last regular payday and the end of the payment period they must be separately reported no later than two working days after the end of the payment period. In the month illustrated above out-of-cycle payments made between the 7th and 15th (dark grey dates) need to be reported at the latest within 2 working days after the 15th of the month. Similarly, any payments made during the period 21st – 31st must be reported at the latest by the second working day after month end. Payments on different days during the period that falls between the last regular payday and the end of the payment period can be reported in the same return.

The need for the exception relating to out-of-cycle payments which occur after the last regular payday but before the end of the employer's payment period will be reviewed after Inland Revenue has completed the transfer of PAYE from its old to its new computer systems after 2020.

Employment income information when employment ends

New section 23M requires an employer, who intends to permanently cease to employ, to notify Inland Revenue within 30 working days of the date on which they ceased to employ any staff. This notification will deregister the customer as an employer. The previous obligation in RD 22(6) of the Income Tax Act 20017, to inform the Commissioner if the employer ceased business has been repealed.

Correction of Errors

New section 23N provides a regulation making power for matters relating to correcting errors in employment income information. The Governor-General may make regulations by Order-in-Council on the recommendation of the Minister of Revenue following appropriate consultation.

If regulations for the correction of errors are required during the transitional period (1 April 2018 – 1 April 2019) new section 46(8) provides a regulation making power on the same basis as described above in relation to 23N.

Consultation was conducted through an officials' issues paper *PAYE error correction and adjustment* released in August 2017 and officials are advising Ministers on the recommended content of regulations which it is anticipated will be made with effect from1 April 2019[7].

Filing requirements, payroll software and variation of requirements

New section 23O(1) requires the Commissioner to prescribe both electronic and non-electronic forms and modes of delivery and permits the Commissioner to set specifications for payroll software.

To permit payments to be processed new section 23O(2) authorises the Commissioner to require information to accompany payment. Until all PAYE information is processed in Inland Revenue's new computer system (estimated for 2020), this section will be used to require the continuation of the existing requirement for a *PAYE income payment form (IR345)*. This form is due at the same time as the payment to which it relates.

New section 23P defines payroll software as a commercially available payroll system or service or bespoke equivalent. This definition is not intended to capture those who use spreadsheets or electronic calculators to assist in the calculation of their payroll.

New section 23Q allows the Commissioner to vary the requirements set out in the subpart 3C and schedule 4 for an employer or class of employers.

Penalties

Late payment penalties (shortfall penalty)

Because there are no mandatory changes for the timing of PAYE and related deductions, there are no changes in the penalty provisions around non-payment of PAYE and related deductions, other than updating the references and terminology. Section 141ED, previously "Not paying an employer monthly schedule amount" becomes "Penalty for unpaid amounts of employers' withholding payments".

Discretion not to impose penalties

New sections 139A(9) and 139AA(7) provide the Commissioner with a discretion not to impose late filing and non-electronic filing penalties because of resource constraints during the period of co-existence between Inland Revenue's old and new software platforms. The discretion is only available if the non-compliance is not serious or unreasonable.

This discretion will allow the Commissioner to apply her resources to educating customers to support them to understand the new regime and to get it right from the start. As a consequence of the Commissioner focusing her resources on assistance rather than enforcement, there will be a period of leniency around the imposition of late filing and non-electronic filing penalties during the early stages of payday filing. The capacity to impose late filing and non-electronic filing penalties remains for cases where the employer is deliberately non-compliant or otherwise behaves unreasonably.

The explanation of late filing and non-electronic filing penalties as they will apply from the period of co-existence between the old and new software platforms is set out below.

Late filing Penalties

An amendment to section 139A provides that the late filing penalty will remain a monthly penalty of $250. The late filing penalty under section 139A will not be imposed for the first occasion of late filing in a twelve month period. This continues the current approach. After the first instance of late filing in a month, an employer will be advised that a penalty will be imposed if there is a further failure to file on time within 12 months.

The monthly calculation of the penalty means that an employer who pays employees on a weekly basis and who fails to meet the due date for filing on more than one occasion during a month will incur the same penalty as an employer who runs a monthly payroll and is late providing their one submission.

Example

Matias and Carrie run a business which withholds more than $50,000 of PAYE and ESCT a year so they are in the online group. Matias manages the payroll which runs every week but he does not always meet his filing obligations with Inland Revenue.

In February Matias missed two due dates for filing employment income information. Because it was not the first time in a twelve month period, a penalty of $250 was imposed.

Three months later Matias again missed a filing obligation, in respect of one payday return during the month, and was again penalised $250.

[7] **Note**: one of the changes consulted on in the officials' issues paper – accepting negative values in a return – would not be possible until after the end of the period of co-existence for PAYE on Inland Revenue's old and new computer systems, which is not expected before 2020.

The key date for determining whether there is a penalty is the month in which the information is due, not the month in which the payday fell. The examples below illustrate this point.

Example

Every Wednesday Jennie does the pay for her partner's company which is in the online group. The company has already received a notice that if its employment income information is late again within a twelve month period it will receive a late filing penalty.

The last Wednesday in February is the 27th and the information is due on the 1st of March. Jennie failed to provide the information by the 1st of March and subsequently missed the due date for information for one payday in March. Because the due dates which were missed were both in March, a single late filing penalty of $250 is imposed.

Example

After several months of on time filing Jennie failed to provide employment income information on time for the last three paydays in October which occurred on the 17th, 24th and 31st of October. The due dates for information relating to the first two paydays are the 19th and 26th of October and a late filing penalty of $250 is imposed for information due in October.

The due date for the last October payday is the 2nd of November and the company also receives a late filing penalty of $250 for the late filing of information due in October.

Non-electronic filing penalty

Under an amendment to section 139AA the non-electronic filing penalty remains a monthly penalty. An employer who failed to file electronically information relating to each of the four paydays in a month would face the same penalty as an employer with the same sized payroll, who failed to meet their obligation on one occasion during the month. The penalty is the greater of $250 or $1 for each employee whose information has not be returned electronically in the month.

Example

F Charm Ltd withholds more than the threshold amount of $50,000 of PAYE and ESCT. The company has been notified by Inland Revenue that from a specified future date, they will be in the "on-line group" and required to provide employment income information electronically and that the due date for the information will be two working days after payday. They are also advised that if they believe they have grounds, they can apply for an exemption from electronic filing.

F Charm Ltd does not seek an exemption and has not changed their filing method by the time the notice period expires. They pay staff weekly and the number employed varies. In July the numbers reported each week varied from 70 – 90 but over the month 95 different employees were reported as being paid. The last payday in July was the Thursday 26th and the information should have been received electronically on July 30th. The returns were submitted on paper and failed to meet the new due dates.

The non-electronic filing penalty for the month is the greater of $250 or $1 for each employee whose information is not filed electronically which in this case was 95. F Charm Ltd is penalised $250 for not filing electronically in July.

Because it was the first occasion (month) in a twelve month period on which they had failed to file on time, F Charm is notified that a further failure to file on time will incur a late filing penalty.

Due dates for payment of late filing penalties

New section 142(1A) provides that a late filing penalty is due 30 days after the end of the month in which the employer is required to deliver the employment income information in question.

Example

R V Winkle Ltd is in the online group and run a fortnightly payroll. The company is occasionally late to file their employment income information.

Information for May was due on the 5th and 19th of May but the second return was not received until the 26th which was the fifth working day after payday. Because it is not the first time in twelve months that the Company has filed late they have already received a letter advising that a penalty will be imposed for a further failure to file on time within twelve months.

A late filing penalty is imposed on RV Winkle and Associates. It has a due date of 30 June which is thirty days after the end of the month (May) in which the information was due.

Example

S White and Associates is in the non-electronic employer group and runs a weekly payroll. They have elected to provide their employment income information twice a month (due dates ten working days after the 15th and ten working days after month end). S White and Associates are sometimes late to provide their information. They have received notice that a penalty will be imposed for a further failure to provide information on time within twelve months.

S White and Associates provide information on time in April and their first return in May is received on time. Because all the information expected in May (the information for the second April payment and for the first May payment) is received on time no penalty is imposed in April.

However, S White and Associates are late to provide their second return for May. It was due ten working days after the end of the month on the 14th of June but was not received until the 22nd, six working days late.

A late filing penalty is imposed on A White and Associates. It has a due date of 30 July which is thirty days after the end of the month (June) in which the information was due.

Due dates for payment of non-electronic filing penalties

Amended section 142G provides that non-electronic filing penalties are due 30 days after the end of the month in which the employer was required to file in the prescribed electronic form or by way of the prescribed electronic communication.

Example

F Charm Ltd.'s penalty for non-electronic filing, for due dates in July, is due on 30 August.

As illustrated above for the late filing penalty it is the date that the information should be received in electronic format that determines whether a penalty will be imposed for that month, not the date of the payday.

Example

F Charm Ltd continues to submit employment income information on paper through August. The information relating to paydays on 2nd, 9th, 16th and 23rd of August is due in August.

F Charm Ltd's failure to submit its employment income information electronically in August will give rise to a non-electronic filing penalty for August due on 30 September.

The last payday in August is Thursday 30th, with the information due to be received in electronic format by Monday 3 September.

For the failure to file electronically on 3 September a non-electronic filing penalty will be imposed with a due date of 30 October.

TRANSITIONAL PROVISIONS FOR THE INTRODUCTION OF PAYDAY REPORTING

Sections 227C and 227D of the Tax Administration Act 1994

Background

The transitional provisions allow an employer or payroll intermediary in the online group to adopt payday filing on a voluntary basis during the period April 2018 – March 2019. The opportunity for early adoption on a voluntary basis is restricted to those who submit their information electronically. The voluntary adoption period is intended to allow those who need to install upgrades to their payroll systems to choose a time that is convenient to them.

The last employer monthly schedule, prior to commencing payday filing, is due on its normal timetable, the 5th or 20th of the following month as appropriate, during the first month of payday filing.

Application Dates

The transitional provisions come into force on 1 April 2018. However, section 227C(8)(a) provides that for an employer the provisions come into effect when the employer elects to submit their employment income information on a payday basis during the voluntary period.

The election process for employers who chose to adopt payday filing during the voluntary period will vary depending on the filing method the employer chooses to use. If the employer chooses to payday file using the 'onscreen form' in myIR or through 'file upload' in myIR, they are asked to contact Inland Revenue on 0800 377 772 (small or medium business) or 0800 433 553 (significant enterprise customers). Depending on demand the telephone process may be replaced with an online process, if so details will be available on Inland Revenue's website.

Employers who choose to provide employment income information direct from their software will need to talk to their software provider to ensure that the functionality is available. Beginning to file payday information direct from software will constitute an election.

Detailed Analysis

Payday provision of employment income information is required from 1 April 2019. Notwithstanding the new regime being effective from 1 April 2019, new section 227D(1) provides that the old rules apply to the employer monthly schedule and employer deductions form(s) for March 2019. These returns will be due in April 2019 on the 5th or 20th as appropriate.

New section 227D(3) applies to employers who are required to remit PAYE deductions to Inland Revenue on a twice-monthly basis. These employers are required to apply the new rules in relation to the tax treatment and reporting of employee share scheme benefits received by their employees or former employees during the 16 March 2019 to 31 March 2019 period. This rule prevents an EMS relating to April 2019 being filed during May 2019.

New section 227C identifies a transitional period for the voluntary application of the employment income information provisions. The transitional period starts on 1 April 2018 and ends on 31 March 2019.

An employer in the online group can choose to adopt the payday filing rules during the period from April 2018. The rules for the voluntary application of the employment income information provisions are set out in new section 227C. An employer can voluntarily adopt payday filing at the beginning of any month[8] during the transitional period.

For an employer's first month under the payday filing rules, new section 227D(2) provides that the old rules still apply to the employer monthly schedule and employer deduction form(s) relating to the previous month.

Example

R Stilt and Co are in the online group and have elected to opt in to payday filing from the beginning of September 2018.
R Stilt and Co pay their staff fortnightly. The Company withholds less than $500,000 of PAYE and ESCT so they pay PAYE and related deductions to Inland Revenue once a month - by the 20th of the following month. In September 2018 their paydays are on the 12th and 26th of the month.

R Stilt and Co's employer monthly schedule, employer deduction form and payment for August 2018 is due on the 20th of September 2018.

R Stilt and Co's first payday return is due two working days after payday, on the 14th of September. The second return is due two working days after the second payday, on the 28th of September.

No changes have been made to the due dates for the payment of PAYE and other deductions so the employer deduction form and payment are still due for the September paydays, on the 20th of October.

If an employer chooses to provide employment income information on a payday basis during the transitional (voluntary) period, they must also apply the other relevant provisions including, for example, the requirements for information about new and departing employees and the reporting of benefits under employee share schemes.

New section 227C(4) requires that an employer who chooses to adopt payday filing of employment income information during the transitional period applies the modifications to the rules relating to benefits under employee share schemes (otherwise effective from 1 April 2019) for all employee share scheme benefits received by their employees or former employees on or after the date that is 20 days before they made their election.

New section 227C(9) provides that an employer who elects to provide employment income information on a payday basis during the transitional period may not opt out without the Commissioner's agreement. This provision is intended to ensure that support is provided and that Inland Revenue is aware of the nature of any difficulties employers are having. Inland Revenue also needs to be aware of the employer's intended method of submitting information. It is not intended to unreasonably prevent an employer opting out during the transitional period.

[8] Because an 'employer monthly schedule' relates to a month payday filing should begin from the beginning of a month.

CONSOLIDATION OF PAYE ADMINISTRATIVE REQUIREMENTS

Sections 22, 22AA, 23, 24B to 241B, schedules 3 and 5, and table 1 of the Tax Administration Act 1994

Sections RD 4, RD 12, RD 21 and RD 22 of the Income Tax Act 2007

Sections 34 and 202 of the Student Loan Scheme Act 2011

Section 163 of the Child Support Act 1991

Key features

This Act consolidates and simplifies the structure of the administrative requirements relating to PAYE in the Tax Administration Act 1994. This change sees much of the detail being placed in schedules to the Act. In addition to the changes already outlined, the provisions relating to record keeping and tax codes are restructured.

The consolidation necessitates some changes to the Income Tax Act 2007 and consequential changes to the Student Loan Scheme Act 2011 and Child Support Act 1991.

In addition, there are a small number of policy clarifications and changes. These include clarifying the circumstances in which the non-notified tax codes applies and providing that the threshold for twice monthly remittance of PAYE and other deductions can be changed by Order-in-Council following consultation.

Application Dates

The changes come into force on 1 April 2019.

Detailed analysis

Record Keeping

The Act brings together the sections that impose PAYE record-keeping requirements on employers. New schedule 3 itemises the information that employers must record and keep.

New section 22AA contains the PAYE record keeping obligations and also requires employers to keep the records required under the KiwiSaver Act 2006, the Student Loan Schemes Act 2011, and Child Support Act 1991. The new section places the detail of the specific records in new schedule 3 Table 1: Record-keeping requirements for employers and PAYE intermediaries. This table sets out the items for which records, certificates and notifications are required to be kept.

An amendment to section 23(2) provides that where information has been transmitted electronically, an employer is not required to retain the employment income information that has been provided to the Commissioner.

PAYE tax codes

The Act consolidates the core requirements relating to tax codes in subpart 3D, placing the detail in schedule 5 parts A and B. The intent is to restructure the existing provisions to improve clarity.

The amendments clarify the circumstances in which an employee must be taxed at the "no notification" rate. Section 24B(3B) previously provided that this rate (currently 45 cents in the dollar) applied when the employee had not provided their employer with a tax code notification and the Commissioner has not provided the employer with a tax code or special tax code for the employee.

The prescribed form for a tax code notification requires the employee to provide their name and tax file number, in addition to their tax code. The employee's name and tax file number are critical to establishing their identity. New section 24E now makes explicit that not providing a name, tax file number, or tax code, will result in the employee being placed on the "non-notified" tax code. The exceptions are where the Commissioner has provided the information to the employer or the employee is a non-resident seasonal worker in their first month of employment in New Zealand. The no notification tax code has now been renamed the "non-notified" tax code.

The requirement that an employee must certify their entitlement to work in New Zealand when completing their tax code certificate is repealed on 1 April 2019. Under the Immigration Act 2009 employers have a positive obligation to determine that workers are legally able to work for them. Holding a copy of the employee's tax code declaration, where an employee self-certifies their immigration status, does not discharge this obligation and the requirement has been repealed.

Schedule 5 part A contains detailed provisions in relation to the application of general (not special) tax codes. As noted above, the intent is to improve clarity, not to amend the provisions. Part A contains provisions relating to:

- combining tax codes;
- changes to tax codes and when changes to tax codes apply;
- the steps the Commissioner may take if she considers that an incorrect tax code is being used, and the consequential requirements on the employer;
- when entitlement to use a tax code ends; and
- a table of tax codes.

Schedule 5 part B contains detailed provisions relating to special and particular tax codes.

- the Commissioner's ability to provide a special tax code;
- what a special tax code may apply to, what it may require and how the Commissioner is to calculate it;
- the requirement on the Commissioner to notify the relevant department if the code is issued in relation to superannuation or veteran's pension income;
- the overriding nature of a special tax code;
- the Commissioner's ability to cancel a special tax code;
- tax codes for private domestic workers; and
- tax codes for non-resident seasonal workers.

New section 24IB allows the Commissioner to vary requirements relating to tax codes in a similar way as was previously set out in the now repealed section 24P.

Amendments to the Income Tax Act 2007

With the exception of the change which enables the threshold for twice monthly remittance of PAYE and related deductions to be amended by Order in Council, the PAYE related changes to the Income Tax Act 2007 are largely consequential on consolidating the administrative requirements for PAYE into the Tax Administration Act 1994.

New section RD 4(7) provides that the Governor-General may, on the recommendation of the Minister of Revenue, make an Order in Council amending the threshold amount for twice monthly remittance of PAYE and related deductions. Before making a recommendation, the Minister must undertake appropriate consultation.

Section RD 4 previously expressed the requirements for monthly or twice monthly remittance of amounts of tax withheld in terms of the information obligations set out in RD 22. Replacement section RD 4 now includes the criteria previously prescribed in RD 22 namely the $500,000 a year threshold for twice-monthly payment, the rules for new employers, and how the threshold is to be applied if the employer runs more than one business or is a person to whom control has become vested or passed.

Section RD 22 as amended provides that obligations on employers to provide employment income information are as set out in the Tax Administration Act sections 23E - 23H.

New subsection RD 22(2) clarifies that where an employee has a special tax code of zero, or is a recipient of schedular income that has a special tax rate of zero the employer or PAYE intermediary, despite not withholding PAYE, must nonetheless report employment income information to the Commissioner.

The obligation on an employee to provide information to the Commissioner in certain circumstances was previously set out in both RD 4(2)(b) and RD 21(1)(a). The Act repeals RD 4(2)(b) and amends RD 21(1) (a) which now provides that the requirement on an employee to provide employment income information is as set out in new section 23I of the Tax Administration Act 1994.

Section RD 12 relating to multiple payments of salary or wages has been clarified so that the requirement to treat the amounts as one payment only applies where the employment situations are with the same employer.

CHANGES FOR THE PAYROLL SUBSIDY

Sections, 3 "tax" and "tax position", 15C, 15G, 15H, 15I, 15J, 15M, 185, 185C, 185D of the Tax Administration Act 1994; sections RD 2, RD 64, RP 2 - RP 5, RZ 14, YA 1 "listed PAYE intermediary" and "subsidy claim form" of the Income Tax Act 2007; Income Tax (Payroll Subsidy) Regulations 2006; Anti-Money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2014

The eligibility threshold for the payroll subsidy is lowered to $50,000 of PAYE and employer's superannuation contribution tax (ESCT) withheld annually by the employer, from 1 April 2019. The payroll subsidy will be repealed the following year with effect from 1 April 2020.

Background

Inland Revenue currently pays a payroll subsidy to listed PAYE intermediaries taking on the PAYE obligations of eligible employers. It is available for up to five employees of an employer per PAYE income payment. To reduce compliance and administrative costs the subsidy is paid by Inland Revenue directly to the listed PAYE intermediary on a monthly basis.

The subsidy was introduced to encourage small employers to outsource their PAYE obligations to approved listed PAYE intermediaries to make compliance easier for them, give small employers more time to run their business, and improve the overall operation of the PAYE system.

The changes to the payroll subsidy are included in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act, which contains a range of measures to modernise the administration of PAYE.

Key features

For the 2019/20 tax year from 1 April 2019, to better target assistance to small employers, the eligibility threshold for the payroll subsidy is lowered from currently $500,000 to $50,000 of PAYE and ESCT withheld by the employer for the preceding tax year. The new eligibility threshold is contained in section RP 4 of the Income Tax Act 2007. New subsection RP 4(1D) of the Income Tax Act 2007 allows the Commissioner to continue to pay the payroll subsidy for an employer who would typically fall below the threshold of $50,000, but who is above the threshold because of a one-off event such as a redundancy payment or a payment on retirement.

The payroll subsidy is repealed on 1 April 2020. New section RZ 14 contains a transitional provision to ensure that PAYE intermediaries can claim and receive the payroll subsidy for PAYE income payments made before 1 April 2020 within the then existing rules and timeframes.

Application date(s)

The payroll subsidy threshold reduction from $500,000 to $50,000 applies from 1 April 2019.

The payroll subsidy provisions are repealed in their entirety effective 1 April 2020. New transitional provision section RZ 14 also applies from 1 April 2020.

TAX TREATMENT OF ADVANCE PAYMENTS OF HOLIDAY PAY OR SALARY OR WAGES

Section RD 13 of the Income Tax Act 2007, section 67(3)(a) of the KiwiSaver Act 2006 and schedule 2, clause 2(a)(i) of the Student Loan Scheme Act 2011

An amendment has been made to the Income Tax Act 2007 to give employers the option to tax holiday pay (or salary or wages) paid in advance as if the lump sum payment was paid over the pay periods to which it relates, or under the existing extra pay method.

Background

In November 2015, Inland Revenue clarified its operational position on the correct tax treatment of holiday pay. Under this operational position, the tax treatment of holiday pay depends on whether the holiday pay is a lump sum payment (in which case it should be treated as an extra pay), or is included in an employee's regular pay or paid in substitution for an employee's ordinary salary or wages when annual paid holidays are taken (in these cases it should be treated as salary or wages).

Following the publication of its operational position on the correct tax treatment of holiday pay, Inland Revenue received feedback from payroll software providers that treating holiday pay paid in advance as an extra pay would result in less accurate withholding of tax than industry adopted alternative methods that were already in place, which they expressed a desire to be permitted to use.

As the payroll software providers pointed out, in the case of holiday pay paid in advance[9], extra pay tax treatment has a tendency to result in over-withholding of PAYE. This is because extra pay tax treatment essentially over-taxes the leave payment by using the employee's marginal rate (for a payment that does not represent an increase in total annual earnings), while the payments made in each of the subsequent periods that have only part of the earnings are under-taxed.

More accurate withholding outcomes could be achieved if PAYE was deducted as if the lump sum payment was paid in its normal cycle over the pay periods to which the leave relates (the alternative treatment). Feedback received in response to the previous Government's *Making Tax Simpler: Better administration of PAYE and GST* consultation suggested it was common practice to apply this alternative treatment for end of (calendar) year holiday pay paid as a lump sum. Anecdotally, it is common for employees in some industries to work longer hours in the lead up to Christmas, which can exacerbate the over-withholding if the extra pay formula is used. This, combined with receiving no income during the following weeks when the holiday is taken, may cause financial hardship.

This alternative treatment would, however, be more complicated for employers to apply than treating the payment as an extra pay. This is due to the need, when future payments are made for pay periods to which the leave relates, for employers to calculate PAYE based on all earnings for the pay period, less PAYE already deducted for the pay period. This will occur for pay periods that are not taken entirely on leave, but partially taken on leave and partially worked in. This makes the alternative treatment too complex to be suitable for employers who do their payroll manually to be required to use; extra pay tax treatment remains appropriate for them.

A similar issue arises in the situation of salary or wages paid in advance.

To strike a balance between the desire for more accurate withholding of PAYE and the impact on compliance costs, a legislative amendment was proposed to give employers the option to tax holiday pay (or salary or wages) paid in advance as if the lump sum payment was paid over the pay periods to which it relates, or under the existing extra pay method.

Key features

Replacement section RD 13 of the Income Tax Act 2007 allows an employer to tax holiday pay (or salary or wages) paid in advance as if the lump sum payment was paid over the pay periods to which it relates, or as an extra pay.

A lump sum advance pay can be treated as though it had been paid over the future pay periods to which it relates (section RD 13). If the employer then makes subsequent payments for these pay periods they will need to calculate PAYE based on all earnings for those pay periods minus the PAYE already deducted for that pay period.

Application date

The amendments apply from 1 April 2018.

Detailed analysis

When does the section apply?

Replacement section RD 13 applies when an employee receives:

- an advance payment of salary or wages; or
- a lump sum payment of holiday pay made before the employee takes their holiday, if the employee's employment is continuing. That is, section RD 13 does not apply to a lump sum payment of holiday pay made on termination of employment. Employers continue to be required to tax lump sum payments of holiday pay made on termination of employment as extra pays.

What options does an employer have?

When section RD 13 applies, an employer may choose, for the purposes of withholding PAYE, to treat the lump sum payment:

- as an extra pay; or
- as if it had been paid in its normal cycle for the pay periods to which it relates.

[9] For example, where an employee takes four weeks' annual leave and receives a lump sum payment of holiday pay covering the four weeks in advance.

How does the new option for calculating PAYE for an advance payment work?

If an employer chooses that latter option, the employer is required to calculate the amount of PAYE to withhold from the lump sum payment by:

- apportioning the lump sum payment to the pay period or pay periods to which it relates based on the employee's usual hours of work; and
- calculating the amount of PAYE for each portion of the lump sum, as if the portion were the only payment of salary or wages they made to the employee for the particular pay period; and
- adding together the PAYE amounts for each portion.

How is PAYE calculated for a subsequent payment of salary or wages relating to one of the same pay periods as an advance payment that was taxed using the new option?

If an employer, subsequent to making a lump sum payment to an employee where PAYE was calculated using the new option, makes a payment of salary or wages to the employee for one of the pay periods to which the lump sum relates, the employer is required to calculate the amount of PAYE to be withheld from the payment by:

- adding together the payment of salary or wages and the portion of the lump sum that relates to the pay period; and
- calculating the amount of PAYE that would be required to be withheld from this aggregate amount, as if that amount were a single payment of salary or wages paid by the employer to the employee for the pay period; and
- subtracting the amount of previously withheld PAYE for the portion of the lump sum that relates to the pay period.

Consequential amendments to other enactments

An amendment to section 67(3)(a) of the KiwiSaver Act 2006 specifies that replacement section RD 13 of the Income Tax Act 2007 does not apply for the purposes of calculating employee KiwiSaver contribution deductions.

An amendment to schedule 2 of the Student Loan Scheme Act 2011 specifies that replacement section RD 13 of the Income Tax Act 2007 does not apply for the purposes of calculating student loan deductions from payments of salary or wages.

Example

This example concerns an employer who chooses to treat holiday pay paid in advance as if the lump sum payment was paid over the pay periods to which it relates.

An employee on an "M" tax code is paid weekly wages with the pay period ending on a Sunday and a normal payday of the Tuesday following the end of the pay period. She takes annual leave for the period Thursday, 10 December to 16 December and requests that this is paid to her prior to her taking this leave. The gross payment for this leave is calculated based on Holidays Act calculations at $1,000. Her ordinary wages payment for Monday to Wednesday of the first pay period containing the leave is $600, and her ordinary wages payment for the Thursday to Friday of the second pay period containing the leave is $400. On the Tuesday of the week in which the leave is taken, the employee is paid for the previous week as normal and is also paid her holiday pay as a separate payment.

Note that, in the table below which forms part of this example, the weekly PAYE table for the 1 April 2015 to 31 March 2016 tax year has been used to determine the PAYE deductions. This is intended to be purely illustrative. To determine PAYE deductions, employers will have to use the relevant PAYE table for the tax year in which the payments are made and their pay period length.

Pay period end date	Payment type	Pay date	Payment amount	PAYE withheld	Notes
8 Nov	Ordinary salary or wages	10 Nov	$1,000	$180.26	
15 Nov	Ordinary salary or wages	17 Nov	$1,000	$180.26	
22 Nov	Ordinary salary or wages	24 Nov	$1,000	$180.26	
29 Nov	Ordinary salary or wages	1 Dec	$1,000	$180.26	
6 Dec	Ordinary salary or wages	8 Dec	$1,000	$180.26	
13 Dec	Holiday pay	8 Dec	$400	$56.95	PAYE initially calculated based on $400 for the pay period (for 2 days of leave)
20 Dec	Holiday pay	8 Dec	$600	$94.85	PAYE initially calculated based on $600 for the pay period (for 3 days of leave)
13 Dec	Ordinary salary or wages	15 Dec	$600	$123.31	PAYE calculated on the new total for the pay period of $1,000 ($400 + $600). PAYE withheld from this pay is the difference between the PAYE on $1,000 ($180.26) and what has already been deducted for the pay period ($56.95)
20 Dec	Ordinary salary or wages	22 Dec	$400	$85.41	PAYE calculated on the new total for the pay period of $1,000 ($400 + $600). PAYE withheld from this pay is the difference between the PAYE on $1,000 ($180.26) and what has already been deducted for the pay period ($94.85)
		Total	**$7,000**	**$1,261.82**	

TAX TREATMENT OF A RETROSPECTIVE INCREASE IN SALARY OR WAGES

Section RD 7(1)(b)(iv) and (2) of the Income Tax Act 2007

The *de minimis* rule in section RD 7 of the Income Tax Act 2007 relating to the tax treatment of a retrospective increase in salary or wages has been repealed, as it had become redundant.

Background

Under the PAYE rules, a retrospective increase in salary or wages is treated as an extra pay. This was subject to a *de minimis* provision, so only applied where the total salary or wages a person earned in a week (including the increase) was more than $4. If a person earned less than $4 for the week, the payment would be treated as salary or wages.

This restriction had been part of the PAYE rules since PAYE was introduced in 1958, with the only change to the provision being when it changed to $4 from its original £2 upon the change to decimal currency in 1967.

Given current minimum wage rates, it is extremely unlikely anyone earning salary or wages in New Zealand would receive less than $4 in a week. Therefore, the restriction had effectively become redundant.

Key features

Amendments have been made to section RD 7 to repeal the *de minimis* rule in relation to the tax treatment of a retrospective increase in salary or wages.

Application date

The *de minimis* provision was repealed on 1 April 2018.

APPLICATION OF LEGISLATED RATE AND THRESHOLD CHANGES

Sections RD 10C, RD 14 and RD 67B of the Income Tax Act 2007, sections 64(3B) and 101D(4) and (4B) of the KiwiSaver Act 2006, section 37(3B) of the Student Loan Scheme Act 2011, and regulation 4(1)(d) of the Accident Compensation (Earners' Levy) Regulations 2017

Amendments to the Income Tax Act 2007, the KiwiSaver Act 2006, the Student Loan Scheme Act 2011 and the Accident Compensation (Earners' Levy) Regulations 2017 align the rules about how legislated rate or threshold changes are applied across the different types of PAYE income payments and social policy initiatives administered through the PAYE system, such that the rates and thresholds to be applied are those in force on the date the payment is made.

Background

Prior to the amendments, different types of PAYE income payments and social policy initiatives administered through the PAYE system had different rules about what to do when a legislated rate or threshold change occurred during a pay period, or if a legislated rate or threshold change had occurred between the date a payment was made and the pay period to which the payment relates. The rates and thresholds that applied were sometimes based on the pay date, sometimes pay period end-date or pay period start-date, while sometimes apportionment applied. This created complexity and confusion for employers, in particular for pays that occurred in the period around the end of one tax year and start of the next, when there had been legislated rate and/or threshold changes. This added to employers' compliance costs and increased the risk of errors.

As part of its *Making Tax Simpler: Better administration of PAYE and GST* consultation, the previous Government consulted on aligning the way in which legislated rate and threshold changes are applied, with a pay date approach proposed as the best option for alignment. Submitters strongly supported alignment, with the majority supporting a pay date approach.

Key features

New section RD 10C of the Income Tax Act 2007 provides that, when a tax rate or threshold change occurs that affects the amount of tax for a PAYE income payment, the rates and thresholds to be applied to determine the amount of tax to be withheld are those in force on the date on which the PAYE income payment is paid. If the PAYE rules treat a PAYE income payment as paid on a particular date (which may differ from the actual date of payment), the rates and thresholds to be applied are those in force on the date on which the PAYE income payment is treated as paid.

Section RD 14 of the Income Tax Act 2007, which previously set out the rules for determining the amount of tax to be withheld from a payment of salary or wages when a change occurs to tax rates or thresholds, has been repealed.

An amendment to regulation 4(1)(d) of the Accident Compensation (Earners' Levy) Regulations 2017 ensures that the rule for determining the rate at which an employer must deduct the ACC earners' levy from an employee's earnings is aligned with the rule for the income tax component of PAYE to operate on a pay date basis.

New section RD 67B of the Income Tax Act 2007 provides that, when a tax rate or threshold change occurs that affects the amount of tax for an employer's superannuation cash contribution, the rates and thresholds to be applied to determine the amount of tax to be withheld are those in force on the date on which the PAYE income payment to which the contribution relates is paid. If the PAYE rules treat a PAYE income payment to which the contribution relates as paid on a particular date (which may differ from the actual date of payment), the rates and thresholds to be applied are those in force on the date on which the PAYE income payment is treated as paid. Where an employer's superannuation cash contribution is made that is not tied to a particular PAYE income payment, the rates and thresholds to be applied are those in force on the date on which the contribution is paid to the superannuation fund or under the KiwiSaver Act 2006 to Inland Revenue (whichever applies).

New section 64(3B) of the KiwiSaver Act 2006 provides that, when a change occurs to the minimum employee KiwiSaver contribution rate that affects the contribution that must be deducted from a payment of salary or wages, the rate to be applied to determine the amount of the contribution is the rate applying on the day on which the salary or wages are paid.

Amendments to section 101D of the KiwiSaver Act 2006 provide that the compulsory employer contribution rate to be applied in calculating the amount of a compulsory employer KiwiSaver contribution to be made for a payment of gross salary or wages is the rate applying on the day on which the salary or wages are paid.

New section 37(3B) of the Student Loan Scheme Act 2011 provides that, when a change occurs to the rate at which student loan deductions are required to be made from a payment of salary or wages, the deduction rate to be applied is the rate applying on the day on which the salary or wages are paid.

Application date

The amendments apply from 1 April 2018.

Modernising tax administration – Investment income information

OVERVIEW

Subpart 3E, sections 22AAB, 26, 28B, 32E, 32H, 32L, 49, 51, 57B, 67, &*D, 139AA,142G, 227E, and schedules 3 and 6 of the Tax Administration Act 1994

Sections HM 4, HM 48, HM 62, RA 11, RA 12, RA 15, RE 27, RE 29, YA 1, and schedule 1 of the Income Tax Act 2007

New tax rules have been introduced to improve the administration of investment income information. Investment income refers to interest, dividends, portfolio investment entity (PIE) income, taxable Māori authority distributions and royalties.

The rules aim to reduce compliance costs for recipients of investment income and administrative costs for Government, by improving the administration of investment income to enable the pre-population of tax returns and to ensure that taxpayers' tax obligations and social policy entitlements and obligations are calculated more accurately during the year.

The key changes relate to the following:

- Obtaining more frequent and/or detailed information for interest, dividends, PIEs and Māori authority distributions.
- Encouraging the provision of IRD numbers.
- Improving error correction.
- Increasing electronic filing.
- Improving the administration of RWT exempt-status (certificates of exemption).
- Removing some requirements to provide end-of-year withholding tax certificates.
- Extending the record keeping requirements to include NRWT.

Numerous consequential amendments have been made to reflect terminology and section reference changes.

Application dates

Most of the proposed changes come into force on 1 April 2020, although some apply from 1 April 2018 and 1 April 2019.

DETAIL AND FREQUENCY OF INVESTMENT INCOME INFORMATION

Subpart 3E, sections 49, 51, 57B, 67 and schedule 6 of the Tax Administration Act 1994

Several amendments have been made so that Inland Revenue receives more frequent and detailed information from investment income payers on the amount of income taxpayers earn and the tax withheld on that income.

Background

Previously, Inland Revenue received limited and infrequent information about the investment income that taxpayers earned and the tax withheld or paid on that income. For interest subject to resident withholding tax (RWT) or non-resident withholding tax (NRWT) and portfolio investment entity (PIE) income, Inland Revenue only received information about the income taxpayers earned and the tax deducted from that income after the end of the tax year. For dividends, Māori authority distributions and interest income exempt from RWT or subject to the approved issuer levy (AIL), Inland Revenue only received information about the amounts received by recipients when it was specifically requested, or included by the recipient in their tax return.

A person's social policy entitlements/obligations and tax rate is determined by how much income the person earns. Because Inland Revenue did not receive information on how much investment income a taxpayer had earned during the year, Inland Revenue was not able to:

- ensure taxpayers' tax and social policy entitlements/obligations were more accurate during the year;
- advise taxpayers of the appropriate withholding rate to use;
- pre-populate tax returns with all investment income information.

Taxpayers who had not paid the correct tax or received the correct social policy entitlements during the year needed to square up at the end of the year, resulting in a debt or refund. Often taxpayers were unaware of these obligations - meaning Inland Revenue sometimes paid out more in social policy entitlements than it otherwise should and taxpayers paid less tax and social policy obligations than they should. An estimated $21 to 27 million of income tax per annum was forgone due to interest income not being subject to an appropriate withholding tax rate or returned as income.

Key features

The changes are as follows:

- Payers of interest (including interest on domestically issued debt subject to the approved issuer levy), dividends and taxable Māori authority distributions to provide investment income information to Inland Revenue by the 20th of the month following the month in which the income was paid.
- A multi-rate PIE that is not a superannuation fund or retirement savings scheme will be required to report investment income information to Inland Revenue yearly by 15 May after the end of the tax year.
- A transitional measure: payers of income subject to RWT and NRWT (apart from royalties) are to report the required year-end information by 15 May, rather than 31 May, for the tax years ending 31 March 2019 and 31 March 2020.
- A investment income payer paying more than $5,000 of interest will only need to withhold RWT and report monthly on payments of interest where the payments relating to a taxable activity exceed $5,000, notwithstanding if total interest payments made by the payer (i.e. including payments not made in the course of a taxable activity) exceed $5,000.

Subpart 3E also groups the investment income information reporting requirements by moving other parts of the Act that relate to investment income information to subpart 3E.

Application dates

The amendments apply from 1 April 2020 (voluntary from 1 April 2019), apart from the amendment that brings forward the due date for the provision of information by PIEs, and the transitional measure for interest payers, which apply from the 2018-19 tax year and for the 2018-19 and 2019-20 tax years respectively.

Detailed Analysis

Section 25C – investment income

This section defines investment income as resident passive income subject to a withholding obligation, non-resident passive income and attributed income of investors in portfolio investment entities. The words "subject to a withholding obligation" ensure that non-residents that are not carrying out a taxable activity in New Zealand are not required to provide detailed information.

Section 25D – investment income information

This section defines investment income information, by reference to schedule 6 table 1, to include the following (as applicable):

- The name, IRD number and contact address[10] of the payer of investment income.
- The customer's name, contact address, IRD number and date of birth (if held).
- The customer's tax rate/ prescribed investor rate.
- The amount and type of income paid.
- The amount of tax withheld (if any) and the date it was withheld, as well as any imputation or Māori authority credits attached.
- For PIE funds, whether the fund the payer is invested in is a retirement savings scheme or not.
- Further information as required by the Commissioner.

[10] Contact address is defined in section 14G of the Tax Administration Act 1994 and includes the email address or other electronic address of the person, in addition to the street address of the person or their business.

Investment income information must be provided by the payer:

- for the reporting period, rather than on a cumulative basis; and
- for each owner, where the investment is jointly owned other than by a trust, company or partnership (unless the partners are not required to file a separate partnership tax return).

Date of birth and joint account information obtained prior to 1 April 2018 only needs to be provided to the Commissioner if held in electronic form.

Section 25E – who must provide investment income information to the Commissioner

The following individuals or entities must provide investment income information to the Commissioner:

- Payers of interest (including interest on domestically issued debt subject to AIL)
- Dividend payers.
- A person who pays a royalty to a non-resident.
- A Māori authority that makes a taxable distribution (other than a retirement scheme contribution).
- A multi-rate PIE that attributes income to an investor.
- A public unit trust that pays an amount treated as a dividend on a withdrawal.
- An emigrating company that is treated as paying a dividend to shareholders under section FL 2 of the Income Tax Act 2007.
- A person who is able to claim a tax deduction for interest that they pay to a recipient that doesn't hold RWT exempt status from which RWT is not required to be withheld because:
  - the payment was not made in the course or furtherance of a taxable activity; or
  - the amount paid was $5,000 or less.

Payers of investment income are only expected to pass on information to Inland Revenue that has been provided to them by the payee.

Section 25F – information on interest, sections 49 and 51.

Section 25F provides that a payer of interest subject to RWT, NRWT or AIL (limited to domestically issued debt) must provide investment income information to the Commissioner electronically by the 20th of the month following the month in which the investment income was paid to the investor. Where the investor is a nominee, the information required from the payer is limited to the information held about the nominee unless the payer has access to information on the ultimate investor.

Amendments were also made to sections 49 and 51 to require payers of interest to report year-end information by 15 May, instead of 31 May, for the tax years ended 31 March 2019 and 31 March 2020.

Section 25G – information on dividends

The information provision rules for dividends have been amended to require payers of dividends to provide investment income information electronically by the 20th of the month following the month in which the dividend is paid to the investor. As this information will be provided monthly, the company dividend statement requirement in section 67 has been repealed.

Section 25H – information on royalties

The information reporting requirements imposed on payers of royalties are unchanged but have been shifted from section 49 to section 25H as part of grouping the investment income information requirements.

Section 25I – information on Māori authority distributions

Amendments have been made to require a Māori authority that makes a taxable distribution to a member to provide investment income information to the Commissioner electronically by the 20th of the month following the month in which the distribution is paid to the member.

Section 25J – information on attributed PIE income: non-locked-in funds, section 57B

Investment income information will now be required by 15 May (rather than 31 May) for a multi-rate PIE that is not a superannuation fund or retirement savings scheme (see section on bringing forward due dates for provision of information by PIEs).

Section 57B(7) requires this from 1 April 2018 (first applying to the tax year ended 31 March 2019), from 1 April 2020 section 57B(7) will move to section 25J as part of grouping investment income information requirements.

Section 25K – information on attributed PIE income: locked-in funds

The information requirements for superannuation PIE funds are unchanged – the information is still generally due 30 June after the end of the tax year , the requirements have just moved from section 57B to section 25K as part of grouping investment income information requirements.

Section 25L – information from public unit trusts

Section 25L allows public unit trusts to electronically provide dividend information to Inland Revenue yearly by 15 May, as opposed to monthly. The rationale for this is that most public unit trusts have elected to become PIE funds. The public unit trusts that remain typically have system constraints that prevent them electing to become PIEs and are being wound down as investors exit.

Section 25M – information from emigrating companies

This provision retains the three month timeframe provided for in sections 49 and 51 for an emigrating company to provide information to the Commissioner in relation to the dividend that the company is treated as paying to shareholders under section FL 2(1) of the Income Tax Act 2007[11]. This information must be provided electronically.

Section 25N – information from payers with no withholding obligation

This provision reproduces section 52 of the Tax Administration Act 1994; the section has simply been moved as part of grouping the investment income information requirements.

This section requires a person who pays interest (that they are allowed a tax deduction for and that wasn't paid to a recipient holding RWT exempt status, for which RWT is not required to be withheld (because the amount paid was not in the course of a taxable activity or was equal to or less than $5,000)) to report the amount of income they have paid and details of the recipient/s to the Commissioner electronically with their return of income for the tax year. Changes to section RE 10, described below, have impacted on this obligation.

Section RE 10(3) – interest payments made in relation to taxable activities

Section RE 10 has been amended to provide that a person who pays interest in the course of carrying on a taxable activity is only required to withhold RWT from that interest if the amount that relates to the taxable activity is more than $5,000 for the tax year.

Previously, the $5,000 threshold did not consider the extent to which the loan related to the taxable activity. In other words, an interest payer who paid $5,001 in total but only $100 of the interest related to the taxable activity would be required to deduct RWT on the interest.

This amendment prevents payers of investment income from having to withhold RWT and report monthly on payments of interest made in the course of a taxable activity that are less than $5,000, where the payer has paid over $5,000 of interest in total.

For example, assume James borrowed $150,000 from his parents to buy his first home ($7,500 interest payments per year), but only used the garage of the house for his business of selling go-karts. The garage is 15% of the total size of the house so 15% of the interest ($1,125) is treated as being related to his taxable activity. Previously James would have needed to withhold RWT and report the interest paid to Inland Revenue, but would no longer need to following this amendment.

Section 25R - Investment income information: variation of requirements

Section 25R allows the Commissioner to vary the requirements set out in new proposed subpart 3E and apply those requirements as varied.

It replaces sections 51(6) and 49(5) which allowed the Commissioner to vary the information requirements relating to interest subject to RWT, and income subject to NRWT.

Sections 49 and 51 – RWT and NRWT end of year information (transitional measure

Sections 49 and 51 have been amended to bring forward the deadline for filing annual reconciliations for RWT and NRWT (apart from NRWT on royalties) for the 2019 and 2020 tax years. This is only an interim measure as monthly reporting of this income will begin from 1 April 2020.

Section 57B – Return requirements for multi-rate PIEs

Section 57B has been amended to require multi-rate PIEs that are not superannuation funds to provide their year-end information to the Commissioner by 15 May, rather than 31 May, from the 2018-19 tax year. Section 57B is repealed from 1 April 2020, and its contents moved to sections 25J and 25K as part of grouping the investment income information requirements.

[11] Under this section each shareholder is treated as receiving a distribution equal to the amount they would be entitled to if the company were treated as going into liquidation.

Section 227E – Transitional provision: application of investment income information provisions

New section 227E allows payers of investment income to voluntarily apply the provisions relating to the delivery of investment income information and the correction of errors under the new proposed subpart 3E from 1 April 2019, before the provisions become compulsory from 1 April 2020.

For a person who elects into the new rules partway through the year, the old rules will continue to apply to payments made before the election. This means that a person who opted in part way through the year would need to provide a reconciliation statement by 15 May 2020 in relation to interest payments made under the old rules.

Once a person has elected to apply the new rules during the transitional period, they cannot revert to the old rules unless they get the Commissioner's agreement.

MEASURES TO ENCOURAGE PROVISION OF IRD NUMBERS

Section 28B of the Tax Administration Act 1994, sections HM 4, HM 62 and Schedule 1 of the Income Tax Act 2007

Amendments have been made to encourage taxpayers to provide their IRD numbers to payers of investment income.

Background

Inland Revenue has difficulty attributing income to a taxpayer if it does not have the taxpayer's IRD number. Around 20 percent of the interest certificates received by Inland Revenue do not contain the recipient's IRD number. In relation to portfolio investment entity (PIE) income, 2 percent of investors have not provided their IRD number to their PIE fund.

The non-declaration rate, the rate which applies to taxpayers who have not provided their IRD number to their investment income payer, is too low (33% for interest and 28% for PIE income) to encourage taxpayers on the top marginal tax rate to provide their IRD number to their investment income payer.

Further, taxpayers with social policy entitlements or obligations who can have much higher effective tax rates (taking into account abatement of entitlements or additional obligations), benefited from not providing their IRD number as it made it unlikely Inland Revenue could verify that their investment income was taken into account when social policy entitlements/obligations were calculated. This meant they may have received more social assistance or paid less in child support and student loan repayments than they should.

No changes have been made to encourage provision of IRD numbers by having a higher non-declaration rate in relation to dividends and Māori authority distributions due to system capability concerns, and because Inland Revenue is unable to determine the extent of the non-declaration problem in relation to these types of income until after Inland Revenue begins to receive detailed recipient information. This makes it very difficult to make a satisfactory analysis of the compliance cost versus the benefit at this stage.

Key features

The changes are as follows:

- The non-declaration rate that applies to interest has been increased from 33% to 45%.
- For PIE income, investors opening new investments in multi-rate PIEs will be required to provide their IRD number to the PIE within 6 weeks of opening their account in order to remain a member of the PIE.

The changes should encourage people to provide their IRD numbers so that income is allocated to the relevant taxpayer, ensuring the taxpayer pays the right amount of tax, and receives the correct amount in social policy entitlements, and pays the correct amount in social policy obligations.

Application date

The changes to the non-declaration rate for interest income apply from 1 April 2020. The requirement for new investors in a PIE to provide their IRD numbers in order to stay invested in the PIE came into force on 1 April 2018.

Detailed analysis

Increased non-declaration rate for interest

Schedule 1 part D clauses 3 and 4 of the Income Tax Act 2007 have been amended to increase the non-declaration rate on interest to 45%.

PIE funds – IRD number requirement

Six weeks to provide IRD number

Section 28B of the Tax Administration Act 1994 requires an investor in a multi-rate PIE to notify the PIE of their tax file number within 6 weeks of becoming an investor.

This doesn't apply to a non-resident who does not have an IRD number but provides the equivalent tax identification number for their country of residence, or a declaration if they are unable to.

Non-residents who subsequently become residents are required to provide their IRD number to their PIE within 6 weeks of notifying the PIE that they have become a resident.

Consequence and treatment of not providing IRD number

Section HM 62 of the Income Tax Act 2007 provides that a PIE must close an investor's account, pay the necessary tax and refund the remainder of the balance to the investor where the investor has not provided their IRD number by the date provided in section 28B of the Tax Administration Act 1994 (i.e. within 6 weeks of becoming an investor).

Section HM 4 provides that an investor who has not provided their IRD number to the multi-rate PIE within six weeks of becoming a member is treated as reaching the exit level. This requires the PIE to calculate its tax liability in relation to the exiting investor, under sections HM 42 and HM 47 of the Income Tax Act 2007.

Joint investors IRD numbers

While PIEs are required to get an IRD number for each new investment and may only be collecting one IRD number for joint investments in some cases, they will be required to report the details (including the IRD number) of all of the joint investors from 1 April 2020. As the legislation requiring the reporting of joint investors details has been enacted it is expected that PIEs will hold those details for all joint investors that have made investments from 1 April 2018. PIEs should therefore ensure that they begin collecting these additional details in advance of 1 April 2020.

ERROR CORRECTION

Sections HM 48, RA 11, RA 12 and RA 15 of the Income Tax Act 2007, sections 25O and 227E of the Tax Administration Act 1994

Amendments have been made to allow payers of income subject to RWT and NRWT, and multi-rate portfolio investment entities (PIEs), to correct errors in the current year, and in the following year subject to a threshold, without the imposition of penalties or interest.

Background

Previously, errors arising from withholding too much or too little tax from investment income could only be corrected in the following year by amending a prior year return.

The amendments are intended to make it easier for payers to correct errors where the correction is made within a reasonable length of time. The error correction provisions do not change the obligation to provide correct returns initially and are only available to correct errors.

Key features

The error correction rules are as follows:

- A payer of investment income who does not withhold enough tax from a payment of resident or non-resident passive income may correct the error in the tax year it occurred, or in the following tax year provided the total adjustments made in the following year which relate to the previous year are not more than the greater of:
  - $2,000; or
  - 5% of the payer's withholding liability.
- A payer of investment income who withholds too much tax from a payment of resident or non-resident passive income may correct the error by paying the excess amount to the payee before 20 April after the end of the tax year, if the amount hasn't already been refunded to the payee by the Commissioner. The payer must notify the Commissioner when it refunds the payee, or the Commissioner and the payee if the payer hasn't refunded the amount by 20 April.

- A multi-rate PIE that does not pay the tax liability in relation to its investors correctly may adjust the error within 1 month of discovery. Adjustments made in the tax year following the year in which the error was made are subject to a threshold requiring that the total adjustments are no more than the greater of:
  - 2,000; or
  - 5% of the income tax liability of the PIE.
- Where the Commissioner notifies a payer of investment income that a payee is using the incorrect RWT rate, the Commissioner must also notify the payee at the same time.

Application date

The amendments apply from 1 April 2020 (can also apply to investment income payers who have voluntarily adopted monthly reporting from 1 April 2019).

Detailed analysis

Error correction mechanism – underpayments of tax on passive income

Section RA 11 has been amended to allow payers of resident passive income and non-resident passive income who, through an error, have not withheld enough tax from a payment, to correct the error (subject to some limits) without the imposition of penalties or interest.

The investment income payer may correct the error by:

- subtracting an amount from a later payment to the payee;
- recovering an amount from the payee; or
- for a non-cash dividend, adjusting the amount that is subject to tax.

Limits on error correction

For an error discovered in the tax year it was made, the payer must correct the error by the next reporting date for the investment income information relating to the payee.

For an error discovered in the following tax year (year 2), the payer may make an adjustment in year 2[12] to correct the error in year 1, provided the total adjustments made in year 2 relating to errors made in year 1 do not exceed the greater of:

- $2,000; or
- 5% of the payer's withholding liability for RWT or NRWT, as applicable.

Notifying the Commissioner of adjustments

The payer must notify the Commissioner of an adjustment made in the following year when it is made, outlining the details of the investor and the amount of the adjustment. No notification is required for an adjustment made in the year in which the error occurred.

Error correction mechanism – overpayments of tax on passive income

Section RA 12 has been amended:

- to provide an error correction mechanism for when a payer withholds an excess amount of NRWT;
- to correct a drafting error which had the effect of refunding the overpayment of tax twice;
- to require the payer to notify the Commissioner where the amount was refunded to the payee, and to notify the Commissioner and the payee where the amount wasn't refunded.

Error correction mechanism for multi-rate PIEs

Section HM 48 has been amended to allow a multi-rate PIE that has not paid the correct tax liability of an investor to adjust the investor's accruing tax liability in the fund, within 1 month of discovery, in order to correct the error. An adjustment may be made in the year the error is made without limit. An adjustment to correct the error may only be made in the following year provided the total of all adjustments made in year 2 to correct errors in year 1 are no more than the greater of:

- $2,000; or
- 5% of the income tax liability of the PIE for year 1.

[12] Except for an adjustment that recovers the amount from the payee.

Section HM 48(7) ensures that an adjustment that meets the above requirements is not subject to penalties or interest as it is treated as being made on the due date for the original tax payment.

The PIE must notify the Commissioner at the time of making an adjustment in year 2, outlining the details of the investor and the amount of the adjustment.

Tax payments arising from an error

Sections RA 15(5) and RA 15(6), which required the investment income payer who had underpaid tax as a result of an error, to pay that tax to Inland Revenue no later than 20 April after the end of the tax year, have been repealed.

Section RA 11 provides that an underpayment error can be corrected by subtracting an amount from a subsequent payment to the payee. This amount is then paid to the Commissioner at the relevant reporting date for the subsequent payment, which is the 20th of the following month per section RA 15(2).

Where the payer has recovered the amount from the payee directly, this should be reflected in a subsequent report.

Error correction notification

Section 25A has been renumbered to section 26B and extended to provide that where the Commissioner notifies a payer of investment income that a payee is using the incorrect RWT rate, the Commissioner must also notify the payee at the same time.

Section 25O – correction of errors in investment income information

New section 25O provides that a payer may make an adjustment under sections RA 11 or RA12 of the Income Tax Act 2007 in order to correct errors relating to RWT or NRWT.

Section 227E – Transitional provision: application of investment income information provisions

New section 227E allows payers of investment income to voluntarily apply the error correction provisions from 1 April 2019 if they have also voluntarily adopted monthly reporting.

INCREASING ELECTRONIC FILING

Sections 25F to 25N, 25P, 25Q, 139AA and 142G of the Tax Administration Act 1994

Amendments have been made to require investment income payers to file their investment income information electronically, unless they receive an exemption from the Commissioner, and to impose a non-electronic filing penalty for non-compliance.

Background

The majority of investment income returns used to be paper-based. For returns that were able to be filed electronically, there was no electronic filing threshold to require payers of a certain size to file electronically.

This amendment ensures that everyone, other than those who are genuinely unable to access digital services, files electronically. This will not require payers to purchase software as payers will be able to enter the relevant details into an online form through MyIR. Having to apply to the Commissioner for an exemption may encourage people who may be able to file digitally, but would otherwise choose not to, to do so.

Electronic filing is faster and cheaper in terms of compliance costs for payers of investment income and administrative costs for Inland Revenue, and less prone to errors than paper filing.

Key features

- Investment income payers must provide investment income information to the Commissioner in electronic form and by means of an electronic communication as prescribed by the Commissioner.
- The Commissioner may exempt an investment income payer from the requirement to deliver their investment income information electronically, having regard to:
  - the nature and availability of digital services to the payer;
  - the capability of the payer; and
  - compliance costs the payer would incur in complying.
- An investment income payer who does provide their investment income information to the Commissioner electronically is subject to a penalty of $250, due and payable 30 days after the end of the month in which the payer was required to provide the information to the Commissioner electronically.

Application date

The amendments apply from 1 April 2020 (electronic filing will be voluntary from 1 April 2019).

Detailed analysis

Electronic filing

Sections 25F to 25N require the relevant investment income payer to provide investment income information relating to the recipient they pay income to, to the Commissioner in electronic form and by mean of an electronic communication as prescribed by the Commissioner.

The below table outlines the type of investment income payer required to file electronically, and the applicable section:

Income paid by the payer	Section
Interest	25F
Dividends	25G, 25M (in relation to emigrating companies)
Royalties paid to non-residents	25H
Māori authority distributions	25I
Attributed portfolio investment entity (PIE) income	25J and 25K[13]
Interest with no withholding obligation that is allowed as a deduction	25N

Exemption from electronic filing

Section 25P allows the Commissioner to exempt an investment income payer from the requirement to deliver their investment income information electronically. In determining whether to exempt a payer, the Commissioner must have regard to:

- the nature and availability of digital services to the payer, in particular whether the services are reliable;
- whether the payer is capable of using a computer; and
- whether the cost the payer would incur in delivering investment income information electronically would be reasonable in the payer's circumstances.

The Commissioner will publish guidelines on how the exemption will apply.

Non-electronic filing penalty

Section 139AA imposes a non-electronic filing penalty of $250 on payers of investment income who are required to but do not file their investment income information in the prescribed electronic form.

The Commissioner has discretion not to impose non-electronic filing penalties if it is necessary because of resource constraints during the period of co-existence between Inland Revenue's old and new software platforms, and the non-compliance is not serious or unreasonable.

This enables the Commissioner to take an educative rather than a punitive approach during the early stages of the investment income regime while taxpayers are still getting used to the new requirements, and also ensures that Inland Revenue does not need to build software into its existing computer system to administer the penalty when taxes will soon be administered in a new system. Non-electronic filing penalties will still be imposed during the period of co-existence where the investment income payer is deliberately non-compliant or otherwise behaves unreasonably.

The non-electronic filing penalty is payable 30 days after the end of the month in which the payer was required to provide the information to the Commissioner electronically, per section 142G.

Setting electronic and non-electronic filing requirements

Section 25Q requires the Commissioner to prescribe an electronic form and means of electronic communication for the delivery of investment income information, as well as a form of delivery other than by electronic means. The Commissioner may also set specifications for software used in the delivery of investment income information.

[13] Note that electronic filing was already a requirement for PIEs, prior to the enactment of this legislation.

IMPROVING THE ADMINISTRATION OF RWT EXEMPT STATUS

Sections RE 27, RE 29 and YA 1 of the Income Tax Act 2007, sections 32H and 32L of the Tax Administration Act 1994

Amendments have been made to create an electronic database of persons exempt from RWT.

Background

Issues and cancellations of certificates of exemption from RWT were previously published in the *New Zealand Gazette* each quarter. Payers of investment income would need to receive a certificate of exemption from their customers, and check the *Gazette* periodically to ensure it remained valid. The *Gazette* did not adequately reflect all taxpayers who were exempt, as taxpayers exempt under other Acts did not need to apply for a certificate of exemption to be treated as exempt.

This amendment allows for a real-time source of information to enable payers of investment income to easily check whether a customer is exempt from RWT, including customers exempt under other Acts.

Key features

- Payers of investment income are able to determine whether a payer is exempt from RWT by searching an electronic database.
- Terminology change from "certificate of exemption" to "RWT-exempt status".
- RWT-exempt status holders must notify their investment income payer of their status and a change in their status.
- Taxpayers exempt from tax under other Acts (i.e. not the Tax Acts) must apply for RWT-exempt status in order to be exempt from RWT.
- The Commissioner must add a person who has applied and meets the requirements for RWT-exempt status to the electronic register.

Application date

The amendments apply from 1 April 2020.

Detailed analysis

Persons with RWT-exempt status

Section RE 27 has been amended to require a person with RWT-exempt status to notify their investment income payer of their status and a change in their status. It also rolls –over the RWT-exemption certificate requirements – for example, when a person may apply for an exemption and when the exemption is no longer valid, but changes the terminology to RWT-exempt status.

Establishing whether persons have RWT-exempt status

Section RE 29 has been amended to provide that a payer of investment income may establish that a person has RWT-exempt status by searching the electronic register. This is in addition to the existing methods such as the payer taking reasonable steps to confirm that the person is a person listed in section 32E(2)(a) to (h) of the Tax Administration Act 1994.

Taxpayers exempt under other Acts

Income that is exempt under other Acts has been removed from the definition of "exempt interest" in section YA 1. This ensures that recipients of investment income that are exempt under other Acts will need to apply for RWT-exempt status in order to be treated as exempt from RWT.

This income is still exempt from income tax so even if the recipient did not apply for RWT-exempt status and RWT was deducted, the RWT would be refundable at the end of the tax year.

RWT-exempt status when persons meet requirements

Section 32H of the Tax Administration Act 1994 has been amended to require the Commissioner, when a person meets the requirements for RWT-exempt status and applies to the Commissioner, to add the person's tax file number, start date and, if applicable, end date of their exemption to the electronic register of persons with RWT-exempt status. Section 32H has also been amended to provide:

- a person's exemption takes effect on the start date provided in the register, and remains current while their details appear on the register; and
- a person who holds an existing RWT certificate of exemption will be treated as having RWT-exempt status if their name appears on the electronic register of persons with RWT-exempt status. This enables a person with an RWT-exemption certificate to continue to receive an exemption without having to re-apply.

Revocation of RWT-exempt status

Section 32L of the Tax Administration Act 1994 has been amended to remove the requirement to publish a list of cancellations in the Gazette and replaces it with the requirement that the Commissioner publish on the electronic register a list of persons whose RWT-exempt status has been revoked.

TERTIARY EDUCATION SUBSIDIARIES AND RWT-EXEMPT STATUS

Section 32E of the Tax Administration Act 1994

Section 32E of the Tax Administration Act 1994 has been amended to ensure Tertiary education subsidiaries qualify for RWT-exempt status.

Background

Tertiary education institutions (TEI) and subsidiaries that applied their income for the purposes of the TEI were generally income tax exempt as charities until 1 July 2008, when a requirement was introduced for charities to be registered with the Charities Commission[14] in order to be tax exempt. Because the TEIs would have been subject to multiple reporting and monitoring requirements, a specific exemption was enacted for them in section CW 55BA, but this did not cover their subsidiaries.

To restore the position that existed for tertiary education subsidiaries (TES) before the original enactment of section CW 55BA, the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act widened the exemption to include TESs.

There was an unintended gap in the legislation as there is a specific provision (section 32E(2)(kc) of the Tax Administration Act 1994) that allows a TEI to apply for RWT-exempt status, but no provision for TESs. This meant that unless a TES was able to qualify for RWT-exempt status on other grounds (such as turnover exceeding $2 million), they would be unable to qualify for RWT-exempt status. It was not intended than an entity exempt from tax would be unable to apply for an exemption from withholding tax.

Key features

A tertiary education subsidiary that derives exempt income under section CW 55BA of the Income Tax Act 2007 may apply to the Commissioner for RWT-exempt status.

The Commissioner will not grant TEIs with retrospective RWT-exempt status.

Application date

This amendment applies from 1 July 2008, in order to validate any certificates of exemption that may have been issued to TEIs.

REMOVING SOME REQUIREMENTS TO PROVIDE END-OF-YEAR WITHHOLDING TAX CERTIFICATES

Section 26C of the Tax Administration Act 1994

The Tax Administration Act 1994 has been amended to remove the requirement for payers of interest to provide RWT withholding certificates to recipients that have provided the payer with their IRD number.

Background

Previously, payers of interest (or dividends treated as interest and dividends subject to section RE 92(2)) were required to provide RWT withholding certificates to recipients at the end of the year. The recipient then included the information in their tax return.

The new changes to the administration of investment income will mean that Inland Revenue will be able to make this information available on the person's MyIR account, removing the need for the investment income payer to send out RWT withholding certificates.

Certificates would still need to be provided to customers who had not supplied an IRD number, as otherwise Inland Revenue may not be able to match the income to the correct person. It would also highlight to these people that they are subject to the higher non-declaration rate, which may prompt them to file a tax return.

[14] Now Charities Services – Department of Internal Affairs.

Key features

Section 25 of the Tax Administration Act 1994 has been renumbered to section 26C and amended to remove the requirement for payers of investment income to provide RWT withholding tax certificates to recipients of interest (or dividends treated as interest and dividends subject to section RE 9(2)) that have provided their IRD number to their investment provider. However, payers of investment income will be free to issue RWT withholding tax certificates to their customers if they wish.

Application date

The amendments apply from 1 April 2020.

RECORD KEEPING REQUIREMENTS

Section 22AAB and Schedule 3 of the Tax Administration Act 1994.

The Tax Administration Act 1994 has been amended to extend the record keeping requirements to payers of income subject to NRWT.

Background

Previously, payers of income subject to RWT were required to keep records in relation to the payment, but there was no such requirement for income subject to NRWT.

Key features

- Section 26 of the Tax Administration Act 1994, which contained the record keeping requirements for RWT, has been repealed.
- New section 22AAB now contains the record keeping requirements, which have been extended to include NRWT as well as RWT.
- The information the investment income payer must keep on record is contained in new schedule 3, table 2 of the Tax Administration Act 1994, and includes information such as the name, tax file number, address and date of birth (if held by the payer) of the taxpayer who received the income, the amount and type of income, the tax withheld from that income and the date on which it was withheld.

Application date

The amendments apply from 1 April 2020.

EVIDENTIAL REQUIREMENTS FOR TAX CREDITS

Section 78D of the Tax Administration Act 1994

The Tax Administration Act 1994 has been amended to only require evidence of a tax credit from taxpayers who have not provided their IRD number to their investment income payer.

Background

Section 78D required a taxpayer who had a tax credit to provide the Commissioner with a shareholder dividend statement, RWT withholding certificate, or Māori authority distribution statement, depending on the tax credit being claimed.

This is no longer appropriate for declared taxpayers as Inland Revenue will be receiving information from payers of investment income on the amount of income a taxpayer has earned and the tax that has been withheld from that income, and will therefore know the amount of credit the taxpayer is entitled to.

Key features

Section 78D of the Tax Administration Act 1994 has been amended to only require taxpayers who have not provided their IRD number to their investment income payer to provide the Commissioner with evidence of their tax credit.

Application date

The amendments apply from 1 April 2020.

Modernising tax administration – Other items

FBT RETURNS – TRANSITIONAL RULE FOR DATE OF RETURN UNDER CLOSE COMPANY OPTION

Section 46C of the Tax Administration Act 1994

Under the close company option in section 46C(3) of the Tax Administration Act 1994, the due date for filing and paying fringe benefit tax (FBT) is the employer's income tax terminal tax date. If an employer is linked to a tax agent with a valid extension of time arrangement for their clients the employer generally has a two month later terminal tax date. However, the Commissioner can refuse or cancel an extension of time for individual clients and returns of a tax agent under section 37(4A) of the Tax Administration Act 1994. In this case that employer's return(s) has the standard earlier terminal tax date.

Inland Revenue is in the process of transitioning from its current software platform for administering the tax system (FIRST) to the new platform, START. The administration of FBT will be migrated to START ahead of income tax which is planned to follow about a year later. During this time the co-existence of the two platforms will not allow the relevant information to determine the filing date and due date for FBT purposes in these specific circumstances to be extracted from one platform and applied in the other. The new measure addresses this issue.

Key features

Section 46C of the Tax Administration Act 1994 has been amended to include a transitional rule that allows for a two month later due date under section RA 13(2)(a)(i) of the Income Tax Act 2007 for the filing and payment of FBT under the close company option as though the employer would benefit from their tax agent's existing extension of time arrangement.

The transitional rule applies during the period of co-existence under the following circumstances:

- The employer chooses to file and pay FBT under the close company option in section 46C(3) of the Tax Administration Act 1994;
- The employer's income tax return is linked to a tax agent under section RA 13(4) of the Income Tax Act 2017;
- The employer's tax agent has a valid extension of time arrangement under section 37(4) of the Tax Administration Act 1994; and
- The Commissioner has refused to grant or has cancelled the extension of time arrangement for the employer's individual income tax return(s) under section 37(4A) of the Tax Administration Act 1994.

Application date

The transitional rule is treated as coming into force on 1 April 2016 and applies to relevant FBT returns for the 2017/18 tax year onwards and will remain in place for the duration of the transitional period of co-existence.

SETTING A NEW DUE DATE FOR DEFAULT ASSESSMENTS

Sections 142A and 142B of the Tax Administration Act 1994

The amendments bring the two different types of default assessment under the same rules to reduce confusion and simplify the rules.

Background

Section 142A of the Tax Administration Act 1994 sets different due dates for payment of an Electronic Default Assessment (EDA) and Non-electronic Default Assessment (NDA). There are also different treatments for any tax payable from a subsequent amendment to that default assessment.

Key features

New section 142AB aligns the due date for payment of tax for default assessments, whether these are made manually or electronically.

There is no reason why these treatments should be different; taxpayers can be confused about which payment rules apply.

The amended rules will only apply when the default assessment relates to a tax type that has been migrated to Inland Revenue's new START technology system, and when incremental penalties do not apply to the particular tax type.

Application date(s)

The amendments will apply on a date appointed by the Governor-General by Order in Council, and one or more orders may be made appointing different dates for different tax types and purposes.

However, the rules will apply to all taxes from 1 April 2023 at the latest.

Detailed analysis

The previous treatment

Section 142A sets different due dates for payment of an EDA and NDA.

For an EDA:

- The amount payable from the default assessment is due on the original due date for the tax type and period. This means that if the EDA is made after the original due date, as is always the case for GST, late payment penalties will be immediately applied, back-dated to the original due date.
- When the EDA is amended, a new due date will be set that is at least 30 days following the notice advising the taxpayer of the new amount to pay. Therefore, any late payment penalties applied to the EDA will be reversed, and the taxpayer will not be penalised further unless they do not pay any amount due by the new due date.

Example

Horribear Ltd the maker of zombie teddy bears is due to file its GST return for the period ending 31 March 2017 on 28 April 2017. Because of an increasing demand for the new Demon Teddy range, Horribear forgets to file the return in its attempts to produce more Demon bears.

Because the return is unfiled, the Inland Revenue computer system automatically applies an EDA of $1,000 on 14 May 2017. The due date for the EDA is 28 April 2017, so immediately retrospective penalties are applied on the amount of the EDA, with effect from the day after the original due date.

Horribear then files the return on 30 May 2017, and the information from that return is used to replace the EDA with a new assessment of $1,500 to pay.

The taxpayer is given at least 30 days – until 30 June 2017, to pay the $1,500 assessment. There are no back-dated penalties unless they do not pay by the new due date.

For an NDA:

- The amount payable from the default assessment is due at least 30 days from the notice of assessment.
- If the assessment is subsequently amended, then the taxpayer is only given a new due date for any amount payable that is greater than the amount previously payable from the NDA. This new due date will also be at least 30 days after the notice advising the taxpayer of the additional tax to pay.

Example

Dream Liner Ltd, a manufacturer of scented industrial bin liners, is due to file its GST return for the period ending 31 March 2017 on 28 April 2017.

An Inland Revenue investigator decides to make a Commissioner's assessment of $1,000 on 14 May 2017 due to Dream Liner not having filed a number of returns, including this one. Dream Liner is given a due date to pay the $1,000 on 15 June 2017.

The taxpayer then files its return, and the information from the return is accepted as an amendment to the NDA on 30 June 2017, with the resulting assessment being $1,500 to pay.

The $1,000 from the NDA is still due as of 15 June 2017, and the taxpayer is given a new due date of 30 July 2017 to pay the additional $500 of the increased assessment.

The new treatment

New section 142AB will apply to set a new due date for certain assessments. Section 142AB will not apply to assessments made in the absence of a return and to which section 106(1) applies. Section 106 deals with the issue of default assessments, both electronic and non-electronic.

NEW LEGISLATION

Section 142A, which applies to tax types that proposed section 142AB does not apply to, has application to assessments other than EDAs made in the absence of a return and to which section 106(2) applies, which relates to EDAs only. Section 142AB removes this distinction entirely so that no new due date is set for any default assessment, manual or automatic.

In addition, proposed section 142AB does not set a new due date for an increased assessment from a default assessment. This will mean that any subsequent amendments to a default assessment will be due at the original due date. This change reflects the fact that no return was originally filed and removes a benefit to those who do not file compared with those who do file returns and pay tax on time.

Example

Using the facts in the Dream Liner Ltd example above, Dream Liner is due to file its GST return for the period ending 31 March 2019 on 28 April 2019. GST is a tax which has migrated to START and has had incremental penalties removed.

An Inland Revenue investigator decides to make a Commissioner's assessment of $1,000 on 14 May 2019 due to Dream Liner not having filed a number of returns. Section 142AB will not apply to this default assessment and the tax will be due on the original due date of 28 April 2019.

The taxpayer then files its return, and the information from the return is accepted as an amendment to the NDA on 30 June 2017, with the resulting assessment being $1,500 to pay.

Again, section 142AB will not apply as the reassessment relates to the reassessment of a default assessment and thus the $1,500 from the reassessment is still due on the original due date for the tax, 28 April 2019.

Example

Carrying on from the Horribear Ltd example above, in the 2019 year Horribear has a GST review performed by Inland Revenue on its GST return for the period ended 31 March 2017.

Inland Revenue discovers that Horribear has understated its GST output tax for the period by $500. The investigator issues a reassessment for the period to reflect the increase in GST payable.

Assuming that GST has been migrated to the START system and that no incremental penalties apply to GST, section 142AB will apply to the reassessment as it is not a reassessment of a default assessment and therefore a new due date can be set for the payment of the extra GST. The due date for the tax is set for at least 30 days after the reassessment.

THE DATE INTEREST STARTS

Section 120C of the Tax Administration Act 1994

This amendment reduces the number of working days referred to in the definition of "date interest starts" from 15 working days to 10 working days because of the migration of GST to Inland Revenue's START system. This will mean taxpayers who have a GST refund and file early will have use of money interest (UOMI) calculated on that refund earlier than they would under the old rule. This reflects efficiencies in processing time for GST returns in the new START system.

Key features

Section 120C of the Tax Administration Act 1994 outlines the date on which UOMI is calculated from. Specifically, in the definition of "date interest starts", paragraph (c) outlines the date on which a GST refund begins to accrue UOMI. With the migration of GST to Inland Revenue's START system, and the efficiencies this creates, it is now possible to reduce the time before UOMI begins to accrue on GST refunds from 15 working days to 10 working days.

Application date(s)

The application dates is for GST periods ending on or after 1 April 2018.

Detailed analysis

Under the current rules the definition of "date interest starts" in section 120C(c) outlines the date at which interest commences to accrue on a GST refund. This is the latest of:

(i) the day after the earlier of:

(A) the 15th working day after the taxpayer provides a tax return for the return period to which the GST refund relates; and

(B) the original due date for payment of output GST in respect of that return period; and

(ii) the day after the day on which the tax return is provided.

Example

The Drake Ltd operates a bar specialising in vegan cocktails. Due to the strong demand for vegan cocktails The Drake files its GST return monthly but for the month of June 2018 it has a GST refund, due to a large number of purchases made that month getting ready for the Vegan July festival and files its GST return before the due date of 28 July.

The GST return is filed on 7 June 2018. Interest will start accruing to The Drake 15 working days after that, being 28 June if it has not been refunded.

Because of efficiencies in processing GST returns through Inland Revenue's business transformation it is now possible to reduce the 15 working day delay in paying interest in section 120C(1)(c) which will enable taxpayers to earn UOMI sooner when a refund is delayed.

Example

Using the facts from The Drake example above, under the proposed rule The Drake would earn UOMI on its refund from 21 June rather than the 28th under the old rules.

THE DATE AN EXCESS CREDIT ARISES

Section 173L of the Tax Administration Act 1994

There are currently rules within section 173L of the Tax Administration Act 1994 , and in particular section 173L(2), which outline the earliest date that taxpayers are able to transfer all or part of an excess credit. The current rules do not appropriately deal with taxpayers who file their returns early or late. The proposed amendment alters the date a credit arises in respect of goods and services tax (GST) to better reflect when a taxpayer files their return as this is the date that establishes the amount of the credit.

Key features

The date that a credit arises for a taxpayer in respect of GST will change to more closely reflect the date the taxpayer files their return, as this is the day that the amount of the credit is established. For taxpayers who file their GST return on time there will be no change from the current position and the credit will arise the day after the end of the GST return period in which the refund arose.

For those taxpayers who file their return before the due date, the refund will be available on the earlier of:

- the day after the date on which the return is filed; or
- the day after the end of the GST period to which the refund relates.

For taxpayers who file after the due date, the refund will be available on the day after the date the return is filed.

These rules provide that transfers must occur on these dates. There is no change to the effective date for a transfer between non associated taxpayers.

Application date(s)

This amendment applies from 1 April 2018.

Detailed analysis

To more closely align the calculation of the refund with its availability to taxpayers, this section alters the current rules around when the excess tax is available to be used by a taxpayer by moving this date closer to when the return is filed.

For taxpayers who file their GST return on time, the proposed new rules will not change the current date on which a credit is available. These new rules will only affect taxpayers who file their returns early or late.

For taxpayers who file early the date the excess tax becomes available will be the earlier of:

- the day after the date on which the return is filed; or
- the day after the end of the GST return period in which the refund arose.

This will mean that a GST credit will be available to a taxpayer on the day after a GST return is filed if that return is filed before the end of the taxable period. This situation will be rare but may be when a business is closing down and files a return until the date of cessation.

In this situation the credit will be available to the taxpayer the day after the return is filed or the end of the GST return period, whichever is earlier.

Example

Scotty Cycles Ltd sells spin bikes to gyms. They are in an unusual position for the two-month GST period ending 30 June 2018. They have imported a large number of spin bikes and associated parts on 1 June 2018 from the United States for a large order for a leading New Zealand chain of gyms. It will take the rest of the month of June to assemble and test the bikes before they are handed over to the buyer.

Scotty works out that the company will have no other GST credits arising for the rest of the month and it will have no output tax to return. Because of the timing of the sale and the supply of the bikes, Scotty has a GST refund arising for the June period and would like to transfer the refund as soon as possible to pay some other tax liabilities. Scotty completes and files its GST return online through its accounting software on 5 June.

The credit is processed by Inland Revenue and is available for Scotty to transfer on 6 June.

Conversely, for taxpayers who file after the due date, the credit arising will only be available to them once the credit has been established, which is when they file their return for the GST period in question.

Example

Campbell's Hemp Emporium Ltd is a company that sells products made of hemp. It files its GST on a two-monthly basis with the next return due on 28 September 2018. In October 2018 Campbell has a strong upturn in the sale of hemp swimwear as people gear up for the summer season. Because the company is busy making hemp swimwear, Campbell, the owner, forgets to file his 30 September GST return. He realises this in November and files his September return on 18 November. His calculation is a refund amount of $3,000. This credit is available to Campbell's Hemp Emporium Ltd on 19 November.

TRANSFER OF OVERPAID TAX FROM AIM TAXPAYER TO SHAREHOLDERS – EXTENSION OF THE AGENCY MECHANISM

Sections HB13B, RC 35B of the Income Tax Act 2007 and 120LB of the Tax Administration Act 1994

These sections make changes to the way in which an company which uses the accounting income method can transfer overpaid tax to its shareholders. It expands the agency mechanism to allow the transfer of overpaid tax to reduce a shareholders residual income tax amount. It also makes consequential changes and clarification to the transfer mechanism that was previously enacted to facilitate the transfer of overpaid amounts.

Background

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a new provisional tax method called the accounting income method (AIM) which allows certain taxpayers to pay tax as they earn their income using accounting software.

That Act contained a mechanism to allow an AIM entity to transfer to shareholder-employees overpaid provisional tax where shareholder-employee remuneration has not been permitted as a deduction to the company during the year.

This mechanism has the disadvantage of leaving the shareholders of an AIM entity in the provisional tax regime notwithstanding the tax owing on the income may have been fully paid by the entity as a result of the non-deductibility of the shareholder-employee provision.

Key features

These amendments allow an AIM company to act as agent for the shareholder-employees for the purpose of the definition of residual income tax only. This will enable a company using the AIM provisional tax method to make tax payments on behalf of shareholder-employees that will reduce their residual income tax for the year and as a consequence could remove them from provisional tax.

Application date(s)

This amendment applies from the 2018–19 income year to align with the introduction of the AIM provisional tax method.

Detailed analysis

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a new provisional tax method called the accounting income method (AIM) which allows certain taxpayers to pay tax as they earn their income using accounting software.

That Act contained a mechanism to allow an AIM entity to transfer to shareholder-employees overpaid provisional tax where shareholder-employee remuneration has not been permitted as a deduction to the company during the year.

This mechanism has the disadvantage of leaving the shareholders of an AIM entity in the provisional tax regime notwithstanding the tax owing on the income may have been fully paid by the entity as a result of the non-deductibility of the shareholder-employee provision.

These amendments clarify the transfer mechanism and also treat the AIM entity as being the agent for a shareholder-employee where it makes a payment on behalf of the shareholder-employee.

This agency arrangement will allow the transfer of overpaid tax from the AIM entity to the shareholder as a tax credit that can reduce the shareholder-employee's residual income tax and has the benefit of potentially removing the shareholder-employee from provisional tax if sufficient tax is deducted to reduce the shareholder-employee's residual income tax to below the threshold for provisional tax.

Example

Archer Coaching Limited (Archer) provides career coaching to the middle aged. Garry the sole shareholder and employee runs individual and group coaching sessions for the middle aged. Because of the seasonal nature of the work Garry decides to put Archer on the accounting income method for paying provisional tax to account for those seasonal differences.

Each year Archer pays out all of its income as salary to Garry. Archer decides to pay tax on that salary as part of it's AIM instalments and pays tax based on Garry's marginal tax rates following the guidance in the AIM determination that deals with provisions (Determination A9). At the end of the year Archer has overpaid tax due to paying all its profits to Garry.

It decides to transfer that overpaid tax to Garry to cover his tax liability on the income. Because section HD 13B treats Archer as Garry's agent for the purposes of that tax paid. Garry is able to reduce his residual income tax by the amount of that tax credit. At the end of the year Garry has no tax to pay as the amounts paid by Archer fully cover his tax liability on the income. Due to this Garry will not be a provisional taxpayer for that year.

CLARIFY THE DEFINITION OF "PROVISIONAL TAX ASSOCIATE"

Section 120KBB of the Tax Administration Act 1994

This amendment clarifies the definition of "provisional tax associate" that was inserted into the Tax Administration Act 1994 as part of section 120KBB by the Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017. It clarifies that the provisional tax associate rule does not apply in relation to two natural people.

Background

Since the introduction of the definition of "provisional tax associate" a number of external parties raised an issue that the wording of the provision could be read as requiring two natural persons who are associated to use the same provisional tax method. This was not intended.

The uncertainty relates to subparagraph (iii) of the definition in section 120KBB(4), which can arguably be read as requiring two natural persons to use the same provisional tax method. It was only intended that this test consider the association between a company and another person.

Key features

This amendment clarifies that the definition of "provisional tax associate" should only test the association between a company and another person, and does not apply between two natural persons.

Application date(s)

This amendment applies from the 2017/18 income year which is the same application date as the original provision.

CLARIFY THAT TAXPAYERS WHO HAVE A TRANSITIONAL YEAR CAN USE THE CONCESSIONARY PROVISIONS OF SECTION 120KBB OF THE TAX ADMINISTRATION ACT 1994

Section 120KD of the Tax Administration Act 1994

Background

During the select committee stages for the Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017 it was agreed that taxpayers who had a transitional year should be able to use the concessionary use of money interest rules in section 120KBB. A wording change was made to the bill which was considered to be sufficient to permit this. This does not appear to have been the case.

Feedback has been received that it is not clear that a provisional taxpayer who has a transitional year but otherwise meets the requirements of section 120KBB of the Tax Administration Act 1994 can use the concessionary interest treatment in section 120KBB.

Key features

This provision inserts new subsection (1B) to section 120KD of the Tax Administration Act 1994 which relates to the use of money interest calculation for taxpayers who are in a transitional year to clarify that those taxpayers who can use section 120KBB should use that section to determine their use of money interest liability and not section 120KD.

Application date(s)

Because this amendment is clarifying the original intent of the legislation it will apply from the 2017-18 income year which is the date that section 120KBB originally applied.

REMOVE NEW PROVISIONAL TAXPAYERS WHO HAVE A TRANSITIONAL YEAR FROM THE ABILITY TO USE THE CONCESSIONARY PROVISIONS OF SECTION 120KBB OF THE TAX ADMINISTRATION ACT 1994

Section 120KD of the Tax Administration Act 1994

Background

New provisional taxpayers cannot use the concessionary rules for the application of use of money interest in section 120KBB of the Tax Administration Act 1994. They must use the rules for new provisional taxpayers in section 120KC.

However, taxpayers who have an initial provisional tax liability and who also have a transitional year are dealt with under section 120KD as that section applies to taxpayers who have an initial provisional tax liability and a transitional year.

This means that currently a new provisional taxpayer who also has a transitional year will be permitted to use the concessionary rules in section 120KBB, but a new provisional taxpayer who does not have a transitional year cannot use the concessionary rules.

This was not intended and the use of money interest treatment of new provisional taxpayers should be consistent, whether the taxpayer has a transitional year or not.

Key features

This provision amends section 120KD(1B) to the Tax Administration Act 1994 which relates to the use of money interest calculation for taxpayers who have a transitional year, to clarify that taxpayers who have a transitional year and are a new provisional taxpayer must use section 120KD to calculate their use of money interest liability and not section 120KBB.

Application date(s)

This provision will apply from the 2018-19 and later income years. Although the previous position was unintended, the later application date will ensure taxpayers who have made provisional tax payment decisions based on the pre-amended wording of the Act are not adversely affected by the change.

ACCOUNTING INCOME METHOD AND STUDENT LOANS

Section 84 of the Student Loans Scheme Act 2011

Background

The Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017 enacted in February 2017 provided for a new provisional tax method called the accounting income method ("AIM"). The legislation did not correctly provide for those taxpayers who use AIM but also make student loan payments with their provisional tax payments.

Currently the legislation provides for student loan repayments to be made along with AIM payments which could be from 6 to 12 payments per year. However, these repayments can only be accepted by Inland Revenue systems from provisional taxpayers three times a year.

Key features

This provision amends section 84 of the Student Loan Scheme Act 2011 to include the AIM method in subsection 84(2)(a) which requires payments on student loans to be made by provisional taxpayers using the GST ratio, and now the AIM method, to make repayments on three dates during the year.

Application date(s)

This amendment will apply for the 2018-19 income year, which is the same year that taxpayers are able to use the AIM method.

TRANSFERRING PAYE CREDITS TO SHAREHOLDER-EMPLOYEES

Sections LA 6 and LB 1B of the Income Tax Act 2007

Background

The Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017 enacted in February 2017 provided for two new classes of schedular payments; payments under labour hire arrangements made by labour hire firms and voluntary schedular payments. In both these classes, payments made to individuals or a company are subject to withholding tax under the schedular payment rules.

When these rules were introduced, no changes were made to enable the transfer of any tax credits associated with the schedular payment to the company's shareholder-employee(s) where the income related to the schedular payment was passed to them either through the attribution rules in section GB 29 or the shareholder salary provisions in section RD 3B(1)(b) and RD 3C(1)(b).

The new rules enable certain close companies to transfer their schedular payment tax credits to the company's shareholder-employee(s) and will apply when a deduction is made from schedular payments made to a company, and that company subsequently allocates or pays a shareholder-employee salary without tax deducted to its shareholder-employee(s) under the provisions in sections RD 3B or RD 3C or where the income is attributed to them under section GB 29.

Key features

This provision inserts new section LB 1B to the Income Tax Act 2007. This provides for the transfer of any excess schedular payment tax credits to a shareholder-employee where the company attributes income to that shareholder-employee under section GB 29 (Attribution rule) or pays a shareholder salary under sections RD 3B(1)(b) or RD 3C(1)(b).

Application date(s)

Because this amendment is clarifying the original intent of the legislation it will apply from 1 April 2017 which is the date that schedular payments were provided for in respect of labour hire firms.

Detailed analysis

Generally, a schedular payment made to a company is not liable for withholding tax because it does not fall within the definition of "schedular payment" in section RD 8[15]. The new schedular payment classes introduced last year[16] are liable for withholding tax, even if the recipient is a company[17]. This created an issue for companies that received schedular payments which had tax deducted, where the income of the company was ultimately either paid out to the company's shareholder-employee(s) as a shareholder-employee salary without tax deducted[18], or attributable via the personal services attribution rule[19], as the shareholder-employee(s) of the company were not able to claim the tax credits corresponding to the company's schedular payments.

This may have resulted in the company's shareholder-employee(s) being required to pay provisional tax in relation to income which had already been taxed at the company level, despite the company having excess tax credits which could be used to satisfy the tax liability.

This amendment allows a closely held company to transfer any excess tax credits to the company's shareholder-employee(s) who have received a shareholder-employee salary without tax deducted from the company or where an amount of income has been attributed under the personal services attribution rule. This is likely to reduce the likelihood of the company's shareholder-employee(s) being liable for provisional tax, despite having received income without tax deducted.

Example

Toasties by Ben Limited (TbB) is a company owned by Ben that provides specialised toastie sandwich making services. Smith's Hospitality Services Limited (SHS) provides labour hire services to various companies in the hospitality industry. SHS contracts with TbB to provide services to a third party. The total amount paid under the contract between SHS and TbB is $60,000. Under the new labour hire rules this amount is a schedular payment and must have tax deducted from it. TbB chooses a tax rate of 28% as this is Ben's estimate of the amount of tax he will need to pay. 2018 turns out to be a bad year for the demand for Toasties due to the growth in people who are gluten free. It turns out that this is the total income for TbB for the year.

At the end of the year, TbB decides to pay out the $60,000 of income received from SHS to Ben as a shareholder-employee salary under section RD 3B(1)(b). TbB claims a deduction for that amount and has zero income for the year. This results in the company having excess tax credits for the year of $16,800 (ie, $60,000 × 28%).

When filing its 2018 income tax return, TbB allocates that amount of excess credits to Ben to reduce the tax payable on his income for the year. Ben has no other income and when he completes his tax return calculates that the tax payable on his income of $60,000 is $11,020 which he can offset the credit transferred from the company against ($16,800). Because he has chosen a withholding tax rate that is too high, he has excess tax credits which can then be refunded to him.

The amount transferred to the shareholder-employee is a tax credit in their hands under section LB 1. The company's tax credit is reduced by the amount transferred to the shareholder employee. The transfer will also cause a debit to the company's imputation credit account of the amount transferred, which effectively reverses out the original credit (to the extent of the transfer).

[15] There are a number of exceptions to this general rule including companies in the agricultural, viticultural and horticulture industries.

[16] Payments made by labour hire firms in some circumstances, and voluntary withholding agreements

[17] Unless the company has a 0% special tax rate certificate from Inland Revenue

[18] Such as in the circumstances set out in sections RD 3B and RD 3C of the Income Tax Act 2007

[19] Contained in sections GB 27 to GB 29 of the Income Tax Act 2007

MULTIPLE STATEMENTS AND CO-EXISTANCE WITHIN START

Section 183C of the Tax Administration Act 1994

Background

There are rules within the Tax Administration Act around issuing multiple statements of account and the cancellation of use of money interest (UOMI) when a taxpayer pays the entire amount of tax, penalties and UOMI within 30 days of the issue of the statement.

A rule was added to the provision by the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 which introduced a transitional solution for GST statements when GST was migrated to Inland Revenue's new START technology platform.

The amended rules were designed specifically for GST when it migrated to the new START system, now with the continuation of the business transformation programme, it is necessary to modify the cancellation of interest rules for those taxes which will migrate to START from April 2018.

A clarification is also required to the rules to reflect a modification made to the system which reduces the negative application of the previous amendment. The amendment will also extend to multiple notices of assessment as well as statements of account.

Key features

This provision amends section 183C which deals with the cancellation of interest when multiple statements are issued to taxpayers. This provision extends and modifies a rule that was added by the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 to include new tax types that have been transitioned to Inland Revenue's new technology platform START.

Application date(s)

These amendments will apply to a second statement or assessment that is issued by the Commissioner on or after 1 April 2018.

Detailed analysis

These sections extend and slightly modify the cancellation of interest rules for tax types that have been migrated to START. The extension is for the additional tax types that are being migrated to START in April 2018 and a clarification is also required to the rules to reflect a modification made to the system which reduces the negative application of the previous amendment. The amendments will also extend to multiple notices of assessment as well as statements of account.

The rule defines the period in which interest cancellation will run where multiple statements of account or notices of assessment are issued. The rule only applies where two statements or two notices are issued. The current rules will continue to apply where a notice and a statement are issued in respect of the same liability.

Where a statement of account has been issued (the first statement) and a second statement is issued, interest will be cancelled from the date of the first statement and ending on the date payment is received as long as that is within 30 days of the first statement being issued.

Where a notice of assessment has been issued (the first assessment) and a second assessment is issued, interest will be cancelled from the date of the second assessment and ending on the date payment is received as long as that is within 30 days of the second assessment.

This new cancellation of interest provisions will apply for multiple notices and statements issued after 1 April 2018 for the following taxes:

- GST
- Approved issuer levy
- Resident withholding tax on dividends
- Resident withholding tax on interest
- Non-resident withholding tax
- Residential land withholding tax
- Fringe benefit tax

- Gaming machine duty
- Portfolio investment entities that pay tax on an exit or quarterly basis.

Example

Cobra Engineering Limited (Cobra) is a manufacturer of metal fittings for movie sets. Cobra provides fringe benefits to its staff in the form of discounted models of their famous armour. Cobra accounts for fringe benefit tax (FBT) in respect of the discount on those as well as a number of company cars.

It files its June 2018 FBT return on time showing FBT to pay of $3,500. However, due to a clerical error, Cobra does not make the payment due with the return. Inland Revenue issues a statement of account to Cobra showing the amount owing of $3,500 on the 20th of July 2018 along with $15[20] use of money interest charge and a 5% late payment penalty (1%+4%).

Due to another clerical mix up, Cobra loses this statement and the new accounts payable person requests another statement from Inland Revenue which is issued on the 15th of August 2018 during the period between the issuing of the first and second statements another $12 of use of money interest has been incurred.

On the 16th of August Cobra locates the first statement and makes a payment in full of the amount owing on that statement. On the 18th of August the second statement arrives at Cobra's business premises. Because Cobra has made the payment required in the first statement within 30 days of the date of that statement any interest charged between the date of the first statement and the date of payment will be cancelled, no additional payment will be due by Cobra.

ELECTRONIC FILING REQUIREMENTS FOR REGISTERED PERSONS

Sections 36BD, 139AA, 142G of the Tax Administration Act 1994

New section 36BD of the Tax Administration Act 1994 sets up a framework for compulsory electronic filing of Goods and Services Tax (GST) information for GST-registered persons above a certain threshold. An exemption from the electronic filing requirement is available in certain circumstances. The threshold is set by Order in Council. A non-electronic filing penalty will apply to registered persons who do not comply with their electronic filing requirement.

Key features

New section 36BD of the Tax Administration Act 1994 allows for a threshold to be set, above which registered persons will be required to deliver their Goods and Services Tax returns electronically. The threshold is in relation to the value of taxable supplies of a registered person and is to be set by Order in Council following appropriate consultation.

An exemption to the electronic filing requirement is available for certain circumstances. In determining whether to exempt a registered person from the electronic filing requirement under the new section, the Commissioner of Inland Revenue will take into account the following factors:

- The nature and availability of digital services to the registered person, in particular whether the services are reliable;
- whether the registered person is capable of using a computer; and
- whether the cost the registered person would incur in delivering their GST return electronically would be unreasonable in the person's circumstances.

The Commissioner will publish guidelines on how the exemption will apply.

Section 139AA of the Tax Administration Act 1994 has been amended so that a non-electronic filing penalty of $250 applies for registered persons who are required to file electronically but fail to do so. Section 142G was amended that a non-electronic filing penalty is due 30 days after the end of the month in which the registered person is required to provide the return electronically.

Subsection (1)(a) of section 36BD preserves the option for GST-registered persons below the threshold to voluntarily file electronically.

Application date(s)

The changes came into force on 29 March 2018, being the date of Royal Assent. It will affect relevant registered persons once a threshold for the electronic filing requirement is set by Order in Council at a later point in time.

[20] The interest amounts in the example are used for illustrative purposes only.

Employee share schemes

OVERVIEW

Sections CD 25, CD 43, CE 1, CE 2, CE 6, CE 7, CE 7B, CE 7C, CE 7D, CV 20, CW 26B, CW 26C, CW 26D, CW 26E, CW 26F, CW 26G, CZ 1, DV 27, DV 28, EX 38, GB 49B, HC 27, and sections 3(1) and 63B of the Tax Administration Act 1994.

Employee share schemes are arrangements for companies to provide shares and share options to their employees. They are an important form of employee remuneration in New Zealand and internationally. Although the design and the accounting treatment of these plans have evolved considerably over recent decades, the tax rules applying to them in New Zealand had not been comprehensively reviewed during that period and were out of date.

Recently a number of problems with these rules emerged, primarily in three areas:

- complex arrangements allow taxable labour income to be converted into tax-free capital gains;
- there is no employer deduction for the provision of employee share scheme benefits in some circumstances; and
- the rules and thresholds relating to tax-exempt widely-offered employee share schemes are outdated and need review.

New core rules

Changes have been made to the core rules for the taxation of employee share schemes following enactment of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018. The objective of the proposals is neutral tax treatment of employee share scheme benefits. That is, to the extent possible, the tax position of both the employer and the employee should be the same whether remuneration for labour is paid in cash or shares. This will ensure that employee share schemes cannot be structured to reduce the tax payable in respect of these arrangements, as compared to an equivalent cash salary or other more straight-forward employee share schemes.

Generally, these rules will apply to benefits where the taxing point under the previous law has not occurred before 29 September 2018.

This *Tax Information Bulletin* item covers changes that:

- determine the taxing point for employee share schemes as being when an employee is treated as having earned shares under an employee share scheme, and after which they hold the shares like any other shareholder;
- provide a new deduction rule for employers providing employee share scheme benefits to employees, which aligns the tax treatment of providing employee share scheme benefits with the tax treatment of paying other types of employment income;
- simplify the rules for certain exempt employee share schemes, with a greater level of exempt benefits able to be provided and more flexibility in the design of these schemes; and
- make other consequential and technical amendments.

SCOPE OF THE NEW RULES

Sections CE 1, CE 2, CE 6, CE 7, CE 7B, CE 7C, CE 7D, DV 27

The new income and deduction rules apply to arrangements where employees receive shares as part of their remuneration package. There are a number of qualifications and carve outs to the definition of "employee share scheme" so that the rules are appropriately targeted.

Background

The definition of "employee share scheme" is a key component of the rules.

The core employee share scheme rules in the Income Tax Act 2007 previously applied to "share purchase agreements". These are agreements to dispose of or issue shares to an employee, entered into in connection with the employee's employment or service, whether or not an employment relationship exists when the employee receives a benefit under the agreement.

Under the old rules there was some uncertainty as to whether this definition encompassed arrangements entered into before a person commenced a formal employment relationship and had received a PAYE income payment.

This definition also excluded shareholder-employees to the extent to which they chose not to deduct PAYE.

There is no policy rationale for excluding these classes of recipients of employee share scheme benefits.

Key features

The new rules apply to benefits provided under arrangements that involve issuing or transferring shares to past, present and future employees[21] or shareholder-employees (or their associates) of the issuing company (or a group company). They do not apply to arrangements that involve issuing shares to other goods or service providers.

The new rules do not apply to arrangements that require employees to:

(a) pay market value for the shares on the "share scheme taxing date" (described in more detail below, but generally the date on which the employee holds the shares like any other shareholder); or

(b) put at risk shares they acquired for market value, where the scheme provides no protection to the person against a fall in the value of the shares.

They also do not apply to exempt employee share schemes (which have their own specific rules, discussed below).

When the new rules do not apply, shares provided in exchange for goods and services will be taxable to the recipient under general principles applying to barter transactions.

Application date

The new rules apply to benefits provided under employee share schemes which are not taxed under the existing rules before 29 September 2018. There is further detail on the transitional arrangements below.

Detailed analysis

Under sections CE 1(1)(d), CE 2, and CE 6 – 7D, a benefit received under an **employee share scheme** is income of a person. Section DV 27 governs the corresponding deductions available to the employer offering the employee share scheme.

"Employee share scheme" is defined in section CE 7 as an *arrangement* with a purpose or effect of issuing or transferring shares in a company to a person who *will be, is, or has been* an employee (or *shareholder-employee*) of that company or of another company in the same group, if that arrangement is connected to the person's employment or service.

It also includes the provision of shares to an associate of the employee or shareholder-employee (for example, a family trust), if the arrangement is connected with the employee's employment or service.

The use of the term "arrangement" covers all aspects of a scheme, for example, direct transfers of shares, loans to buy shares, bonuses, put and call options, and transfers to trusts, etc. The definition also covers past, present and future employees, and includes shareholder-employees.

However, an employee share scheme does not include an arrangement that requires an employee, shareholder-employee, or associate to:

(a) pay market value for the shares on the "share scheme taxing date" (described in more detail below, but generally the date on which the employee holds the shares like any other shareholder); or

(b) put at risk shares they acquired for market value where the scheme provides no protection to the person against a fall in the value of the shares. This exception does not apply if the person acquired the shares using funds which were required to be used for the acquisition.

Example 1

Jim is employed by ABC Co, a closely-held company. As part of his employment agreement, after he has worked for the company for 3 years, if the company's other shareholders are happy with his performance, they will let him buy 25 percent of the company's shares for their current market value at that time.

While this is an arrangement with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee), market value will be paid for the shares on the share scheme taxing date. Accordingly, this arrangement is not an employee share scheme for the purposes of the proposed new definition.

[21] This includes any person receiving a PAYE income payment. A PAYE income payment includes a schedular payment – that is, a payment subject to withholding because it is of a class set out in Schedule 4 of the Act.

Example 2

Casey, Hamish and Steve get together and incorporate a company to develop some technology-related intellectual property (IP). They are each employed by the company. When the shares are issued they are worth virtually nothing (on a balance sheet basis) and a nominal subscription price of $0.01 is paid by each shareholder-employee. The shareholders' agreement states that to ensure they commit to developing the IP over three years, if they leave within 3 years they forfeit their shares.

While this is an arrangement with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee), market value was paid for the shares, not using money provided to the employees for that purpose, and the employees have then chosen to put the shares at risk. Accordingly, this arrangement is not an employee share scheme for the purposes of the proposed new definition.

Example 3

Melissa is hired as CEO by X Co, a closely-held company with exciting but uncertain prospects. She is paid a $120,000 per annum salary. Because she is an employee, she is also able to buy $50,000 worth of shares (which is the current market value – established by an independent valuation). If Melissa leaves employment within 3 years, X Co has the right to buy her shares back for the lesser of $50,000 and market value. After that date, it has the right to buy the shares back for full market value.

This is because X Co does not want Melissa to hold its shares if she is not part of their team, but after 3 years they are prepared for Melissa to receive the upside in the shares. Before then, she bears the risk of loss but no chance of gain. If the shares fall to $10,000 and Melissa leaves X Co within three years, the company will buy her shares back for $10,000 and she will lose $40,000 of her $50,000 investment.

If Melissa leaves the company within three years and the shares are worth $1 million, then the company will buy them back for $50,000 and Melissa will be denied the upside.

This arrangement is not an employee share scheme as defined as Melissa has paid market value for her shares not using consideration provide to her for this purpose, and has then effectively put them at risk for 3 years.

If X Co paid Melissa a signing bonus of $74,627 on the basis that the after tax amount of $50,000 would be used to acquire the shares, the arrangement would be an employee share scheme – see in particular section CE 7(b)(iii).

The definition of employee share scheme also excludes exempt schemes (which have their own specific rules, discussed below).

TIMING AND AMOUNT OF EMPLOYEE'S INCOME

Sections CE 1, CE 2, CE 6, CE 7, CE 7B, CE 7C, CE 7D, DV 27

The amendments ensure that the timing and amount of an employee's income from an employee share scheme is consistent with other forms of employment income.

Background

Any reward for services is generally taxable as income, under the ordinary definition. However, the application of the common law of income tax to the provision of rewards in the form of property, for example shares or options, has sometimes been problematic.

For that reason, since 1968, New Zealand tax law has contained special provisions relating to the taxation of employee share scheme benefits.

Under the previous law, shares provided under an employee share scheme were taxable when the employee acquired the shares. The previous section CE 6(2) provided that:

- shares acquired pursuant to an option were treated as acquired when the option was exercised. This meant that an employee was not taxed on the grant or vesting of an option, but on its exercise; and
- shares acquired by a trustee for the benefit of an employee (that is, a specific employee) were treated as acquired by the employee, even if the employee might be required to forfeit the shares.

The second of these rules led to outcomes that were neither tax-neutral nor consistent with the taxation of employee share options.

Examples 4, 5, 6 and, 7 (following), reflect the previous rules:

Example 4

Jim has a tax rate of 33%. If his employer offers him a $1,000 bonus if he is still working for the employer in a year's time, he will receive (if he satisfies the condition) $1,000 of taxable income.

If instead his employer decides to pay Jim the same bonus in shares, the tax neutral outcome would be for the employer to provide $1,000 of shares, and for Jim to pay $330 tax.

In both cases Jim receives $1,000 of before-tax income and has paid $330 of tax. Tax will not be a factor in how Jim wants to be paid.

Example 5

Suppose that Jim's employer offers him a cash bonus if he is still working for the employer in a year's time. The amount of the bonus is the value of 1,000 shares in one year's time. Suppose that 1,000 shares are worth $1,000 at the start of the year, when the offer is made, and $1,500 at the end of the year. Jim will not be taxed on $1,000. He will be taxed on $1,500 when he receives the cash bonus.

Instead of offering a cash bonus dependent on the value of the shares, suppose Jim's employer transfers 1,000 shares to a trustee, on the basis that the trustee will transfer them to Jim at the end of the year if he is still with the company, and not otherwise. The economic benefit to Jim is the same as in the first variation of this example. However, under prior law, Jim had income of $1,000 when the shares were transferred to the trustee. This was not consistent with the treatment of equivalent cash remuneration (i.e. the first variation of this example), and therefore was not a neutral tax treatment.

Example 6

Jane's employer decides to provide her with options to buy 1,000 shares in the company. The shares are currently worth $1, and the options have a strike price of $1 (that is, they are issued "at the money"). The options can be exercised only if Jane is still employed in a year. Suppose there is an equal chance that the shares will be worth $600 or $1,600 in a year's time. If they are worth $1,600, Jane exercises the options, and has $600 of taxable income. If they are worth $600, she does not exercise the options, and gets nothing.

Example 7

Instead of providing options, suppose Jane's employer sells her 1,000 shares for $1,000, and provides her with an interest-free loan to fund the purchase. The loan must be repaid after one year. The employer specifies that if the shares have fallen in value at the repayment date, Jane must sell the shares back to the employer for $1,000. Suppose the same share values and probabilities as in example 3. If the shares are worth $1,600 in one year, Jane will keep the shares and pay off the loan. If they are worth $600, she will sell them to the employer for $1,000 and use that money to pay off the loan.

Under prior law, Jane had no taxable income from this arrangement, even though it produced outcomes identical with the option arrangement, under which Jane has $600 of income if she acquires the shares.

The new rules prevent these inconsistent outcomes by deferring the time at which an employee recognises income from an employee share scheme in certain situations. In examples 2 and 4 above, under the new rules, both Jim and Jane will be taxed on the value of the shares once the employment condition is satisfied (in Jim's case) or the employer's right to acquire the shares for $1,000 no longer exists (in Jane's case).

Key features

Section CE 7B provides that benefits provided under an employee share scheme (usually in the form of shares) are assessable income for an employee at the earlier of the date when:

- the benefits are either transferred or cancelled; or
- the employee share scheme beneficiary owns the shares in the same way as any other shareholder. They will not own the shares in the same way as any other shareholder if (for example) the employee is required to forfeit the shares if they choose to leave the company, or the employee is entitled to be compensated for a decline in the value of the shares.

This time is referred to as the "share scheme taxing date". There is no change to the share scheme taxing date for straight-forward employee share options, which already reflects this principle, in that the employee is not taxed until the option is exercised.

The amount of the benefit is the amount received for the transfer or cancellation, or the value of the shares at the share scheme taxing date. It is reduced by the amount paid (if any) for the benefit.

The new rules require matching between the employee's income and the employer's deduction, so the rules outlined above also determine the amount and time of the deduction to the employer (the employer's deduction is discussed further below).

Application date

The new share scheme taxing date and rules for calculating employee share scheme income will apply to benefits provided under employee share schemes which are not taxed under the existing rules on or before 29 September 2018. There is further detail on the transitional arrangements below.

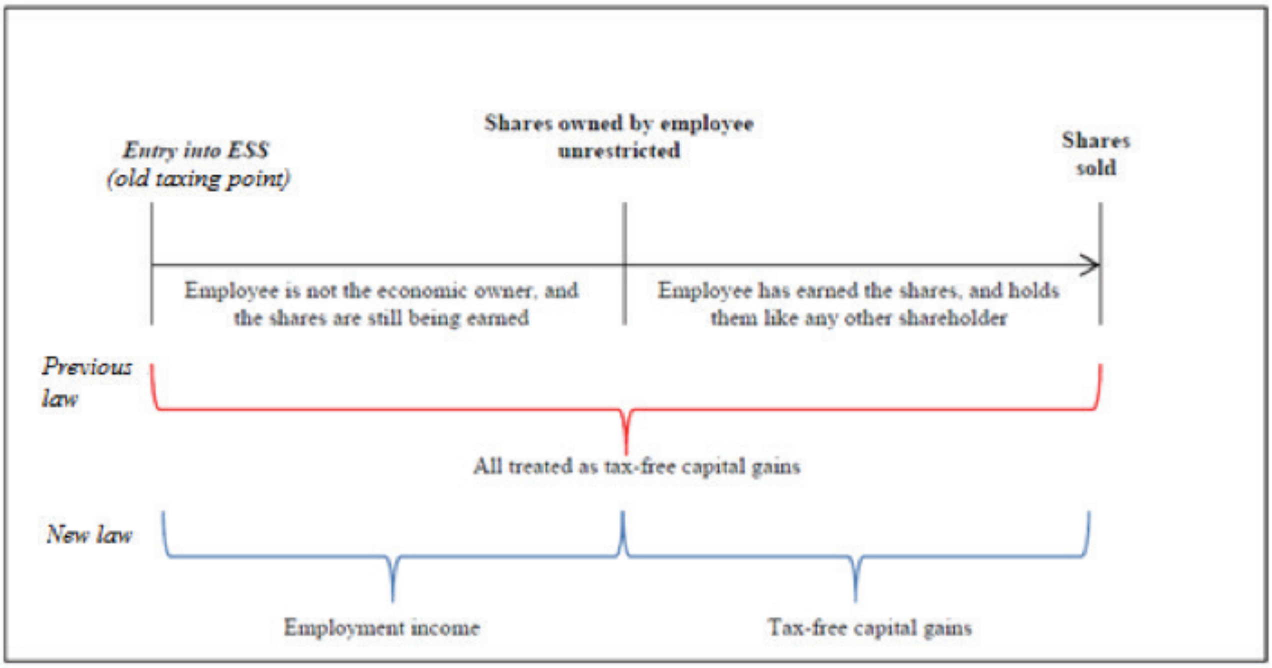
Detailed analysis

Timing of income

The time when the employee is taxable is defined as the "share scheme taxing date", and is defined in section CE 7B.

Unless a share scheme beneficiary first transfers their share scheme benefits to a non-associate, or the company cancels them, the share scheme taxing date is when:

- there is no material risk that beneficial ownership of the shares will change, or that the shares will be required to be transferred or cancelled;
- the employee is not entitled to be compensated for a fall in the value of the shares; and
- there is no material risk that there will be a change in the terms of the shares affecting their value.



If the benefits are cancelled or transferred to a non-associate before these events occur, then the share scheme taxing date is at the time of the cancellation or transfer.

In determining whether there is a risk of a change of ownership, transfer or cancellation, certain rights and requirements do not affect the employee's status as the economic owner of the shares under the scheme (section CE 7B(2)) and are ignored. They are rights or requirements:

- for transfer for market value;
- not contemplated by the employee share scheme;
- that have no material risk of occurring;
- that are of no material commercial significance; or
- that also apply to shares not subject to the employee share scheme.

The following series of examples illustrate how the new rules will work in practice for common types of employee share schemes.

Example 8 – Simple vesting period

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee leaves the company for any reason during the next three years, the shares are forfeited for no consideration. After three years, the shares are transferred to the employee.

Result

The share scheme taxing date is when the three years is up and the employee is still employed.

Analysis

The risk of loss of the shares for the first three years means there is a material risk that the beneficial ownership of the share will change under the terms of the scheme. None of the exceptions apply.

Example 9 – Vesting period with good leaver exception

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee leaves the company for any reason during the next three years, the shares are forfeited for no consideration. However, if the employee ceases employment because of death, illness, disability, redundancy or retirement within the three-year period they are entitled to the shares. After three years, the shares are transferred to the employee.

Result

The share scheme taxing date will be the end of the three-year period if the person is still employed, or when the person leaves for any of the above reasons.

Analysis

There is a material risk that the employee will leave employment for some other reason than those listed (for example, a better opportunity presents itself). The share scheme taxing date does not occur so long as that risk exists, because it means that there is a material risk that the beneficial ownership of the shares may change under the terms of the scheme.

Example 10 – Vesting subject to misconduct

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. The shares are transferred to the employee if they are still employed by the company after three years. Also, if the employee ceases employment for any reason other than being subject to disciplinary action or committing some form of employment-related misconduct during the three-year period (i.e. being a "bad leaver") the employee is entitled to the shares at that time.

Result

The share scheme taxing date is when the shares are initially transferred to the trust, and the income will be their value at that time.

Analysis

The risk of the employee losing their job for these "bad" reasons during the three year period, and thus losing entitlement to the shares, is not sufficiently material to require deferral.

Example 11 – Vesting subject to misconduct with accrual

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee is still employed by the company after three years, the shares will be transferred to the employee. If the employee ceases employment for any reason other than being subject to disciplinary action or committing some form of employment-related misconduct during the three-year period (i.e. being a "bad leaver") the employee is entitled to a pro rata portion of the shares based on completed years' service (for example, nothing for the first year, one third of the shares if the employee leaves between one and two years, etc.).

Result

There will be three share scheme taxing dates – at the end of years 1, 2 and 3 respectively. The employee will be taxed at the end of each year on the value at that time of one third of the shares.

Analysis

Until the end of the first year, if the employee leaves for another job, they will not be entitled to any shares. Once the first year is completed, they will be entitled to one third of the shares, provided they are not a bad leaver during the next two years. The risk that the employee will leave for another job is sufficiently material that it defers the share scheme taxing date for two thirds of the shares. The risk that the employee will leave as a bad leaver is not material so it does not defer the share scheme taxing date for the other third. The fact that the shares are held by the trustee until the end of year three does not of itself defer the share scheme taxing date.

Example 12: Complex vesting

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee ceases employment during the next three years due to being subject to disciplinary action or committing some form of employment related misconduct, the employee forfeits all shares.

If the employee ceases employment during the next three years due to death, illness, disability, redundancy or retirement, all shares are transferred to the employee.

If the employee ceases employment during the next three years for any other reason, a pro rata portion of the shares is transferred to the employee, equal to the number of complete months since the transfer divided by 36(months).

After three years if the employee is still employed, all the shares are transferred to the employee.

Result

The employee has income at the end of each month equal to the value at that time of the additional number of shares to which the employee is entitled if the employee leaves "for any other reason".

Analysis

The risk of the employee leaving voluntarily for another job is sufficiently high to be material. The risk of the employee leaving as a bad leaver is not. Accordingly the share scheme taxing date arises as the employee becomes entitled to retain the shares if she leaves the company other than as a bad leaver.

Example 13 – Performance hurdles

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. The employee is not entitled to the shares unless a total shareholder return[22] hurdle (measured as an annual percentage) is also met. If the hurdle is met in year 1, one third of the shares vest. If it is met in year 2, a further one third of the shares vest. Also, if it was not met in year 1, but is met on a combined basis over years 1 and 2, a further one-third of the shares will vest. The same approach applies in year 3.

No shares vest once the employee leaves the company. Vested shares are not transferred to the employee, but held by the trustee until the three years is up. If the employee leaves during that period for any reason other than being a bad leaver, the vested shares will be transferred to the employee.

Result

There will be three possible share scheme taxing dates – at the end of years 1, 2 and 3 respectively. The employee will be taxed at the end of each year on the value of the shares that vest at that time.

Analysis

Until the end of the first year, if the employee leaves for another job, they will not be entitled to any shares. Once the first year is completed, they will be entitled to retain one third of the shares, provided they are not a bad leaver during the next two years, and provided the year 1 performance hurdle is met. The risk that the employee will be a bad leaver is not material so it does not defer the share scheme taxing date. The fact that the shares are held by the trustee until the end of year 3 does not of itself defer the share scheme taxing date.

Example 14 – Vesting period, with compulsory sale for market value thereafter

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee leaves the company for any reason during the next three years, the shares are forfeited for no consideration. After three years, the trustee retains legal ownership of the shares, and the employee must transfer their rights back to the trustee or A Co when the employee leaves. However, once the three-year period is up, the employee will receive the market value of the shares when their beneficial ownership is transferred.

Result

The share scheme taxing date is when the three years is up and the employee is still employed.

Analysis

Once the three-year period has expired, the employer's or trustee's right to acquire the beneficial interest in the shares is for market value, and is therefore not taken into account in determining the share scheme taxing date (section CE 7B(2)(a)).

Example 15 – Insubstantial put option

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. The shares will be transferred to the employee if she is still employed in three years' time. Also, if the employee ceases employment during that time for any reason other than being subject to disciplinary action or committing some form of employment-related misconduct during the three-year period (i.e. being a "bad leaver") the employee is entitled to the shares.

Until the shares are transferred, the employee has the right to sell its beneficial interest in the shares back to the trustee for a total price of $1.

Result

The share scheme taxing date would be when the shares are provided to the trustee.

Analysis

The employee's right to sell the shares for $1 is not, at the time it is granted, a right which has a material risk of being exercised, given that there is no liability attached to the shares and that they are then worth $10,000. This right would therefore not defer the share scheme taxing date.

[22] Annual "total shareholder return" is a combination of dividends paid and appreciation in share price during a year.

Example 16 – Loan funded scheme A

Facts

B Co provides an employee with an interest-free full recourse loan of $10,000 to acquire shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee leaves within three years, the shares must be sold back to the trustee for $10,000, which must be used to repay the loan;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme; and
- if the employee chooses to continue, the loan is only repayable when the shares are sold.

Result

The share scheme taxing date will be the earlier of when the employee leaves employment, or the expiry of the three years.

Analysis

Until the three years are up, if the employee leaves B Co for whatever reason, they lose their beneficial ownership of the shares for an amount that is not their market value. So the share scheme taxing date will, on the face of it, be the end of that three-year period. If the employee leaves within that period and is therefore required to transfer their rights, the sale price will be taxed. But since the sale price is the same as the amount contributed, there will be no gain or loss. Once the three-year period is up, the employee will either have no employee share scheme income (if they sell the shares back to the trustee for $10,000) or will pay tax on the difference between the value of the shares at that time and their $10,000 price (if they choose to keep the shares).

Example 17 – Loan funded scheme B

Facts

B Co provides an employee with an interest-free loan of $10,000 to acquire shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme;
- if the employee chooses to continue, the loan is only repayable when the shares are sold;
- the loan is limited recourse for the first three years (i.e., during that period, the amount repayable is limited to the value of the shares at the time of repayment); and
- if the employee leaves within three years, or chooses at the end of the three years to sell the shares to the trustee, they must be sold back to the trustee for market value.

Result

The share scheme taxing date will be the earlier of when the employee leaves employment, or the expiry of the three years.

Analysis

The requirement to sell the shares for their market value, if the employee leaves in the first three years, does not defer the share scheme taxing date. However, the limited recourse loan provides a benefit to the employee which compensates the employee for a fall in the value of the shares. Accordingly, the share scheme taxing date is the same as for Example 16 – that is, the end of three years (when the loan ceases to be limited recourse) or when the shares are sold to the trustee. If the employee sells the shares for less than $10,000 (because that is their market value), the employee will have a deductible loss from the scheme under the employee share scheme rules, equal to the difference between the sale price and the $10,000 cost of the shares. They will have debt forgiveness income of an equal amount. If they retain the shares at the end of the three year period, they will have income equal to the difference between the shares' value at that time and $10,000.

Example 18 – Loan funded scheme C

Facts

B Co provides an employee with an interest-free loan of $10,000 to acquire shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme;
- if the employee chooses to continue, the loan is only repayable when the shares are sold;
- if the employee leaves within three years, or chooses at the end of the three years to sell the shares to the trustee, they must be sold back to the trustee for market value; and
- at the time of such a sale, the employer must pay the employee the amount of any decline in the value of the shares since the grant date.

Result

The share scheme taxing date will be the earlier of when the employee leaves employment, or the expiry of the three years.

Analysis

The employer's promise to pay a bonus equal to the decline in the value of the shares is a benefit which compensates the employee for a decline in the value of the shares. The share scheme taxing date does not arise until that promise ceases to apply. If the employee sells the shares for less than $10,000 they will have a deductible loss from the scheme, which will be equal to the income they will recognise due to the payment from the employer.

Example 19 – Loan funded scheme D

Facts

B Co provides an employee with an interest-free full recourse loan of $10,000 to acquire shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee leaves within three years, or chooses at the end of the three years to sell the shares to the trustee, they must be sold back to the trustee for market value;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme; and
- if the employee chooses to continue, the loan is only repayable when the shares are sold.

Unlike in example 11, there is no arrangement for the employer to pay the employee the amount of any decline in value of the shares.

Result

The share scheme taxing date is when the agreement is entered into.

Analysis

From the time the agreement is entered into, the employee has the full risk and reward of share ownership. Although the funding for the purchase is provided by the employer, the funding is full recourse and the employee holds the shares in the same way as any other shareholder.

Example 20 – Vesting only in the event of a sale or IPO

Facts

C Co transfers 1,000 shares to a trustee for an employee. The shares remain held on trust until the employee leaves, more than 50 percent of C Co is sold, or C Co is listed (whichever happens first). If the employee leaves first, the shares are forfeited. If more than 50 percent of C Co is sold, the employee's shares must also be sold and the employee will receive the proceeds. If C Co is listed, the shares are released to the employee.

Result

The share scheme taxing date is when the employee leaves, or C Co is sold or listed.

Analysis

Because the employee forfeits the shares for no consideration if they leave, the share scheme taxing date will be deferred until the employee leaves (in which case there will be no income), the shares are sold (in which case the sale price will be taxable), or the shares are released to the employee (the market value of the shares will be taxable).

Example 21 – Blackout periods

Facts

Acme Limited (a listed company) agrees to issue 1,000 shares to Jason under an employee share scheme, if Jason remains employed for three years. Jason does so, and Acme Limited transfers 1,000 shares worth $10,000 to him on 31 December 2018. Under securities law, Jason is unable to sell the shares at that time, due to restrictions on insider trading. On 20 February 2019, the restrictions on selling the shares no longer apply and Jason sells half of his shares. The sale price is $4,200, or $8.40 per share. He sells the remaining shares 6 months later for $7,500.

Result

Jason's share scheme taxing date is the date when the shares vested (31 December 2018), not the end of the blackout period (20 February 2019). Jason therefore has employment income of $10,000. The $800 loss on the first sale of 50 percent of his shares will generally be a capital loss. The profit of $2,500 on the sale of the remaining parcel will generally be a capital gain.

Analysis

The issue in this example is whether the insider trading restriction defers the share scheme taxing date. A prohibition on the sale of shares does not create a risk that beneficial ownership may change, and is a right or requirement in relation to the retention of shares, not the transfer of shares. The general principle illustrated by this example is that inability to sell employee share scheme shares does not mean that the employee has received no value or that they should not be taxed (the same principle applies to employees of unlisted companies who are prohibited from selling their shares by the company's constitution or shareholder agreement). Regardless of the transfer restriction, the employee will be entitled to dividends and any increase or decrease in the shares' value over time.

The same outcome would be produced if the trading restrictions were part of the terms of the scheme as opposed to being a statutory restriction.

Example 22 – Reclassifying shares

Facts

On 30 November 2018, Startup Co issued 10,000 special employee shares, which it calls E Class shares, to its CEO. The E class shares have no rights to a dividend, no voting rights, and a right to 0.1c per share on liquidation of the company. However, the terms of the E Class shares also provide that if Startup Co achieves certain performance hurdles by the third balance date post-issue, the terms of all or some of the E Class shares will change so that they have the same rights as ordinary shares in Startup Co. Shares whose rights to do not change, will be cancelled.

At the time the E Class shares were issued, they were valued at $1,000. The performance of the company by 31 March 2021 means 75 percent of them are reclassified into ordinary shares, valued at $12.50 per share, giving a total value of $93,750.

Result

The share scheme taxing date for the E Class shares will be the date when their rights change or they are cancelled.

Analysis

So long as there is a material possibility that the E class shares will become ordinary shares, there is a material risk that there will be a change in their terms affecting their value (section CE 7B(1)(a)(iii)). Accordingly the share scheme taxing date cannot occur until the possibility of that change no longer exists.

Amount of income

The amount of income to the employee is the value of the shares at the share scheme taxing date (or the transfer price if transferred to a non-associate, or the amount paid for cancellation, if cancelled by the employer), less the amount paid for them.

Even where benefits are conferred on or transferred to an associate of an employee, it is always the employee who is taxed on the income. If the amount paid exceeds the value of the shares at the share scheme taxing date, the difference is deductible to the employee (sections CE 2(3) and DV 27(3)).

Apportionment for overseas service

The new rules contain an expanded income apportionment formula (section CE 2(5) and (6)). The expanded formula applies to all employees (rather than only transitional residents as in the old section CE 2(9)). It excludes from taxable income employee share scheme benefits which accrue while a person is neither New Zealand resident nor deriving New Zealand source income.

The extent of such accrual is determined by first establishing the entire period over which the benefit accrues, and then determining the proportion of that period during which the person is non-resident and not deriving New Zealand source income from their employment. The period of accrual ends once the rights vest, rather than when the income arises. So, for example, in the case of an option, the period of accrual ends once the options are *exercisable* rather than when they are actually *exercised*.

The employee share scheme income is treated as non-residents' foreign source income (which is not taxable income) to the extent of this proportion.

Example 23 – apportionment for overseas service – options

Facts

Nick is employed by Eagle Limited. On 1 June 2017 he was granted an option to buy 1000 shares for $500. The option vests one year after it was granted (1 June 2018). He can exercise the option at any time between 1 June 2018 and 1 June 2020.

Nick is sent on secondment to Eagle Limited's Australian parent company, Philly Limited, on 30 June 2017 for two years. He does not return to New Zealand throughout his secondment and loses his New Zealand tax residence from the day he left New Zealand, as he has been away for more than 325 of 365 days, and does not have a permanent home in New Zealand.

Nick returns to New Zealand at the end of his secondment (30 June 2020). On 1 December 2018, Eagle Limited shares are worth $2 per share. Nick decides to exercise his option for $500. He therefore earns income of $1500 on 1 December 2018.

Result

Nick's income of $1500 is apportioned by reference to the date when the options vested (1 June 2018), not the share scheme taxing date (1 December 2018):

$1500 × 336 days (offshore period) ÷ 365 days (earning period) = $1380.82

The earning period is from 1 June 2017 to 31 May 2018 The offshore period in this case would be from 30 June 2018 to 31 May 2018– the number of days in the earning period when Nick was not resident in New Zealand.

Therefore $1380.82 is treated as non-residents' foreign-sourced income and is not taxed in New Zealand. Nick will be taxable on the remaining $119.18 of his employee share scheme benefits.

Analysis

The earning period ends when the option vests, not when it is in fact exercised. However, that does not affect the principle that the amount of income that must be apportioned is determined by the value of the shares when the option is exercised.

Transfers to associates

There is no change to the treatment of transfers to associates. Such transfers do not trigger the share scheme taxing date (section CE 7B(1)(b)).

Rollover relief for transfer to new scheme

If a person's employee share scheme rights are cancelled and replaced with rights in a different scheme, the value of the replacement rights is not included in the person's income arising due to the cancellation of the original scheme (sections CE 2(2)(c) and CE 7D). In the usual case where an employee's rights in an existing scheme are simply replaced by rights in a new scheme, no income will arise under section CE 2.

The benefit provided by the replacement scheme is taxed appropriately by applying the new rules to that scheme.

TIMING AND AMOUNT OF EMPLOYERS' DEDUCTION

Sections CV 20, DV 27 and DV 28

A deduction is available to employers providing employee share benefits, which matches the income to employees in timing and quantity. Deductions previously available for other payments are disallowed where those payments would otherwise lead to a double deduction.

Background

The principle of neutral tax treatment of employee share scheme benefits supports employers being entitled to a deduction for the value of the benefit provided. The fact that the issue of shares by a company does not involve an explicit cash cost does not affect this principle. There is a transfer of value to the employee from the other shareholders, which arises whether that value is transferred as cash or as shares in the company.

Under the corporate tax system, where company expenses are deducted by the company as a separate taxpayer from its shareholders, this cost must be recognised in the calculation of income by the company, rather than the shareholders on whose behalf the income is earned and the cost incurred.

Ways to create a deduction existed under the old rules. For example, the employer could claim a deduction for

- payment of a bonus to the employee which was used to fund a full value share acquisition;
- contributions to an employee share trust, which would then acquire shares for the employee; or
- reimbursement to a parent company to compensate it for providing employee shares.

However, the tax treatment of these transactions was uncertain, and structuring to achieve the deduction sometimes incurred unnecessary transaction costs.

There was also the potential for the amount and timing of the deduction created by such transactions to not correctly reflect the economic cost to the company of providing the employee share scheme benefits.

Key features

The new rules allow a deduction to an employer equal in amount and timing to the income derived by an employee under the new rules, and deny a deduction for any other amount incurred to provide that benefit. They do not affect the deductibility of costs incurred in establishing or operating a scheme. They also allow an employee who pays more for shares than they are worth at the share scheme taxing date a deduction for that amount.

Application date(s)

The new share scheme taxing date and rules for calculating employee share scheme income will apply to benefits provided under employee share schemes which are not taxed under the existing rules on or before 29 September 2018.

Detailed analysis

An employer is denied a deduction for expenditure or loss incurred in providing employee share scheme benefits (section DV 27(2)), except for:

- costs incurred in making a loan under the scheme or in establishing or managing the scheme (section DV 27(3)). Costs of establishing or managing include legal and accounting fees incurred in setting up the scheme, as well as on-going management fees. Deductibility of these costs is left to the usual capital/revenue tests. Costs incurred by an employee share scheme trust are treated as incurred by the employer or issuing company, as a result of the new provision treating the trustee of an employee share scheme trust as a nominee of the employer or issuing company (section CE 6);
- an amount equal to the employee's income, which is treated as a cost incurred at the same time as the employee recognises the income (section DV 27(6)-(8)). Deductibility of this cost depends on meeting the general permission and not being subject to any of the limitations. However, deductibility is not limited by the apportionment formula in new section CE 2(5) and (6); and
- amounts which are taxable to the employee as employment income other than as employee share scheme benefits (section DV 27(5)). This is intended to preserve a deduction for the cost of paying a bonus where the payment of the bonus is part of the terms of an employee share scheme.

Accordingly:

- payments to fund an employee share scheme trust to acquire shares, or to reimburse a parent for providing shares, are not deductible; and
- in order to correctly calculate their deduction, as a practical matter, employers need to either prohibit employees from transferring their rights to a non-associate before the share scheme taxing date, or place a requirement on employees to inform them of the time and amount paid in such a transfer.

In order to prevent double deductions, when shares are provided to an employee and a deduction has been taken for that provision other than in accordance with to the new section, the deduction under the new section is reduced by the earlier deduction (section DV 27(8)(b)). However, it is only the amount of any deductions in respect of costs attributable to the particular share scheme benefits which have given rise to taxable income to the employee in question which are taken into account.

Transitional arrangements

As a transitional measure, the deduction rules provide for a mechanism to make adjustments to deductions incurred before 29 September 2018 (six months after the date of Royal Assent) (section DV 27(8)(b)(ii)).

Example 24

Facts

On 1 July 2016, a New Zealand subsidiary of an Australian multinational provided an employee with an option to acquire 5,000 shares in the Australian parent for $3 per share, exercisable on or after 1 July 2018, provided the employee was still employed by the group at that date. The employee remained employed, and exercises the option on 3 December 2018, when the shares are worth $3.50 each.

Scenario 1

Suppose that the employer had to make a recharge payment to the parent when the options were issued, of $500, being their value at that time. The employer took a deduction for this payment.

Result of Scenario 1

The employer has income of $250. This is the result of the formula in section DV 27(7), being $250-$500. The $250 is the employee's income under section CE 2(1). The $500 is the previous deduction allowed to the employer. Subsection (9) states that a negative amount is income.

Scenario 2

Suppose that the recharge payment is still $500, but it is made when the option is exercised.

Result of Scenario 2

The employer has a deduction of $250. The recharge is not deductible due to section DV 27(2). Subsection (7) gives a deduction for the $250 which is taxable to the employee.

EFFECT OF DEDUCTION AND PAYMENTS ON AVAILABLE SUBSCRIBED CAPITAL

Sections CD 25 and CD 43

The new rules tax any benefit conferred on an employee by the issuance of shares in an employee share scheme in the same way as an equivalent cash payment followed by an acquisition of shares in the issuing company. Consistent with this principle, the rules provide for an increase in the employer's available subscribed capital (ASC) by the amount deemed to be paid (plus actually paid) for the shares. The rules also cater for the situation where the employer is not the company issuing the shares.

This is a taxpayer-friendly measure to ensure employee share schemes are not disadvantaged as a form of remuneration compared with an equivalent cash transaction, which would generally give rise to an ASC increase.

Background

To ensure neutrality between provision of benefits under an employee share scheme and an equivalent cash transaction, as well as providing for the income and deduction consequences, the new rules provide for changes to a company's ASC.

To do this, the rules provide for an increase in the employer's ASC by the amount deemed to be paid (plus actually paid) for the shares. The proposed rules also cater for the situation where the employer is not the company issuing the shares (this is common where the employer company is a subsidiary and the employee receives shares in the parent company).

In order to cater for the common practice of acquiring employee share scheme shares from other shareholders rather than by a fresh issue of shares, it is also necessary to ensure that the treasury stock regime can apply sensibly to employee share schemes.

Key features

The ASC provisions deal with the effect of employee share scheme transactions on the employer and (if different) the company whose shares are provided to the employee (the share provider).

The amount of the deduction to the employer will give rise to additional ASC for the employer and, if the shares issued are in the parent of the employer, the parent. In the latter case, any reimbursement paid to the parent reduces the subsidiary's ASC but does not increase the parent's ASC. If the employer has income from the issue of the shares, its ASC is reduced.

The rules also ensure that the acquisition of shares from an employee as part of an employee share scheme can be treated for tax purposes as an acquisition of treasury stock provided the shares are re-allocated within a certain period of time. This rule applies regardless of whether the shares are acquired by the company itself and not cancelled, or they are acquired by a trustee who is treated for tax purposes as a nominee of the company.

A company can choose not to apply these new ASC rules if it issues employee share scheme shares for market value.

Application date

The ASC rules apply to the provision of shares which are taxed under the new rules.

Detailed analysis

Under section CD 43, if the employer is also the company whose shares are provided, then the employer's ASC is:

- increased by:
  - the amount received for the provision of the shares (under existing section CD 43(2)(b)); and
  - the amount of its deduction for the provision of the shares (under new section CD 43(6E)(a));
- decreased by the amount of any income arising if it has income because the value of the shares provided is less than the amount received from the employee (under new section CD 43(29)).

ASC Example 1

Facts

Employer Co issues 700 shares worth $3 each to an employee for $2 per share (that is, at a $1 per share discount). The scheme taxing date is the date of issue. The employee has $700 income and Employer Co has a $700 deduction.

ASC Result

Employer Co's ASC increases by $2,100, being the total of the $1,400 received for the provision of the shares and its $700 expenditure incurred for providing the shares.

ASC Example 2

Facts

Employer Co issues 700 shares worth $3 each to an employee for $2 per share, funded by a loan from the employer. If the employee is still employed by the company after one year, the employee will receive a bonus of $1,400 grossed-up for PAYE, the net amount of which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $4 each.

ASC result

Issuing the shares gives rise to ASC of $1,400. If the shares are repurchased because the employee does not remain employed, that will usually give rise to an ASC reduction of $1,400 (unless the shares are held by a trustee or as treasury stock).

Otherwise, at the share scheme taxing date, Employer Co's ASC will increase by a further $1,400. This is made up ofthe $1,400 that it received from the employee for the shares and $1,400 it incurred in providing the shares (the difference between the value of the shares on the vesting date and their cost to the employee).

ASC Example 3

Facts

Employer Co issues 700 shares worth $3 each to an employee for $2 per share, funded by a loan from the employer. If the employee is still employed by the company after one year, the employee will receive a $1,400 bonus (grossed-up for PAYE), which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $1 each.

ASC result

As for example 2, at the share scheme taxing date Employer Co's ASC will first increase by $2,800 (made up of the amount received from the employee for the shares plus the expenditure incurred by the company to provide the shares). However, the ASC amount will then decrease by $700 because the value of the shares provided is less than the amount received from the employee (section CD 43(29)).

If the employer is not the company whose shares are provided, then the employer's ASC is:

- increased by the amount of its deduction for providing the shares (new section CD 43(6E)(a));
- decreased by the amount of any income arising if it has income because the value of the shares is less than the amount received from the employee (new section CD 43(29)); and
- decreased by the amount of any reimbursement paid to the share provider (new section CD 43(6F) and (6H)).

The adjustment is made to the employer's share class most similar to the shares provided under the scheme. If the decrease due to reimbursement exceeds the increase arising due to a deduction, and the excess is greater than the ASC of the relevant share class, the reimbursement amount is to that extent taxed as a dividend (section CD 43(6I)).

ASC Example 4

Facts

Parent Co, the 100 percent owner of Employer Co, issues 700 shares worth $3 each to an employee of Employer Co for $2 per share. The scheme taxing date is the date of issue. The employee has $700 income and Employer Co has a $700 deduction.

ASC result for Employer Co

Employer Co's ASC increases by the amount of its $700 expenditure.

ASC Example 5

Facts

Parent Co issues 700 shares worth $3 each to an employee of Employer Co for $2 per share, funded by a loan from Parent Co. If the employee is still employed by Employer Co after one year, the employee will receive a $1,400 bonus (grossed-up for PAYE) from Employer Co, which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $5 each.

If the employee remains employed, Employer Co will have a deduction of $2,100, being the difference between the market value of the shares at that time (700 × $5), and their cost to the employee (700 × $2).

ASC result for Employer Co

If the employee stays employed for the year, at the share scheme taxing date, Employer Co's ASC will increase by $2,100 - the amount which is both taxable to the employee and expenditure for Employer Co under the employee share scheme rules.

ASC Example 6

Facts

As for ASC Example 5, Parent Co issues 700 shares worth $3 each to an employee of Employer Co for $2 per share, funded by a loan from Parent Co. If the employee is still employed by the Employer Co after one year, the employee will receive a $1,400 bonus (grossed-up for PAYE) from Employer Co, which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $5 each.

However, unlike Example 5, if the shares are not forfeited, Employer Co pays Parent Co $1 per share reimbursement.

ASC result for Employer Co

Employer Co's ASC will increase by $1,400 if the employee remains employed, which is the difference between its $2,100 deduction and its $700 reimbursement to Parent Co.

If the shares are provided by the ultimate parent of the employer, the ASC of the parent company is:

- increased by:
  - the amount paid by the employee for the shares (under existing section CD 43(2)(b)); and
  - the amount of the employer's deduction for the provision of the shares (new section CD 43(6E)(b));
- decreased by the amount of any income arising to the employer if it has income because the value of the shares provided is less than the amount received from the employee (new section CD 43(29)); and
- unaffected by any amount paid to it by the employer (new section CD 43(20B)).

ASC Example 7 – Parent Co

Facts

Parent Co, the 100 percent owner of Employer Co, issues 700 shares worth $3 each to an employee of Employer Co for $2 per share. The scheme taxing date is the date of issue. The employee has $700 income and Employer Co has a $700 deduction.

ASC result for Parent Co

Parent Co's ASC increases by the $1,400 received for the issue of its shares plus the $700 deductible to Employer Co (for a total ASC increase of $2,100).

ASC Example 8 – Parent Co

Facts

Parent Co issues 700 shares worth $3 each to an employee of Employer Co for $2 per share, funded by a loan from Parent Co. If the employee is still employed by the Employer Co after one year, the employee will receive a $1,400 bonus (grossed-up for PAYE) from Employer Co, which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $5 each.

ASC result for Parent Co

The initial issue of the shares gives rise to ASC of $1,400. If the shares are repurchased by Parent Co because the employee does not remain employed, that will usually give rise to an ASC reduction of $1,400. Otherwise, at the share scheme taxing date, Parent Co's ASC will increase by a further $2,100, the amount which is both taxable to the employee and expenditure for Employer Co.

ASC Example 9 – Parent Co

Facts

As for ASC Example 6, Parent Co issues 700 shares worth $3 each to an employee of Employer Co for $2 per share, funded by a loan from Parent Co. If the employee is still employed by the Employer Co after one year, the employee will receive a $1,400 bonus from Employer Co, which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. If the shares are not forfeited, Employer Co pays Parent Co $1 per share reimbursement. The shares are worth $1 each after one year.

ASC result

Parent Co's ASC will increase by $1,400 when the shares are issued. If the employee remains employed:

(a) the reimbursement of $1 per share does not affect Parent Co's ASC; and

(b) Parent Co's ASC decreases by $700 – the amount of the income arising to Employer Co as a result of the amount payable by the employee for the shares ($1,400) being in excess of the value of the shares at the share scheme taxing date ($700).

Treasury stock

If an employee share scheme trustee acquires shares for the purposes of the scheme, those shares are treated as acquired by the share issuer (section CE 6). The amount paid to the selling shareholder for their acquisition is a dividend, unless one of the exceptions to dividend treatment applies.

If the shares are held by the trustee, the treasury stock rules apply to them. Amendments have been made to the treasury stock rules so that they apply more clearly in such a case.

New section CD 25(1)(a) makes it explicit that the treasury stock regime can apply to an acquisition by an employee share scheme trust, just as if the shares were acquired by the company and not cancelled.

For shares allocated to an employee within one year of their acquisition by the company or a trustee, their acquisition and re-issue will be ignored by the share issuer (but not an employer who is not the share issuer) for ASC purposes. This will happen due to the operation of the usual treasury stock provisions (i.e. section CD 25(19)) in relation to the amount received by the company on re-issue and the definition of "returns" in section CD 43(2)(c) in relation to the amount paid by the company to acquire the shares. Note that the shares would only have to be *allocated* to the employee under the scheme within 12 months of acquisition to qualify for treasury stock treatment – they do not have to be transferred to the employee.

The only time any ASC adjustment is required is when shares are not allocated to an employee within one year of acquisition, issue or ceasing to be allocated to another employee, or when shares are issued for other than market value.

Shares which are allocated to an employee within a year and then forfeited by the employee are treated as acquired by the company at that time *for the amount the trustee paid for them when originally acquired* (new section CD 25(7)). The shares will continue to be dealt with as treasury stock, but with a new acquisition date.

Shares which are not allocated within one year are treated as having been acquired on market and cancelled (amendments to section CD 25(2)(b)).

ASC Example 9 – Parent Co

Facts

An employee share scheme trust for Employer Co acquires 700 Employer Co shares on market for $2.50 per share. Six months later, when they are worth $3 per share, it allocates them to an employee for $2 per share. The purchase price is funded by a loan from Employer Co. If the employee is still employed by Employer Co after one year, the employee will receive a $1,400 bonus from Employer Co (grossed-up for PAYE), which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment.

After one year, the shares are worth $5 each.

ASC result for Employer Co

The trustee's acquisition of the shares is treated as an on-market acquisition of treasury stock by Employer Co. Because the shares are allocated to an employee within 12 months of acquisition, the acquisition is not treated as reverting to an on-market cancellation under section CD 25(2). Therefore the amount paid to acquire the shares does not reduce Employer Co's ASC and the $1,400 paid by the employee to acquire the shares does not increase Employer Co's ASC.

If the employee does not stay for 12 months, Employer Co will be treated as acquiring the shares at that time for $2.50 per share, the amount for which they were initially acquired on market. This acquisition will not reduce Parent Co's ASC if the shares are allocated to another employee within 12 months.

Shares issued for market value

The ASC rules applying to employee share scheme shares can be disregarded by a company if it issues employee share scheme shares for market value, or a reasonable estimate of market value, at the time of issue. In this case, the company's ASC is not affected by the amount of any income or deduction arising due to any difference between the issue price and the value of the shares at the share scheme taxing date.

ASC Example 11 – Loan funded scheme

Facts

B Co provides an employee with an interest-free full recourse loan of $10,000 to acquire newly issued shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee leaves within three years, the shares must be sold back to the trustee for $10,000, which must be used to repay the loan;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme; and
- if the employee chooses to continue, the loan is only repayable when the shares are sold.

The employee remains employed for three years, and chooses to continue in the scheme, as the shares are worth $18,000 at that time.

Result

B Co's ASC will increase by $10,000 when it issues the shares. Prima facie it will also increase by $8,000 at the end of year 3, unless the company elects to the contrary.

Analysis

The $10,000 received by B Co is ASC under section CD 43(2), because it is within the definition of "subscriptions". The $8,000 is also included in "subscriptions" under section CD 43(6E). However, B Co can elect out of section CD 43(6E), because it issued the shares for their market value (section CD 43(6EB).

EXEMPT EMPLOYEE SHARE SCHEMES

Sections CW 26B, CW 26C, CW 26D, CW 26E, CW 26F, CW 26G, DV 28, and section 63B of the Tax Administration Act 1994.

The Income Tax Act 2007 provides a concessionary regime to employers who offer shares to employees under certain widely-offered "exempt employee share schemes".

The old rules governing such exempt schemes were out of date, complex and no longer fit for purpose. They also did not fit within New Zealand's broad base, low rate tax framework. The new rules:

- modernise and simplify the criteria for these schemes, including removing employers' 10% notional interest deduction;
- increase the monetary threshold for the schemes (which has not been increased since 1980); and
- address the current ability for employers to claim unintended deductions for the cost of providing the exempt share benefit to employees.

Background

Since the 1970s, the Income Tax Act has contained a concessionary regime to encourage employers to offer shares to employees under certain widely-offered employee share schemes. The concession is on the basis that the schemes are designed to increase employee engagement at all levels of the company and align employee and shareholder incentives. They may also assist employees to develop and improve financial literacy skills.

There were previously two main tax benefits available under the regime.

1. Exemption for employee: The value of a benefit received by an employee under a concessionary scheme is not taxable to the employee.
2. Deemed interest deduction for employer: The employer is given a deemed deduction of 10% notional interest on loans made to employees to buy shares. This is additional to any deduction for actual interest incurred on money borrowed to finance the scheme.

Another benefit under the regime is that interest-free loans made under an exempt scheme are automatically exempt from Fringe Benefit Tax (FBT). The FBT-exempt status of the loans is a limited benefit. In most cases such loans would be FBT-exempt in any event, as "employee share loans" (that is, any loan provided by an employer to an employee to purchase its shares under an employee share scheme). The only real benefit of the specific FBT exemption is that the interest-free loan can be FBT-exempt regardless of the company's dividend paying policy.

There were various issues with the old regime:

- the regime was complex and inflexible;
- the tax benefits of the regime were uncertain and poorly targeted;
- the regime did not explicitly limit the amount of tax-free benefit that can be conferred;
- there were some minor drafting issues with the legislation; and
- the maximum amount an employee could pay for shares ($2,340 over a three-year period) had not been adjusted since 1980, and this meant as a practical matter that the benefits available under the regime were very limited. Adjusted for wage inflation, the figure would now be around $13,000.

Key features

The new rules simplify and clarify the legislation relating to exempt schemes, while retaining many of the key features of the original schemes and their tax treatment. In many cases, the requirements are relaxed. Where the original policy was no longer appropriate or unintended consequences arose, the amendments address this.

Under the new rules, shares provided to employees under schemes that meet certain criteria (described below in the detailed analysis) are exempt income to the employees. Benefits provided under schemes that qualified for the old tax-exempt treatment simply continue to qualify under the new legislation, but such schemes are now entitled to provide the same level of exempt benefits as new schemes.

For all exempt schemes, from 6 April 2017, employers are explicitly denied a deduction for the cost of providing the shares (other than scheme management and administration costs) and the 10% notional interest deduction is repealed.

The automatic exemption from FBT for loans provided under exempt schemes in section CX 10(2) continues.

Application date

The amendments generally apply from 29 March 2018. However, new section DV 28, which denies employers a deduction for expenditure or loss in relation to an exempt employee share scheme (other than establishment or operational costs) applies on and after 6 April 2017 if shares under the exempt scheme were acquired other than in the ordinary course of the scheme.

Detailed analysis

Income tax exemption for shares provided under exempt schemes

Section CW 26B provides that amounts derived from exempt schemes are exempt income.

While a tax exemption for employment income does not fit generally within New Zealand's broad-base, low-rate tax framework, given there is a limit on the amount of benefit that can be provided under the scheme ($2,000 per employee per annum) and the scheme has to be offered to almost all employees, it is appropriate to retain the tax exemption to minimise compliance costs.

Employer deduction for shares provided under exempt schemes

There were several potential deductions associated with exempt schemes:

1. the 10% notional interest deduction with respect to employee share loans;
2. costs associated with setting up and running the scheme; and
3. in some cases, the direct or indirect costs of acquiring shares for the scheme.

The 10% notional interest deduction in 1 above has been repealed. The original policy rationale for this benefit is unclear and it is inconsistent with our BBLR tax framework.

New section DV 28 denies a deduction for any costs associated with exempt schemes, other than administrative and management fees associated with setting up and running the scheme. This is on the basis that when the rules were originally enacted (in the 1970s) it was not envisaged that employers would be eligible for a deduction (as there is no deduction for issuing shares). It has subsequently become apparent that employers can adopt structures that allow them to claim deductions. These deductions are unintended and should never have been available. Therefore, employers are not able to extend these unintended deductions by accelerating the purchase of a large parcel of shares through a trust, which are then allocated to employees over a number of years in the future. However, provided that the shares have been acquired in the ordinary course of the scheme, a later application date (29 March 2018) is appropriate.

This ensures that the unintended deductions identified in item 3 above are no longer available, but the deductions identified in item 2 are still available, subject to the usual limitations. This is consistent with the general deductibility provision for employee share scheme benefits in new section DV 27.

Meaning of exempt scheme and criteria for qualifying for exemption

The new rules have been designed to ensure existing schemes (i.e. schemes in existence before the effective date of the new rules) that meet the criteria described below can continue to operate without unnecessary disruption. Therefore, to the extent possible the existing rules have been retained and simply clarified.

Existing exempt schemes approved by the Commissioner under previous legislation (for example, section DC 12 of the Income Tax Act 2007), continue to be "exempt employee share schemes" and are eligible for the tax exemption, provided they continue to meet the criteria under which they were approved as modified by the increase in the benefit level in section CW 26C(2).

The underlying policy of the criteria is to ensure:

1. the scheme is genuinely offered to the vast majority of employees on equal terms – for example, it cannot just be targeted towards executives;
2. related to 1, all employees have to be able to afford to participate in the scheme, not just the more highly paid employees. This is achieved by limiting the cost of the shares that can be offered, requiring employers to provide financing for any cost or because the employee does not have to pay anything for the shares;
3. there is a limit on the benefit that can be provided; and
4. the scheme is genuinely a share scheme and not just a mechanism to provide tax-free cash to employees (this is why there is a restriction period).

Criteria

To achieve this policy, all the following proposed criteria must be met in order for a scheme to be exempt.

- The cost to employees of shares made available for purchase must not exceed their market value at the date of purchase but may be less (section CW 26C(2)(a)).
- The maximum value of shares provided under an exempt scheme is $5,000 per annum (section CW 26C(2)(b)).
- The maximum discount an employer can provide to an employee is $2,000 per annum (section CW 26C(2)(c)). This means that the most an employee can spend buying shares per annum is $3,000 ($3,000 plus the $2,000 discount means a maximum value of $5,000 worth of shares). This equates to a maximum cost of $9,000 over three years.
- Ninety percent or more of full-time permanent employees who are not subject to securities law of other jurisdictions must be eligible to participate in the scheme. If the scheme applies to part-time employees or to seasonal employees, the same threshold applies (section CW 26C(3)(a)-(c)). Previously, all full time employees were required to be eligible to participate.
- If the scheme has a minimum spend requirement, the amount can be no more than $1,000 per annum (section CW 26C(3)(d)). This is the updated equivalent of the old section DC 13(4) and increases the $624 per three year figure.
- Any minimum period of service which may be required before an employee becomes eligible to participate must not exceed three years (or the equivalent of three years full-time service) (section CW 26C(3)(e)).
- If the employee is required to pay any amount for the shares, then the employer must provide a loan for that amount or allow the employee to pay for the shares in instalments (section CW 26C(4)(a)).
- Loans to employees for the purchase of shares must be free of all interest and other charges (section CW 26C(4)(b)).
- Employees will repay loans by regular equal instalments at intervals of not more than one month over a period between three and five years from the date of the loan (section CW 26C(4)(d)). This requirement can be satisfied by arrangements where shares are acquired regularly by the employee (for example, each payday) with the entire purchase price paid off each time, and also to arrangements where shares are acquired once and the purchase price is paid off in instalments.
- Generally speaking, the shares must be held (either by the employee or by a trustee of a trust on behalf of the employee) for the longer of three years and when the loan is repaid – this is to ensure that the scheme is really a share purchase scheme, and not a mechanism for providing cash remuneration. However, the employee is not required to hold the shares beyond the date their employment ends. Also, if the employee has paid full market value for the shares, then they only have to hold them until they have fully repaid the loan (section CW 26C(7).
- The employee can choose to withdraw from the scheme by giving the employer 1 months' notice and have their shares purchased back for the lesser of market value and cost (section CW 26C(6)).
- If participation in the scheme is causing serious hardship for the employee, the terms of payment can be varied or employees can be allowed to withdraw from the scheme and receive the market value of their shares (section CW 26C(5)).
- If the employee leaves employment before the three years is up, then:
  - if they leave because of death, accident, sickness, redundancy or retirement at normal retiring age they can keep the shares (subject to repayment of the loan) or have the shares bought back for the lesser of market value and cost; and
  - if they leave for any other reason, the shares are bought back at the lesser of cost and market value (section CW 26C(6) and (9)).
- The exempt scheme does not require approval by the Commissioner of Inland Revenue, however, the Commissioner must be notified of the scheme's existence and the employer must advise the Commissioner of shares granted and contributions received under the scheme on an annual basis, in an annual return (section 63B of the Tax Administration Act 1994).
- There is no requirement for a scheme to have a trustee – many schemes have trustees as a matter of convenience. Removing this requirement provides greater flexibility (especially for small employers who may not want the administrative expense of operating a trust for a small scheme).

TECHNICAL, CONSEQUENTIAL AND TRANSITIONAL MATTERS

Sections CE 2, CE 6, CZ 1, EX 38, GB 49B, HC 27, and section 3(1) of the Tax Administration Act 1994.

A number of transitional and consequential provisions are needed to support the core amendments. These provisions:

- specify a cost base for shares acquired under an employee share scheme (new section CE 2(4));
- provide for the treatment of employee share scheme shares subject to the foreign investment fund (FIF) rules (amended section EX 38);
- specify the treatment of employee share scheme trusts (new section CE 6 and repeal of previous section HC 27(3B));
- introduce a specific anti-avoidance rule to counteract tax avoidance transactions with respect to employee share schemes (new section GB 49B);
- make an amendment so that shortfall penalties apply to employers who do not take reasonable care in reporting employee share scheme benefits (amendments to the definition of "tax shortfall" in section 3(1) of the Tax Administration Act 1994);
- provide transitional rules for existing schemes to ensure taxpayers have sufficient time to amend schemes (if necessary) to take account of the new law following enactment of the Bill (new section CZ 1); and
- replace the former terminology – share purchase agreement – with the new term – employee share scheme – throughout the Income Tax Act 2007 and Tax Administration Act 1994.

Application date

There are various application dates for each of the amendments, as specified below.

Key features

Cost base

Income from an employee share scheme benefit is added to the cost of the shares for tax purposes (new section CE 2(4)). Similarly, a deduction reduces the cost base.

This provision applies from 29 September 2018.

FIF regime

The new rules effectively exclude from the FIF regime employee share scheme shares which are treated as owned by the employee for tax purposes but for which the share scheme taxing date has not arisen. Before that time, it is appropriate to tax the dividends on the shares, but not appropriate to tax any change in value, since that will be taxed when the shares give rise to income under section CE 2. See amendments to section EX 38.

This provision applies from 29 September 2018.

Trusts

As referred to above, an employee share scheme trustee is treated as the nominee of the employer and (if different) the share issuing company to the extent of is activities on their behalf (new section CE 6). This means that the activities of the trustee on behalf of those companies are treated as undertaken directly by the companies themselves. They will therefore have no effect on the trustee's taxable income. Like any other nominee, the trustee will still have to file a tax return if it is remunerated for its services.

Section HC 27(3B), which dealt with the situation where an employer has claimed a deduction for a settlement on an employee share scheme trustee, has been repealed, as such settlements will no longer be deductible.

These provisions apply from 29 September 2018.

Specific anti-avoidance provision

A new specific anti-avoidance provision allows the Commissioner to counteract any tax advantage gained from an arrangement which attempts to circumvent the intent and application of the share scheme taxing date or employee share scheme definitions.

This provision applies from 29 September 2018.

Penalties

The definition of a "tax shortfall" has been amended so that an employer who is required to report the amount of an employee's share scheme income in a tax return, and who fails to take reasonable care in determining the amount of that income, is liable for the same shortfall penalty whether or not the employer has elected to pay PAYE on the benefit. There is no basis for differentiating in this respect between employers who do and those who do not withhold PAYE.

This provision applies from 29 March 2018.

Transitional rules

Employee share schemes are often long-term arrangements, lasting three or more years. Additionally, new share schemes are set up fairly regularly by companies and it is important for companies and employee participants to have clarity around the tax laws when they enter into these arrangements.

Accordingly, it is important to provide sufficient transitional measures for existing and contemplated employee share schemes. It is not desirable to put employers and employees in a position where employees are being granted employee share scheme benefits without certainty as to their tax treatment. However, it would also not be appropriate for employers and employees to be able to unduly extend the application of the existing rules by artificially qualifying for grandparenting grants of employee share scheme benefits which are not, in substance, intended to be conferred until a much later time.

To balance these competing objectives, there are three types of transitional relief, pursuant to which the new rules will not apply to employee share benefits provided after enactment.

The first is the general implementation rule in section 2(34), which provides that the new taxing provisions only take effect from 29 September 2018. This means the new rules will not apply to benefits where the share scheme taxing date is before 29 September 2018.

The second and third cases of transitional relief apply where the share scheme taxing date is on or after 29 September 2018.

The second case applies to shares granted or acquired (including by a trustee) before 12 March 2016, when the *Taxation of Employee Share Schemes* Officials' Issues Paper was published. Such shares are never subject to tax under the new rules (see section CZ 1(b)).

The third case applies to shares granted or acquired (including by a trustee) between 12 May 2016 and 29 September 2018. Such shares are not taxed under the new rules provided that:

- they were not granted or acquired for a purpose of avoiding the application of the new rules; and
- the share scheme taxing date under the new rules is before 1 April 2022.

In this case, if the shares are taxable under both the old and new rules, the amount taxed under the old rules reduces the amount taxable under the new rules – see section CE 2(1).

Other policy matters

ANNUAL SETTING OF INCOME TAX RATES

Schedule 1 of the Income Tax Act 2007

The annual income tax rates for the 2017–18 tax year are the rates specified in schedule 1 of the Income Tax Act 2007.

Application date

The rates apply for the 2017–18 tax year.

EXTENSION OF THE BRIGHT-LINE TEST TO FIVE YEARS

Sections CB 6A, CB 16A, DB 18A, DB 18AB, FB 3A, FC 9, FO 10, FO 17, GB 52, GB 53, and RL 1 of the Income Tax Act 2007; Section 54C of the Tax Administration Act 1994.

Background

As part of Budget 2015, the Government announced that it would introduce a bright-line test for the sale of residential property. This requires tax to be paid on any gains from the sale of residential property that is bought and sold within two years, with limited exceptions, including the sale of the main family home. The two year bright-line test came into effect for properties acquired on or after 1 October 2015.

Key features

The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018 extends the period of the bright-line test to five years.

The amendments extend the two-year bright-line period to five years while maintaining the other policy settings supporting the bright-line test.

The bright-line test requires income tax to be paid on the gains from residential property bought and sold within five years, subject to some exemptions including the sale of the main home.

The result is that the following features of the two-year bright-line test will continue for the five-year bright-line test:

- The definition of "residential land" covered by the bright-line test includes land that has a dwelling on it, land where the owner has an arrangement to build a dwelling on it, and bare land that may be used for erecting a dwelling under the relevant operative district plan. Residential land does not include business premises or farmland.
- The current exemptions (i.e. the main home, transfers upon death, or a transfer under a relationship property agreement) will continue to apply.
- The definition of main home includes a dwelling that has been used predominantly, for most of the time the person owns the land, as the person's main home.
- The main home exclusion is available to properties held in trust. However, people cannot use the main home exclusion for multiple properties held through trusts.
- The main home exemption cannot be used if it has already been used twice in the two year period preceding the date of disposal, and also cannot be used by a person who has a regular pattern of buying and selling their main home.
- Residential land withholding tax will apply to taxable sales by offshore persons (i.e. vendors who are living outside New Zealand).
- Specific anti-avoidance rules remain to counter companies and trusts being used to circumvent the bright-line test.
- Vendors will continue to be allowed deductions for property subject to the bright-line test according to ordinary tax rules.
- Losses arising from the bright-line test will remain ring-fenced so they may only be used to offset taxable gains from other land sales.

The two-year bright-line test will continue to apply to residential land if a taxpayer first acquired an interest in the land on or after 1 October 2015, but before 29 March 2018.

Application date

The five-year bright-line test applies to residential land if a taxpayer first acquires an interest in the land on or after 29 March 2018.

DEMERGERS – COMPANY SPLITS BY AUSTRALIAN ASX LISTED COMPANIES

Section CD 29C, ED 2B, FC 2, YA 1 "ASX-listed Australian Company", schedule 25

Amendments to the dividend rules in the Income Tax Act 2007 now provide that certain transfers of shares received by New Zealand shareholders as a result of a company split (demerger) by ASX-listed Australian companies are not treated as a dividend.

Background

A "demerger", or company split, describes the situation when a company (or a group of companies) splits off part of itself and distributes that part to its shareholders. The effect of the demerger is that shareholders, instead of having one shareholding in the company, have two different shareholdings and the shares can be traded separately.

Prior to the amendment, the full value of the shares in the demerged company received by the New Zealand shareholder was treated as a dividend under the Income Tax Act. This is because a dividend is broadly defined by the Income Tax Act as generally any transfer of value from a company to a shareholder that is caused by the shareholding.

For tax purposes, the amount of the dividend is usually very large as it will equal a significant percentage of the corporate group's total market value.

The Government considered the tax treatment a problem because a demerger is, in substance, the division of a corporate group rather than a distribution of income. Following a demerger, shareholders, for the most part, have the same (or close to the same) proportionate interest in the same underlying assets. Therefore, a demerger can be thought of as akin to a share split, with the assets of the corporate group divided between the split shares.

This means, in principle, there is no distribution of income or underlying assets by the corporate group on a demerger that should be taxed as a dividend. A shareholder's economic ownership has not changed.

The tax treatment of demergers can raise issues for both New Zealand and foreign companies, but the problem was most acute for demergers by listed Australian companies. This is because:

- New Zealand companies can often structure their demergers so that no dividend arises, and
- shares in other foreign companies are more commonly subject to the foreign investment fund (FIF) rules (which ignore dividends).

Shareholdings in respect of listed Australian shares are not subject to the FIF rules. Further, listed Australian companies often have several thousand New Zealand shareholders that are taxable on any dividends received, but they do not structure their demergers to be efficient for New Zealand tax purposes. Dividend taxation for Australian demergers was therefore seen to be disadvantageous to New Zealand shareholders. In comparison, Australian shareholders are not usually taxable on a demerger.

The amendments therefore remove the receipt of shares by a New Zealand taxpayer from the dividend rules in the Income Tax Act 2007 when those shares are the result of a demerger by a listed Australian company, provided that the demerger is not treated as a dividend under Australian tax law. The focus on Australian-listed companies is based on the need to develop a solution that addresses the greatest need, primarily shareholdings by New Zealand individuals in ASX-listed Australian companies.

Key features

New section CD 29C provides that the transfer of shares by an ASX-listed Australian company in a subsidiary company to a shareholder meeting the conditions in new section ED 2B is not a dividend.

New section ED 2B sets out the four conditions (see Detailed analysis) needed for section CD 29C to apply. It provides a formula to calculate the cost price of shares in the new company, which is relevant for taxpayers who hold the ASX-listed company's shares as revenue account property.

Section ED 2B also provides for the adjustment of available subscribed capital amounts.

Consequential changes have been made to sections FC 2 and YA 1. Schedule 25 is also consequentially amended.

Application date

The amendments will apply to the 2016–17 and later income years.

Detailed analysis

Scope of the proposed amendments

The amendments apply to shares and stapled securities issued by Australian resident companies listed on the ASX. The Income Tax Act's definition of "share" includes stapled securities.

New section CD 29C provides that a transfer of shares in a subsidiary company to shareholders by way of a demerger is not dividend if the conditions of section ED 2B are met.

New section ED 2B imposes four conditions on the demerger if the shares transferred to the shareholder are to be excluded as a dividend under section CD 29C:

- The company (the splitting company) must be an ASX-listed Australian resident company: A company is considered ASX listed if it has shares included in an index that is an approved index under the ASX Operating Rules. From the 2017–18 income years, the scope of the ASX-listed Australian company definition is widened to include a company included on the official list of ASX Limited, in line with the changes to the term made by the Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016. The requirement that the Australian company maintain a franking credit account means the amendment does not apply to unit trusts. Unit trusts are not generally taxed as companies under Australian tax law and distributions from unit trusts are not taxed as dividends in Australia.
- The company must transfer shares in the subsidiary owned by the splitting company to the shareholders of the splitting company. The condition is directed at shareholders who receive shares in the new subsidiary only. It does not apply to all shareholders in the splitting company.
- For each shareholder receiving the transfer of shares, any difference in the shareholder's proportional interest must be negligible. A shareholding change would be considered negligible and ignored under section ED 2B if:
  - the change in proportion of total shares held by the shareholder after the demerger is negligible (measured by reference to the individual shareholding in the splitting company before the demerger and the subsidiary after the demerger), or
  - the shareholder has a negligible market value interest in the subsidiary (measured by reference to the total market value of the subsidiary) and any difference is the direct result of non-participation in the demerger by some shareholders.

  The tests in sections ED 2B(1)(c) and (2) are intended to ignore negligible differences in shareholder interests before and after a demerger that could arise from rounding changes or when shareholding interests change because of non-participation by some shareholders in the demerger. In the latter case, the difference must be as a direct result of the impossibility or impracticability for a shareholder to participate in the demerger.
- The share transfer is not a payment of income (taxable or exempt) under Australian tax law. Taxpayers can refer to statements from the Australian Tax Office or the company's demerger documents to help determine this. This condition ensures that the dividend exclusion does not apply if the demerger results in an in-substance distribution of income.

Example

Aus Co Limited, an ASX-listed Australian company, proposes to split itself into two companies of equal size. An analysis of its shareholders, finds that:

- 5.3 percent of Aus Co's shareholders cannot be located, and
- 9.7 percent of Aus Co's shares are held by institutional investors in a jurisdiction that would result in significant compliance costs if Aus Co were to invite those shareholders to participate in the demerger.

Aus Co decides to proceed and invites the remaining 85 percent of its shareholders to participate in the demerger.

As 15 percent of Aus Co's shareholders do not participate in the demerger, the relative interests of shareholders who participate and receive a transfer of shares in the subsidiary will change.

Consider the position of the following shareholders:

- Shareholder 1 holds a current interest of 7% in Aus Co (the splitting company) and participates in the demerger. Following the demerger, shareholder 1 now holds an 8.2% interest in Aus Co and the demerged subsidiary. As the change in shareholding is negligible, the transfer of shares is not a dividend under the Income Tax Act.
- Shareholder 2 holds a 0.5% interest in Aus Co and participates in the demerger. As the shareholding is negligible by reference to the total market value interest in the subsidiary, and any difference is the result of non-participation by other shareholders, the transfer of shares in the subsidiary is not a dividend under the Income Tax Act.

NEW LEGISLATION

Treatment of shareholders

Section ED 2B also sets out the consequences for taxpayers affected by a demerger that holds the shares as revenue account property. While it does not necessarily follow, it is expected when shares in the splitting company are held on revenue account that the new shares in the subsidiary company would be held by the taxpayer on the same basis (unless there is information held by the taxpayer to the contrary). The new section sets out the rules for determining a new cost base for shares in the splitting company and shares in the subsidiary.Consider the simplified example below:

Example

Tom holds shares in ASX Co Limited with a cost price of $1,000. The shares are held on revenue account. At the time of a demerger by ASX Co Ltd, the market value of the shares is $2,000. The demerger will result in two companies of equal size ASX Co Ltd and NZ Co Ltd. Tom will hold shares with a value of $1,000 in each.

The cost of shares in ASX Co is calculated as:

$\$1,000 \times \$1,000 \div (\$1,000 + \$1,000) = \$500$.

The cost of shares in NZ Co is calculated as:

$\$1,000 \times \$1,000 \div (\$1,000 + \$1,000) = \$500$.

Treatment of available subscribed capital (ASC)

Section ED 2B allows the subsidiary company to recognise, if the information is available and it is practical to do so, an ASC balance, with a corresponding reduction in the ASC balance of the splitting company.

If the information about the splitting company's or subsidiary's ASC is not available, or it is not practical to collate the information because of the costs connected with doing so, the ASC of the subsidiary is treated as having a nil opening balance.

New Zealand companies are able to obtain a binding ruling from Inland Revenue to confirm the amount of ASC, if necessary.

AMENDMENT TO THE BANK ACCOUNT REQUIREMENT FOR OFFSHORE PERSONS

Section 55B of the Tax Administration Act

This amendment provides the Commissioner with discretion to allocate an IRD number to an offshore person who does not have a New Zealand bank account if she is satisfied with their identity and background.

Background

Before this amendment, from 1 October 2015, offshore persons had to provide the Commissioner with evidence of their New Zealand bank account before an IRD number could be issued to them[1].

As this requirement had proved difficult to comply with, the amendment gives the Commissioner the power to issue IRD numbers to offshore persons without a New Zealand bank account when she is satisfied with their identity and background.

Key features

The amendment, contained in section 55B of the Tax Administration Act 1994, provides the Commissioner with discretion to allocate an IRD number to an offshore person who has no New Zealand bank account if she is satisfied with their identity and background. This may assist taxpayers who have difficulty in obtaining a New Zealand bank account.

Section 55B replaces section 24BA, which contained the original bank account requirement, in its entirety. Section 55B is a more suitable location for the amendment as it follows sections relating to the requirements for the provision of information (the repealed section 24BA followed provisions requiring taxpayers to keep records).

Application date

The amendment applies from the date of Royal assent, 29 March 2018.

[1] This requirement is subject to some exceptions. For example, there is no need to submit evidence of the New Zealand bank account if a reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 has conducted, for the applicant, the procedures for customer due diligence required under that Act and regulations made under that Act.

Definition of 'offshore person'

For the purposes of the bank account requirement an "offshore person" includes both individuals and non-individuals.

An individual is an offshore person if they are:

- not a New Zealand citizen and do not hold a residence class visa granted under the Immigration Act 2009;
- a New Zealand citizen who is outside New Zealand and has not been in New Zealand within the last 3 years; or
- a holder of a residence class visa granted under the Immigration Act 2009, who is outside New Zealand and has not been in New Zealand within the last 12 months.

A non-individual, such as a company or a trust, is an offshore person if they are 25% or more controlled or owned by an offshore person. For the full definition refer to section 7(2) of the Overseas Investment Act 2005.

Identity criteria

The Commissioner will need to be satisfied with the identity and the background of an offshore person who has no New Zealand bank account, before an IRD number is issued to them. Guidance on acceptable documents and information that needs to be submitted for the Commissioner's consideration is published on Inland Revenue's website **www.ird.govt.nz** (keywords offshore, IRD number, bank account). The documents/information to be submitted depends on whether an offshore person is an individual or a non-individual; and if it is a non-individual, whether or not it is incorporated or not.

Examples below illustrate how the Commissioner may exercise her discretion. Further guidance can be found on Inland Revenue's website **www.ird.govt.nz** (keywords offshore, IRD number, bank account).

Example 1

Adam, who usually resides in California, needs an IRD number as he is coming to New Zealand for 3 months to work for a New Zealand subsidiary of an American parent. Adam is therefore considered an offshore person for tax purposes in New Zealand. The American parent wants to ensure that Adam has his IRD number before his arrival in New Zealand. As Adam has no New Zealand bank account, he will need to submit the following documents with his IRD number application form:

- At least two forms of photographic documentation - such as passport, the United Sates social security card, or his Californian driver licence
- A document confirming his foreign tax information number (TIN), or the reason why no TIN is held
- Proof of current or most recent previous address – such as a utility statement
- Proof of reason for IRD number application (such as the letter from his company confirming that he is going to work on the project in New Zealand)
- A bank account statement with the bank account details in the United States as New Zealand has a Double Tax Agreement with the United States (New Zealand and the United States also have a reciprocal agreement to improve international tax compliance and to implement the Foreign Account Tax Compliance Act (FATCA)).

Because Adam is outside New Zealand at the time of applying, his documents will need to be certified by a relevant agency in California authorised to certify this type of documentation under the laws of California. It can be a professional authorised to certify documents in California (such as a lawyer or notary public), an agency that has issued the original document, a regulatory authority (such as the Internal Revenue Service (IRS)), a judicial authority, or the Californian bank where Adam's bank account is held.

Further details can be found at Inland Revenue's website **www.ird.govt.nz** (keywords offshore, IRD number, bank account).

Example 2

Heidi and Emma are young German nationals who have completed their secondary schooling in Germany and want to work and travel in a number of countries, one of which is New Zealand. They both apply for their IRD numbers following their arrival in New Zealand. Emma already has a fully functional New Zealand bank account, but Heidi does not.

If using an IRD number application form, Heidi will need the following documents:

- One form of photographic identification – such as a passport, German driver licence or German identity card
- Proof of current or most recent address – such as a utility statement
- Proof of reason for applying for the IRD number (such as a job offer or visa allowing to work in New Zealand);
- Her TIN (or reason why there is no TIN).

If using an IRD number application form, Emma will need to provide the same documents as Heidi, but Emma will also need to provide proof of her fully functional New Zealand bank account. The evidence of a fully functional bank consists of a bank statement with at least one deposit and one withdrawal, of different amounts.

When in New Zealand, Heidi and Emma will need to take the originals and legible copies of supporting documents and photographic identification to an authorised Inland Revenue agent (for example, an Automobile Association branch), for "face-to-face" verification. The agent will then post the verified copies of their documents to Inland Revenue.

If applying for an IRD number online through MyIR, the list of documents for Heidi and Emma will slightly differ from the above, as Inland Revenue relies on some checks performed by Immigration New Zealand.

Further details can be found at Inland Revenue's website **www.ird.govt.nz** (keywords offshore, IRD number, bank account).

Example 3

A company incorporated in Singapore wants to open a branch in New Zealand. It is listed on the stock exchange, and it has more than 5 shareholders. The company needs an IRD number, to pay its income tax. The company will need to provide the following documents:

- Certified copy of the certificate of incorporation;
- Details of the stock exchange listing;
- Certified passport photo page for at least one executive office holder or director;
- Certified proof of residential address for at least one executive office holder or director;
- Names, addresses, and TIN numbers of all directors; and
- A bank account statement with the company's bank account details in Singapore as New Zealand has a Double Tax Agreement with Singapore, and both countries have also agreed to automatic exchange of financial account information).

The company's documents will need to be certified by a relevant agency in Singapore, authorised to certify these types of documentation under the laws of Singapore. It can be a professional authorised to certify documents in Singapore (such as a lawyer or notary public), an agency that has issued the original document, a regulatory authority (such as the Inland Revenue Authority of Singapore (IRAS)), a judicial authority, or the Singaporean bank where the company's bank account is held.

Further details on how to submit the application can be found at Inland Revenue's website **www.ird.govt.nz**.

Other exceptions

There are other exceptions to the bank account requirement. Section 55B(2) provides that offshore persons do not have to provide evidence of their New Zealand bank account if:

- they need a tax file number solely because they are a non-resident supplier of goods and services under the Goods and Services Tax Act 1985; or
- they are registered, or have applied to be registered, under section 54B of the Goods and Services Tax Act 1985; or
- a reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 has conducted for them the procedures for customer due diligence required under that Act and regulations made under that Act.

Additionally, in accordance with section 55B(3), a non-resident seasonal worker under the recognised seasonal employer instructions is not required to provide the Commissioner with a current New Zealand bank account for the first month of a period of employment in New Zealand and can use the NSW tax rate. At the expiration of the first month, the evidence of the New Zealand bank account must be provided to the Commissioner so that the NSW tax rate can continue to be used (unless another exception applies). In the alternative, their earnings will be subject to the "no notification" tax code.

PETROLEUM MINING DECOMMISSIONING

The tax rules for petroleum mining previously included a "spread-back" process which allowed prior income tax periods to be reopened to include losses arising from decommissioning expenditure incurred in the current year. This method ensured that decommissioning expenditure, which is a large cost incurred near or at the end of production, did not result in a loss carried forward that would be of no value to the petroleum miner unless it had income from another source.

As the spread-back required Inland Revenue to amend assessments for previous periods, it involved high compliance and administration costs and was considered an outdated process. A number of other issues were also identified where the previous petroleum mining decommissioning rules were not sufficiently detailed, or arrived at an incorrect outcome.

As well as correcting the identified issues, the spread-back mechanism for deducting decommissioning costs has been replaced with a refundable credit similar to other refundable credits already included in the Income Tax Act, most relevantly the refundable credit for mineral mining rehabilitation expenditure.

Application date

The replacement of the spread-back with a refundable credit and other related provisions applies for the 2018–19 and later income years.

The repeal of the terminating provisions in sections IZ 2 and IZ 3 and consequential changes also apply for the 2018–19 and later income years.

The correction of the cross-reference error in section IS 5(1)(a) applies for the 2008–09 and later income years to align with the commencement of the Income Tax Act 2007.

Credit use-of-money interest (UOMI) does not arise for the previous loss spread-back for income tax returns filed after the introduction date of the bill on 6 April 2017. This provision has been repealed for the 2018–19 and later income years along with the other spread-back provisions, as noted above.

Key features

Refundable credit

The main effect of the amendments is to replace the existing spread-back process for petroleum mining decommissioning with a refundable credit. As part of these amendments, a number of further refinements to the legislation have been made.

Under the new rules, a petroleum miner will be eligible for a refundable credit for the following amounts:

- any decommissioning expenditure the petroleum miner incurred in the year; and
- any development expenditure that has not been deducted at the time commercial production ceases.

The refundable credit is calculated by multiplying the lesser of qualifying expenditure and the petroleum miner's net loss by the petroleum miner's current tax rate. The maximum refundable credit is limited to income tax paid by the petroleum miner (or a consolidated group it is a member of) in prior years. The exception to this is when a petroleum miner is decommissioning operations outside New Zealand, in which case the maximum refundable credit is limited to New Zealand income tax paid on petroleum mining operations outside New Zealand.

To prevent a petroleum miner from temporarily ceasing commercial production in order to access a refundable credit, any expenditure qualifying for a refundable credit due to permanently ceasing commercial production is added back as income if production restarts using those assets.

Use-of-money interest (Section 120X of the Tax Administration Act 1994)

When a petroleum miner used the spread-back process, it received a refund of income tax paid in prior years. This was a mechanism for recognising the tax benefit of expenditure incurred in a current period, rather than a reduction in tax payable in those prior years. Accordingly, it was never intended that these refunds should be eligible for credit UOMI. The previous provisions did not reflect this intent. A specific provision has been introduced to ensure credit UOMI is not paid on any refunds arising from the previous spread-back process in periods prior to the refundable credit applying.

Terminating provisions (Sections IZ 2 and IZ 3 of the Income Tax Act 2007)

Sections IZ 2 and IZ 3 were terminating provisions to preserve concessionary treatment that applied to petroleum miners before the rules changed in 1990. These provisions, and a number of consequential provisions, are now redundant and have been repealed.

The one reference in the Income Tax Act 2007 to a "petroleum mining company" that was unrelated to these terminating provisions was its use in the section YA 1 definition of a "controlled petroleum mining holding company". To be consistent with existing definitions, including the section YA 1 definition of a "controlled petroleum mining holding trust", the reference to "petroleum mining companies" has been replaced by "petroleum miners that are companies".

Background

The tax rules for petroleum mining split the life of a petroleum field into two distinct phases: exploration and development. "Exploration" is generally done under a prospecting or exploration permit and involves looking for oil and gas reserves that can be extracted in commercially feasible quantities, whereas "development" is done under a mining permit and involves the extraction of oil or gas for commercial production.

"Exploration expenditure" is deductible when incurred, whereas "development expenditure" is spread over either seven years or under the reserve depletion method which spreads the deduction over the remaining life of the field.

A petroleum miner will incur significant decommissioning expenditure before relinquishing its mining permit. Decommissioning is what happens to wells, installations and surrounding infrastructure when a petroleum field reaches the end of its economic life. Offshore decommissioning usually involves:

- the plugging and abandoning of wells;
- removal of equipment; and
- the complete or partial removal of installations and pipelines.

The policy underlying both the former spread-back and the new refundable credit tax rules recognise that this expenditure is an unavoidable consequence of the production process and that industry-specific timing rules should allow deductions for this expenditure to be effectively offset against income derived in earlier periods.

In the absence of industry-specific tax rules a petroleum miner may pay tax in earlier periods then incur decommissioning expenditure which would be carried forward as a loss to future periods. Unless the petroleum miner had income from other sources, such as a separate field, this loss would never be utilised. The petroleum mining rules recognise that this would be inappropriate given income tax should be based on the net result of an activity, and would discourage petroleum exploration and development. Or, it could encourage a petroleum miner to decommission a field that still contained economically recoverable reserves to ensure that any deductions could be offset against the higher income amounts that are derived in earlier years of a field's life.

To address this issue, a petroleum miner could previously request that the Commissioner reopen earlier tax years to claim a deduction for losses arising "because of the relinquishment of the permit". This process was referred to as a "spread-back". Deductions were spread back to a previous year to the extent taxable income was returned generating a refund of tax, and if those deductions exceed the amount of profit the remainder was carried back another year and so on.

Historically, there were a number of spread-back provisions, for both income and deductions, in the Income Tax Act. These spread-backs are viewed as an outdated approach that results in high compliance and administration costs. Many spread-back provisions have been removed as part of previous reforms and with the removal of the petroleum decommissioning spread-back there are no remaining provisions that spread back deductions equivalent to how the petroleum decommissioning rules previously operated.

The need to amend the petroleum mining rules was an opportunity to modernise the decommissioning rules in a manner that was broadly consistent with existing policy but reduced compliance and administration costs.

Detailed analysis

Amount of the refundable credit (sections LA 6, LT 1 and LT 2 of the Income Tax Act 2007)

A refundable credit is only available to a petroleum miner for qualifying deductions. The deductions that can qualify for a refundable credit are expenditure on decommissioning or any previously undeducted development expenditure at the time petroleum mining operations are permanently ceased.

To the extent a petroleum miner has a loss that is equal to or less than the qualifying deductions this amount is multiplied by the petroleum miner's tax rate. For example a petroleum miner with a $1,000,000 loss for a year, including $800,000 of decommissioning expenditure, could qualify for a refundable credit of $800,000 × 28% = $224,000.

The refundable credit is capped at the amount of income tax paid by the petroleum miner, and any consolidated group it is a member of, in all previous years.

If the refundable credit arises from petroleum mining operations outside New Zealand, the amount of the refundable credit is limited to New Zealand tax paid on those operations. No similar ring-fencing applies to petroleum mining operations within New Zealand.

Any losses that do not qualify for a refundable credit will continue to be carried forward, subject to satisfying the ordinary rules.

Relinquishment of a permit (section LT 1 of the Income Tax Act 2007)

The previous spread-back process was driven off either the year in which a petroleum permit was relinquished or expenditure was incurred because of the relinquishment of the petroleum permit.

The requirement for a permit to be relinquished has been removed. Instead, a refundable credit is available in the year qualifying decommissioning expenditure is incurred. In addition, a refundable credit is available to the petroleum miner for any previously undeducted development expenditure in the year commercial production ceases.

Decommissioning (sections CT 6, DT 16, EJ 20 and YA 1 of the Income Tax Act 2007)

The definition of "removal or restoration operations" has effectively been replaced by the new definition of "decommissioning". This change arose predominately due to the removal of the relinquishment of a permit criterion, as discussed above.

The definition of "decommissioning" is intended to cover actions undertaken by (or on behalf of) a petroleum miner to transition from the commercial production of petroleum to the eventual relinquishment of the permit. These actions include the planning and management of decommissioning as well as the physical removal or restoration of petroleum mining assets. These actions can be undertaken at any point during the life of the permit area and are no longer linked directly to the relinquishment of the permit.

Except as noted below, the definition of "decommissioning" does not apply to an exploration well. Expenditure on abandoning an exploration well continues to be deductible under section DT 1(1) but will generally not meet the definition of "decommissioning" so will not qualify for a refundable credit.

Actions to abandon a well that was drilled as an exploration well will only meet the definition of "decommissioning" in the following circumstances:

- Exploration wells that have been subsequently used for commercial production which have triggered sections CT 3 and DT 7 and meet the definition of a "commercial well" in paragraph (b)(i) of the decommissioning definition.
- Exploration wells in the same permit area and geologically contiguous with a commercial well that are abandoned as part of an arrangement that includes decommissioning the commercial well. Such wells are used, or are suspended for potential future use, to support the extraction from commercial wells, and it may be commercially sensible for them to be abandoned at the same time that the commercial well is decommissioned. To be part of an arrangement this must be between the petroleum miner (or farm-in party) and the person undertaking the decommissioning so that synergies arise from undertaking decommissioning of both wells together. It would not be sufficient for the two wells to be referred to in a decommissioning plan provided to the Government or Government agency.

Wells drilled for the reinjection or disposal of water or gas are specifically included where they were used in the commercial production of petroleum.

In addition to the actions above, the decommissioning definition also includes the ongoing monitoring of a well or site that had itself met the "decommissioning" definition.

Petroleum mining operations (sections CT 5, CT 6, CT 6B, DT 15, DT 20, EJ 18 and LT 2 of the Income Tax Act 2007)

The definition of "petroleum mining operations" in section CT 6B has been amended by removing the "removal or restoration operations" criteria. The equivalent of "removal or restoration operations" in the proposed legislation is "decommissioning". However, decommissioning has not been added to the definition of petroleum mining operations as the definition of decommissioning uses the term "petroleum mining operations" so including decommissioning as part of petroleum mining operations would create a circular reference. So that the scope of petroleum mining operations is broadly maintained, a number of references within the Income Tax Act 2007 to petroleum mining operations have had "or decommissioning" added.

Ceasing commercial production (section EJ 13 of the Income Tax Act 2007)

A petroleum miner who meets the other requirements is entitled to a refundable credit for any previously undeducted development expenditure. This entitlement is triggered once a petroleum miner permanently ceases commercial production. The definition of "petroleum mining operations" has been amended to exclude removal or restoration operations so that decommissioning is not part of petroleum mining operations. As a consequence, in most instances, a petroleum miner that ceases commercial production will do so while continuing to undertake decommissioning, and production will cease in a period prior to the relinquishment of the permit.

"Commercial production" is not a defined term but is already used in a number of places in the Income Tax Act 2007. It aligns with the term used in section DT 6 as "petroleum produced in commercial quantities on a continuing basis under a petroleum permit". Petroleum extracted from an exploration well or under an exploration permit is not treated as commercial production as it is not intended to be extracted on a continuing basis.

Undeducted development expenditure will arise when a petroleum miner spreads development expenditure:

- under the default method and ceases commercial production within seven years of development expenditure being incurred; or
- under the reserve depletion method and ceases production before extracting all of the petroleum included in the probable reserve amount in the formula in section EJ 12B(3).

The justification for allowing a refundable credit when commercial production ceases is that at this point the petroleum miner will no longer be deriving an enduring benefit from this development expenditure in future years even if the petroleum permit has not yet been relinquished.

Restarting commercial production (sections CT 5B, DT 5, DT 7 and DT 7B of the Income Tax Act 2007)

To prevent a petroleum miner from temporarily ceasing production in order to obtain a refundable credit before restarting production, section CT 5B adds back as income amounts of undeducted development expenditure qualifying for a refundable credit in the year commercial production restarts. This income is then spread, consistent with other development expenditure, in a similar manner to that already applied for the claw-back of exploration wells used for commercial production.

This provision applies when production is restarted to the extent that petroleum assets that were used in the original commercial production are reused in the resumed commercial production. This provision will not apply when a petroleum miner restarts production in the same area using entirely new assets.

Notification requirements (section LT 1 of the Income Tax Act 2007)

A petroleum miner must notify Inland Revenue before filing a return that includes a refundable credit.

This requirement is included in section LT 1(1)(b) due to the potential size of a of refundable credit and also because a petroleum miner that has finished decommissioning may no longer have a presence in New Zealand if the refundable credit was subsequently found to be incorrect.

Aside from being before filing the return of income, no specific time has been specified for this notification to be provided. However, officials expect that providing the notification as soon as possible prior to the return being filed may assist in facilitating a timely refund.

Inland Revenue has, and will continue to have, continuing interaction with the small number of petroleum miners and farm-in parties that could potentially qualify for a refundable credit. No specific notification requirements have been prescribed but officials expect these taxpayers would contact Inland Revenue through their normal communication channels so the taxpayers and their refundable credit can be identified and processed by the relevant staff in a timely manner.

A petroleum miner that did not satisfy the notification requirement may be prevented from accessing a refundable credit in which case any losses would be carried forward in the standard manner.

Interaction with imputation credit accounts (sections OB 37, OP 35, RM 2(1B), RM 13 and RM 15 of the Income Tax Act 2007)

A petroleum miner that is an Imputation Credit Account (ICA) company is required to have a sufficient credit balance in its imputation credit account to obtain a refund for a refundable credit. A refundable credit is a refund of overpaid tax under section RM 2(1B). A refund of overpaid tax for an ICA company is restricted by section RM 13. This is consistent with the previous treatment under the spread-back.

Under the previous spread-back, section RM 15(2) allowed a petroleum miner to treat their imputation credit balance as increased to the extent they had forfeited imputation credits due to a loss of continuity between when the income tax was originally paid and the decommissioning expenditure was spread-back. New section RM 15(3) continues this treatment for refundable credits so any taxpayer eligible for a refundable credit can treat their imputation credit balance as increased by up to the amount of credits forfeited due to a loss of shareholder continuity.

As well as treating the imputation credit balance as being increased by section RM 15, it may also be necessary for a portion of the imputation debit for the refund to be disregarded when there has been a breach of shareholder continuity – otherwise the petroleum miner would end up with a debit imputation balance and have to pay further income tax. For the previous spread-back, and other refunds of overpaid income tax, this is achieved by a specific carve-out in section OB 32(2)(b) for companies and section OP 30(2)(b) for consolidated imputation groups. Equivalent carve-outs have been added for refunds of a refundable credit in sections OB 37(1C) and OP 35(1C). These provide that the imputation debit is reduced by the lesser of:

- the imputation credits forfeited due to shareholder continuity; or
- the amount the refundable credit exceeds income tax paid since the loss of continuity.

The reason for this second bullet point is the refundable credit is calculated by looking back at tax paid in previous periods. Where a person eligible for a refundable credit has paid income tax since losing shareholder continuity, it is these credits that should first be used to satisfy a debit arising from refundable credit.

Farm-out arrangements (sections CT 5B, EJ 13, LT 1, LT 2 and YA 1 of the Income Tax Act 2007)

Farm-out arrangements are an existing feature in the petroleum mining rules where another party undertakes work for the petroleum miner in exchange for an interest in the permit or the profits arising from the permit. A farm-in party is already entitled to a deduction for farm-in expenditure, that if it were incurred by a farm-out party would be petroleum development expenditure, exploratory well expenditure, or prospecting expenditure.

To the extent a farm-in party incurs decommissioning expenditure or has unamortised development expenditure upon the cessation of commercial production, these deductions are also eligible for a refundable credit. For the avoidance of doubt, a number of provisions have been amended to specifically allow for this treatment by a farm-in party.

As with a petroleum miner, a farm-in party with unamortised development expenditure will only be eligible for a refundable credit when commercial production in a permit area ceases. If a farm-in party ceases production in that permit area but commercial production continues by a petroleum miner or another farm-in party no refundable credit is available. This is to prevent access to a refundable credit when no equivalent refundable credit would have been available to continuing petroleum miners or farm-in parties.

OVERSEAS DONEE STATUS

Schedule 32 of the Income Tax Act 2007

The following charities have been granted donee status from the 2017–18 and later income years:

- Byond Disaster Relief New Zealand
- Flying for Life Charitable Trust
- Médecins Sans Frontières New Zealand Charitable Trust
- Tony McClean Nepal Trust
- Zimbabwe Rural Schools Library Trust

The Act also makes changes to other existing charities listed on schedule 32:

- "Against Malaria Foundation (New Zealand)" replaces "The World Swim for Malaria Foundation (New Zealand)" with effect from 3 July 2008.
- "Child Rescue Charitable Trust" replaces "Destiny Rescue Charitable Aid Trust" with effect from 11 August 2017.

Background

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

Donee status entitles individual donors to a tax credit of 33⅓ percent of the 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 dates

The new insertions apply from the 2017–18 and later income years. The other changes to the schedule apply from the dates specified above.

TRUSTEE CAPACITY

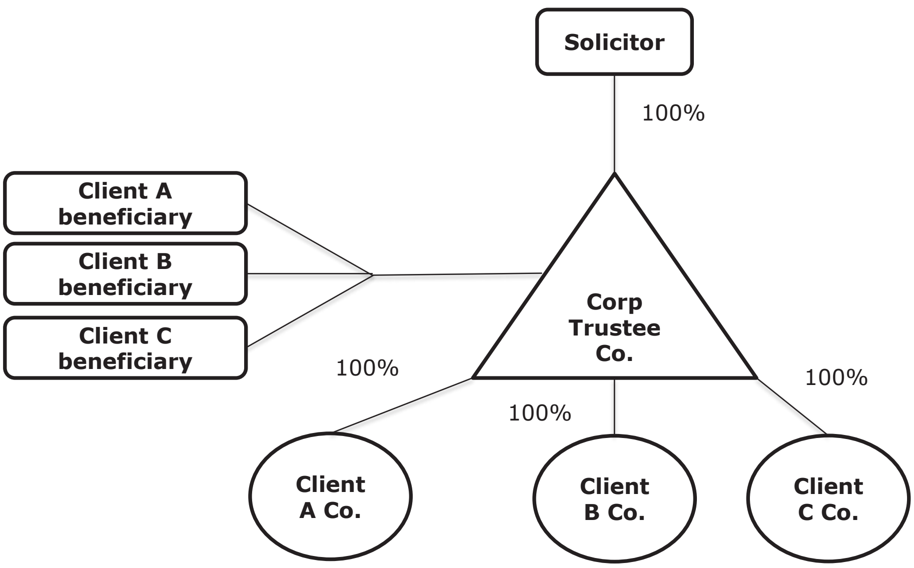
Sections CQ 5(1)(d), DG 3(3), DG 14, DG 14(1)(b)(i), DN 6(1)(d), EX 68(1)(a), FE 3(1)(a), FE 4(1), HA 7(1)(a), MA 1, OB 1(2)(a)(ii), OB 2(2)(a)(i), RE 11(1), RE 12, RE 12(5)(a)(ii), YA 1, YA 5, YB 3(5), YC 9(3), YD 1, YD 2, schedule 1 part D clause 4 of the Income Tax Act 2007; section 3 of the Tax Administration Act 1994; section 2A(1)(hb) of the Goods and Services Tax Act 1985.

New section YA 5 of the Income Tax Act 2007 provides that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal, body corporate, or other capacities. There are a number of exceptions to this general rule where it would be contrary to the policy intent of provisions referring to companies or natural persons to exclude a corporate or natural person trustee. Consequential amendments have also been made to the Income Tax Act 2007, the Tax Administration Act 1994, and the Goods and Services Tax Act 1985.

Background

Two recent High Court decisions (*Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140 and *Staithes Drive Development Ltd v Commissioner of Inland Revenue* [2015] NZHC 2593) changed how the voting interest test, which is used to measure the ownership of companies, including their association, is applied to corporate trustees. In both cases, the High Court held that the voting interests in the relevant companies were held by the legal owner of shares, effectively ignoring the capacity in which those shares were held. This means that the voting rights attached to shares owned by a corporate trustee are attributed to that trustee's natural person shareholders in their personal capacity.

The approach taken by the High Court had the potential to result in overreach in the application of the associated person rules. For example, if a solicitor holds shares in a trustee company, which in turn holds shares in a number of unrelated client companies on trust for unrelated beneficiaries, the otherwise unrelated client companies would be associated for tax purposes (see example below). This could also be the case for other trustee companies that hold shares in companies for otherwise unrelated trusts.



The approach taken by the High Court is also inconsistent with the stated policy intention, which is that corporate trustees should be treated as ultimate shareholders and not a 'look-through' company. The reforms therefore align the legislation with the original policy intent (as reflected in *Tax Information Bulletin* No 5, November 1989; *Tax Information Bulletin* Vol 3, No 7, April 1992; and *Tax Information Bulletin* Vol 21, No 8, 2009).

Key features

The key reforms are:

Income Tax Act 2007

- The introduction of a general rule (new section YA 5) to recognise that a person acting as a trustee of a trust is acting in a capacity that is separate from their other capacities.
- An amendment to the "company" definition in section YA 1 to exclude a company acting in its capacity as trustee.
- An amendment to the "natural person" definition in section YA 1 to exclude a natural person acting in their capacity as trustee.
- A number of consequential rationalising amendments resulting from the general trustee capacity amendment (listed below).
- An amendment to the "close company" definition in section YA 1 to ensure trustees continue to qualify as shareholders in a close company.
- An amendment to section HD 15 (asset stripping of companies) to ensure the provision applies to a company that is acting in the capacity of trustee.
- An amendment to the residence rules in sections YD 1 and YD 2 to ensure that the residence rules for natural persons and companies continue to apply to these persons acting in the capacity of trustee.

Tax Administration Act 1994

- Introducing a new definition of "natural person" to exclude a natural person acting in their capacity as trustee except for the purposes of the definition of "qualifying resident foreign trustee" and the serious hardship provisions in sections 177 and 177A.

Goods and Services Tax Act 1985

- An amendment to the "associated persons" definition to associate a trustee and a person with the power to appoint or remove that trustee.

Application date

The application date for all of the trustee capacity amendments is 29 March 2018, the enactment date of the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act.

Detailed analysis

General rule

New section YA 5 of the Income Tax Act 2007 provides a general rule that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal, body corporate, or other capacities. The new provision, in conjunction with amendments to the definitions of "company" and "natural person", clarifies that:

- any reference to "company" in the Income Tax Act does not include a corporate trustee (subject to any identified exceptions); and
- any reference to "natural person" in the Income Tax Act does not include a natural person trustee (subject to any identified exceptions).

The new rule addresses the overreach that could arise as a result of the High Court decisions (explained above) by ensuring that if a person is the trustee of more than one trust, the person is acting in a different capacity for each trust. The rule also ensures that a corporate trustee is not looked-through, including for the purpose of association.

"Company" definition

The definition of "company" in section YA 1 now excludes corporate trustees from the definition to ensure that if a company is acting in its capacity as corporate trustee, it will be treated as a trustee (and not a company) for tax purposes.

This change is consistent with the policy intent of most of the rules referring to companies. For example, the various company loss grouping and dividend provisions are not intended to apply to a company acting in its capacity as trustee. The exemption in section CW 9 for dividends derived from a foreign company would also not apply to dividends derived by a corporate trustee resident in New Zealand. Another consequence of the general rule is that corporate trustees will not be able to claim the automatic interest deduction for companies in section DB 7. Like other non-corporates, they will need to satisfy the general permission to claim a deduction for interest expenditure under section DB 6.

"Natural person" definition

Similarly, the definition of "natural person" in section YA 1 now excludes natural person trustees from the definition to ensure that if a natural person is acting in their capacity as natural person trustee, they will be treated, for tax purposes, as a trustee (and not a natural person).

Exceptions to the general rule

"Close company" definition

The definition of "close company" in section YA 1 of the Income Tax Act has been amended to include trustees (natural person or corporate) to recognise that many close companies are owned in family trust structures. As a consequence of this change, a minor amendment to section DG 3 was made to remove the reference to natural person trustees – as the clarification is no longer necessary.

Asset stripping of companies

Section HD 15 has been amended to ensure it still applies to a company acting in its capacity as trustee, consistent with Inland Revenue's view that section HD 15 applies to corporate trustees. Section HD 15 authorises the Commissioner of Inland Revenue to recover income tax from the directors and shareholders of a company who have entered into an arrangement or transaction to deplete the company's assets so that it is unable to satisfy its tax liabilities. Without the change, a corporate trustee could enter an arrangement to deplete its assets so that it is unable to satisfy its tax liabilities, and the Commissioner would have no means of recovering any of the corporate trustee's unpaid income tax from its directors or shareholders.

Residence rules

The residence rules in subpart YD have been amended, clarifying that both the natural person residence test in section YD 1, and the company residence test in section YD 2, continue to apply to trustees – ensuring that trustee residence can still be tested.

Along with this amendment, section YD 1 has been aligned with its original policy intent by replacing all references to "person" in the section with "natural person". This confirms the current practical application of section YD 1 to natural persons only.

Consequential amendments

To ensure the general rule applies consistently throughout the Income Tax Act, a number of consequential amendments were made to remove or replace phrases that are no longer necessary given the general trustee capacity rule, or repeal provisions that are no longer necessary as a result. The consequential amendments affect the following provisions:

- CQ 5(1)(d) (*When FIF income arises*)
- DG 3(3) (*Meaning of asset for this subpart*)
- DG 14(1)(b)(i) (*Interest expenditure: non-corporate shareholders*)
- DN 6(1)(d) (*When FIF loss arises*)
- EX 68(1)(a) (*Measurement of cost*)
- FE 3(1)(a) (*Interest apportionment for individuals*)
- FE 4(1), paragraph (c) of the definition of "excess debt entity"
- FE 4(1), definition of "natural person"
- HA 7(1)(a) (*Shareholding requirements*)
- MA 1 (*What this subpart does*)
- OB 1(2)(ii) (*General rules for companies with imputation credit accounts*)
- OB 2(2)(a)(i) (*Australian companies choosing to have imputation credit accounts*)
- RE 11(1) (*Notification by companies*)
- RE 12(5)(a)(ii) (*Interest*)
- YA 1, paragraphs (a) and (b) of the definition of "initial provisional tax liability"
- YA 1, paragraph (a)(i) of the definition of "look-through counted owner"
- YA 1, paragraph (c) of the definition of "look-through interest"
- YB 3(5) (*Company and a person other than company*)
- YC 9(3) (*Shares or options held by trustees*)
- Schedule 1, Part D, clause 4 (*Interest: most companies*)

Amendments to the Tax Administration Act 1994

A new definition of "natural person" has been introduced into section 3 of the Tax Administration Act 1994 to exclude a natural person acting in their capacity as trustee, consistent with the position under the Income Tax Act. The "company" definition in the Income Tax Act 2007 will continue to apply to the Tax Administration Act by virtue of section 3(2).

The new definition of "natural person" includes a 'carve-out' to ensure all references to "natural person" in the "qualifying resident foreign trustee" definition and both sections 177 and 177A (serious hardship provisions), include a natural person trustee. The carve-out is consistent with Inland Revenue's policy that the hardship provisions in the Tax Administration Act are applicable to natural person trustees are personally liable for trustee debts.

Amendments to the Goods and Services Tax Act 1985

New section 2A(1)(hb) has been introduced into the Goods and Services Tax Act. This establishes a mirror provision to section YB 11 of the Income Tax Act, by providing a test associating a trustee and a person with the power to appoint or remove that trustee. This will help ensure that there would be association in similar situations like those that arose in the above High Court decisions.

A person holding the power of appointment or removal is excluded from the associated person test if they hold their position by virtue of their position as a provider of professional services. This carve-out is consistent with the equivalent test in section YB 11 of the Income Tax Act.

PHARMAC REBATES AND GST

Sections 2(1), 25(1)(b), 25(1B) and 25(7) of the Goods and Services Tax Act 1985

This amendment addresses current uncertainty around the GST treatment of rebates paid to Pharmac under an agreement to list a pharmaceutical on the Pharmaceutical Schedule. The amendment ensures that the GST treatment for rebates paid to Pharmac is the same regardless of whether the rebates relate to pharmaceuticals purchased for use in the hospital setting (hospital rebates) or purchased for use in the community setting (community rebates).

Background

Under section 25 of the Goods and Services Tax Act 1985 (the GST Act), suppliers and recipients are required to make adjustments when the agreed consideration for the supply of goods and services changes – for example, because of an offer of a discount or otherwise. The adjustments ensure that the correct amount of GST is returned and claimed on the supply. Credit and debit notes are used to adjust GST if a tax invoice or GST return has already been issued.

Currently, rebates are paid to Pharmac (acting as agent for GST-registered DHBs) under a Pharmac agreement for a range of different circumstances, including when the pharmaceutical supplier wishes to provide a discount on a confidential basis. These rebate payments are passed onto DHBs in full. Owing to the unique way pharmaceuticals are publicly purchased in New Zealand, these rebates paid by suppliers to Pharmac could have different GST treatments depending on whether the pharmaceuticals are purchased in the community setting or the hospital setting.

Community rebates (which relate to pharmaceuticals purchased for use in the community by pharmacies) are not subject to GST as these payments are not considered to alter the previously agreed consideration for the supply of pharmaceutical products. This is because the individual pharmacies that have purchased pharmaceuticals do not receive the rebates. Instead, it is the DHBs, through Pharmac as their agent, that receive the rebate payments. In other words, there is not a sufficient connection between the rebate payment and the original purchase of the pharmaceuticals.

Conversely, hospital rebates (which relate to pharmaceuticals purchased by DHBs for use in hospitals) were considered to alter the previously agreed consideration for the supply of pharmaceuticals and, therefore, were subject to GST. This is because DHBs purchase the pharmaceuticals from the supplier and, through Pharmac acting as the DHBs' agent, receive the rebate payments from the supplier directly.

The different GST treatment gave rise to uncertainty and compliance costs for Pharmac and their suppliers in having to differentiate, for GST purposes, between community and hospital rebates and became unworkable in practice.

In the 2015–16 financial year, community rebates comprised 93 percent of all Pharmac rebates, while hospital rebates made up the remaining 7 percent. The amendment clarifies the current uncertainty associated with the different GST treatments. It also minimises the administrative costs of change to Pharmac and its suppliers by aligning the GST treatment of hospital rebates with the 93 percent of Pharmac rebates that are not already subject to GST.

The fiscal impact of these rebates was neutral under either setting. In the hospital setting the supplier grossed up the rebate payments by the GST amount, and the subsequent adjustments made by the supplier and DHBs cancelled each other out.

Key features

Section 25 of the GST Act has been amended to exclude rebates paid to Pharmac (either acting on its own account or as an agent for a public authority) under a Pharmac agreement from altering the previously agreed consideration for the supply of pharmaceuticals.

The amendment means that regardless of the type of rebate, pharmaceutical suppliers and recipient DHBs will not have to make the necessary GST adjustments required under section 25 of the GST Act.

The terms "Pharmac", "Pharmac agreement", and "Pharmaceutical" are defined in new section 25(7) of the GST Act and are linked to the definitions and concepts in the New Zealand Public Health and Disability Act 2000.

Application date(s)

The amendment will apply to rebates paid to Pharmac on or after 1 July 2018.

LLOYD'S OF LONDON – TAX SIMPLIFICATION

Sections CR 3B, DW 3B, EY 10, HD 3, HD 17B, HR 13, YA 1 "Lloyd's of London", "schedular income" YD 8B and schedule 1

Amendments have been made to the Income Tax Act 2007 to simplify tax compliance obligations for Lloyd's of London (Lloyd's) in connection with the taxation of life insurance business carried on in New Zealand.

Background

Lloyd's is an insurance market, not an insurance company, and has regulatory approval from the Reserve Bank of New Zealand to underwrite life risk in New Zealand. Members of Lloyd's, both corporate and individuals, join together in syndicates to insure risk.

In the absence of the amendments, the taxation rules for non-resident life insurers would have required each member to obtain an Inland Revenue number and file an annual tax return for any life business in New Zealand. The cost of compliance and associated administration cost with these obligations and requirements was considered to be disproportionate to the estimated tax revenue involved and potentially act as a barrier to enter the New Zealand life insurance market.

The amendments made to the Income Tax Act therefore seek to reduce compliance and administration costs with an associated immaterial fiscal impact relative to the status quo. Precedent exists in tax and prudential supervision law in New Zealand and Australia to accommodate Lloyd's unique business structure.

Tax policy officials propose to review in 2021, and periodically thereafter, whether the proposed amendments fairly reflect the tax that should be paid on profit Lloyd's makes from selling life insurance in New Zealand.

Key features

Collectively the amendments create a special presumptive tax on premiums received by Lloyd's from the sale of term life insurance policies in New Zealand. Tax is assessed and returned by Lloyd's' authorised New Zealand agents. For the purposes of the Income Tax Act, "Lloyd's of London" means a person licenced under the Insurance (Prudential Supervision) Act 2010 to carry on insurance business in New Zealand. In the context of these amendments, the focus is on life risk underwritten in New Zealand.

The presumptive tax is calculated on the basis of 10 percent of gross premiums. The tax rate applicable to this income would be 28%, consistent with the current rate of company tax. This approach is consistent with the policy framework for taxing general insurance sold to the New Zealand market by non-resident insurers.

New section YD 8B determines when the sale of life insurance by Lloyd's has a source in New Zealand. The new section specifies that 10 percent of the gross premium has a source in New Zealand if the life insurance policy is offered or was offered and entered into in New Zealand. The section also specifies the special tax rules that apply to the New Zealand sourced income and the type of life insurance policies affected. The section applies to term life insurance policies – life insurance policies that insure life risk only. Profit participation policies and savings product policies are not within the scope of the amendments.

New section CR 3B treats the portion of the premium that has a source in New Zealand as taxable income.

New section DW 3B denies deductions for any expenditure or loss that has a nexus to income under section CR 3B.

Section EY 10 is amended to ensure that the life insurance taxation rules do not apply to Lloyd's in respect of any income to which section CR 3B applies. This change ensures that section EY 48 does not have application to Lloyd's New Zealand life business.

New section HR 13 sets out the obligations on Lloyd's under the Income Tax Act and treats Lloyd's underwriters as one person. This section establishes that Lloyd's is a New Zealand taxpayer in respect of income that is treated as having a source in New Zealand. This section allows for the operation of new section HD 17B in connection with the payment and return of tax by Lloyd's' authorised agents.

New section HD 17B treats an agent for Lloyd's as responsible on Lloyd's behalf for:

- calculating the tax payable on income under section CR 3B;
- paying the required amount of tax; and
- providing the necessary returns of income.

The obligation on the agent under section HD 17B is limited to the premiums the agents is required to pay to Lloyd's. The section ensures that the agent is only responsible for the Lloyd's business it facilitates, not the entire extent of Lloyd's New Zealand life business. Section HD 17B also ensures that banks and other non-bank deposit takers are not treated as an agent of Lloyd's to the extent that they facilitate payment of any life insurance premiums.

Section HD 3 has been consequentially amended in respect of the obligations on Lloyd's agents under section HD 17B.

Schedule 1 has been amended to specify that the tax rate on income under section CR 3B is 28%.

Application date

The amendments will apply to Lloyd's term life insurance policies sold on and after 1 April 2017.

Remedial matters

EMPLOYEE MEAL ALLOWANCE AND DEFINITION OF "EMPLOYER'S WORKPLACE

Section CW 17CB

Key features

The term "employer's workplace" in section CW 17CB (Payments for certain work-related meals) has been clarified as meaning the workplace of the employer at which the employee normally works.

Application date

The proposed amendment applies from 1 April 2015, to coincide with the application date of section CW 17CB.

Background

Generally meal allowances are taxable as they provide a private benefit. However, there is an exemption for meal allowances and similar employer meal payments that are provided to employees who are working away from their employer's workplace.

This exemption is a practical way of recognising that although the cost of a meal is a private expense, there are additional costs for the employee as a result of their employer requiring them to work away from their usual place of work.

Section CW 17CB, enacted in 2014, specifies the situations when the exemption applies.

For the exemption to apply, the legislation requires the employee to be working away from his or her "employer's workplace". When an employer has multiple workplaces, the issue is whether the workplaces that are not the employee's normal place of work are intended to be covered by the term "employer's workplace". For example, an employer may have offices throughout New Zealand and while employees are generally based at particular offices, their work may require them to occasionally work at other offices.

From a policy perspective, meal allowances and reimbursements should be tax-free if they are genuinely business related, irrespective of where the work takes place away from the employee's normal workplace. This includes work at other offices of the employer. The amendment clarifies this intention.

PORTFOLIO INVESTMENT ENTITY (PIE) REMEDIALS

A number of amendments have been made to the Portfolio Investment Entity (PIE) rules to ensure the legislation aligns with the policy intent and operational practice.

Key features

Notification requirements (sections HM 42, HM 43 and HM 44 of the Income Tax Act 2007 and section 31B of the Tax Administration Act 1994)

A multi-rate PIE must elect to use any of the exit calculation, quarterly calculation or provisional tax calculation options. The provisions that allow for this previously stated that the notice requirements were set out in section 31B of the Tax Administration Act 1994 (TAA). This was changed to section 31C by the Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Act 2016.

Section 31B sets out the one-off notification requirements for becoming or ceasing as a PIE while section 31C sets out ongoing notification requirements to Inland Revenue and the PIE's investors. Section 31B is the appropriate place for notification requirements for PIE calculation methodology but previously neither section included these notification requirements.

The cross-references in sections HM 42, HM 43 and HM 44 of the Income Tax Act 2007 have been updated to refer to section 31B. New section 31B(1B) provides the notification requirements for these elections consistent with the existing process.

The final sentence of each of sections HM 42(1), HM 43(1) and HM 44(1) has also been amended so that they are more consistent with each other as they are all intended to have the same purpose – to cross-reference the notification requirements for the attribution period and calculation option of the PIE to section 31B.

PIE losses (Sections HM 67, HM 68, HM 69 and YA 1 of the Income Tax Act 2007)

In general, multi-rate PIEs are able to cash out their tax losses for the current tax year. Provisional tax PIEs are an exception to this general approach – they are required to carry forward their losses to a later tax year. This less favourable treatment of tax losses was part of the policy trade-off for provisional tax PIEs getting simpler rules.

When an entity elects to become a PIE any loss brought forward is treated as a formation loss and spread over three years. Allowing that loss balance to be immediately cashed out could potentially have a significant impact on aggregate tax collections. The formation loss rules therefore exist largely to protect the Government's revenue flows.

The legislation previously did not cover the treatment of a loss carried forward by a provisional tax PIE when it elected to change to the quarterly or exit options. The definition of a formation loss only included losses incurred prior to the entity becoming a PIE, rather than when it was already a PIE using a different calculation method.

The policy intent is that this should also be treated as a formation loss so that a provisional tax PIE cannot cash out its losses by electing out of the provisional tax calculation method. Accordingly, the definition of formation losses has been extended to include a tax loss arising from a period a PIE applied the provisional tax calculation method before applying a different calculation method.

Ownership interests (Section HM 13 of the Income Tax Act 20077)

Subject to a number of exceptions, a PIE (or investor class within a PIE) can only own up to 20 percent of another entity. This is known as the outbound investment test and is designed so that the PIE cannot exert a significant influence on the underlying entity.

Unlike most comparable tests in the Income Tax Act 2007, this test previously only applied to voting interests without having a market value interest test. A consequence of this was a PIE could potentially have undertaken investments that were any proportion of the value of an underlying entity provided voting interests did not exceed 20 percent. This allowed the PIE to undertake investments that could not be considered portfolio investments and would not be comparable with anything available to an individual investor other than through a PIE.

Amendments have been introduced so a PIE cannot hold a market value interest of greater than 20 percent other than where an existing exemption applies.

Unit trusts and the PIE rules (Sections HM 3(1)(b)(iii) and HM 9(c) of the Income Tax Act 2007)

The entrance criteria to the PIE rules for collective schemes and foreign PIE equivalents, in addition to other entity types such as a company or a superannuation scheme, previously included a criterion starting with "the trustee of a trust that would be a unit trust". Two issues arose from these provisions.

The intention of this category was to allow trusts, which met the other requirements, to be a PIE, including where an entity with sufficient owners to meet the PIE entrance requirements in its own right held all the units in a trust that elected to be a PIE.

The phrase "the trustee of a trust" is used in numerous places in the Income Tax Act 2007 and reflects that a trust has no legal personality and instead, the trustee is liable on behalf of the trust and its beneficiaries. However, in this context applying the test to the trustee instead of the trust was inappropriate.

This is because the PIE rules are intended to apply to widely-held investment vehicles, or vehicles that are used for investment by other widely-held investment vehicles. However, the previous provisions allowed a person who was not intended to receive the benefits of the PIE regime (e.g. a New Zealand trading company) to set up a PIE, using a trust where the trustees met the PIE entrance requirements. This issue could have been resolved by removing the words "the trustee of" from the relevant provisions.

Historically it was considered that one of the requirements for a trust to be a unit trust was that it had to have more than one unit holder (for example see public ruling BR Pub 95/5A *Relationship between the "unit trust" and "qualifying trust" definitions*). This restriction was not considered necessary for the purposes of a trust accessing the PIE rules, hence the wording of former sections HM 3(1)(b)(iii) and HM 9(c) including "a trust that would be a unit trust if there were more than 1 subscriber, purchaser, or contributor participating as beneficiaries under the trust".

On 29 July 2016 Inland Revenue released interpretation statement IS 16/02: "*Income Tax – Unit Trusts – When a unit trust can have a single unit holder*". This interpretation statement concludes that the essential feature of a unit trust is the provision of the facilities for subscribers to participate, and that is not altered by there being only one subscriber or the intention that there will continue to be only one subscriber.

On the basis of this interpretation, the relevant wording of the entrance provisions referred to above became largely redundant. This is because a trust would already not be excluded from being a unit trust by only having one subscriber, purchaser, or contributor provided there were facilities for more than one subscriber, purchaser, or contributor. These trusts will therefore be unit trusts which meet the existing entrance criteria as a company in sections HM 3(1)(b)(i) and HM 9(a).

Therefore, sections HM 3(1)(b)(iii) and HM 9(c) are no longer necessary and have been repealed.

Application date

The amendments came into force on the date of Royal assent, 29 March 2018.

DONEE STATUS FOR COMMUNITY HOUSING ENTITIES

Section LD 3(2)(ac) of the Income Tax Act 2007

Section LD 3(2)(ac) of the Income Tax Act has been amended to ensure that community housing entities have done status only for the period that the entity qualifies for the income tax exemption in section CW 42B. This means that donations made to the entity during that period would be eligible for the donations tax concessions.

Background

From 14 April 2014, donations made to community housing entities that meet the requirements to derive exempt income under section CW 42B, qualify for the donations tax concessions.

However, due to an earlier amendment to section LD 3(2)(ac), donors were able to claim a tax credit or gift deduction for donations made to a community housing entity when the entity did not meet the requirements of section CW 42B. This was possible because the previous wording stated that a donation tax concession was available for donations made in a tax year that the entity met the requirements to derive exempt income under section CW 42B.

This meant that a donation made to an entity that began a tax year qualifying for the section CW 42B income tax exemption, but ceased to qualify later in that year, would have still qualified for a donation tax credit or gift deduction. For example, if a community housing entity met the section CW 42B requirements from 1 April 2016 until 30 September 2016, under the previous wording of section LD 3(2)(ac), any donations made to that entity between 1 October 2016 and 31 March 2017 would have qualified for a donation tax credit because the donation was made during the 2016–17 tax year. This was not the intention of the provision.

The amendment to section LD 3(2)(ac) therefore ensures that donation tax concessions are available only for donations made to a community housing entity during the period the entity qualifies for the income tax exemption under section CW 42B.

Application date(s)

The amendment applies from 14 April 2014, when sections LD 3(2)(ac) and CW 42B came into force.

THE USE OF PART-YEAR ACCOUNTS FOR THE ACCOUNTING STANDARDS TEST

Sections EX 21B(5), EX 21F

New section EX 21F of the Income Tax Act 2007 allows a person (or a member of their group) who only holds an income interest in a controlled foreign company (CFC) for part of an accounting period to use accounts that cover that part-period to calculate whether the CFC passes the active business test under the accounting standards test.

Background

The amendment addresses the concern that a person who only owns an income interest in a CFC for part of an accounting period may not have access to the CFC's prepared accounts for the full accounting period and must therefore use the default test to determine whether the CFC passes or fails the active business test.

To determine whether a CFC is a non-attributing active CFC under section EX 21B, two different methods are available – the default test in section EX 21D and the accounting standards test in section EX 21E. The default test uses tax concepts specified in the Income Tax Act 2007, while the accounting standards test is a concessionary approach which allows the taxpayer to use accounts prepared under a permitted accounting standard (for example, International Financial Report Standards (IFRS) with some adjustments. If less than 5 percent of the CFC's total income is passive income under either method, the active business test is passed, the CFC is a non-attributing active CFC and no CFC income or loss is required to be attributed.

If a person uses the accounting standards test and breaches the 5 percent threshold, they may then do the calculation using the default test. If they fail the active business test using the default test, they are required to calculate their attributable CFC income or loss for the accounting period. There is some overlap between the calculations undertaken for the default test and the calculations undertaken to calculate the attributable CFC income or loss.

The calculation under both the default test and the accounting standards test look at the full accounting period for the CFC. Under the accounting standards test, this requires a set of accounts for the full accounting period prepared under an applicable accounting standard, for example IFRS.

One issue prior to the enactment of this Bill was that when a person only has an income interest in a CFC for part of an accounting period, they may not have a set of accounts for the full accounting period which meets the required standard. This means they were unable to use the accounting standards test and were instead required to use the default test, which can be more compliance intensive, even if it was clear that the CFC is an active business.

Key features

New section EX 21F allows a person (or a member of their group) who only holds an income interest in a CFC for part of an accounting period to determine whether the active business test is passed under the accounting standards test, using accounts prepared for that part-period of ownership, provided the accounts meet the other requirements set out in sections EX 21C and EX 21E.

If the accounts do not meet the requirements of section EX 21C or if they do not cover the entire part of the accounting period when the CFC is owned by the person or a member of the person's group, they must use the default test in section EX 21D.

Application date

The amendment is treated as coming into force on 1 July 2009.

AVAILABILITY OF FOREIGN TAX CREDITS

Sections LK 1 and LK 2

Amendments in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 provide that a foreign tax credit will be available under section LK 1 of the Income Tax Act 2007 for foreign income tax paid in relation to a CFC from which attributable income is derived, when the foreign income tax has been paid by the taxpayer's parent or a member of the taxpayer's group.

Background

Under section LK 1, a person with attributed Controlled Foreign Company (CFC) income is provided a tax credit for income tax paid in relation to the CFC. This ensures that the income derived by the CFC is not double taxed. Similarly, a foreign tax credit is also provided under section LK 1 for foreign income tax (including withholding tax) paid in relation to the CFC against the New Zealand shareholder's income tax liability.

For a foreign tax credit to be available under section LK 1, the foreign income tax must be paid by the CFC from which the income is derived or by the person with the attributed CFC income in relation to the CFC from which the income is derived.

In some situations, it is possible that foreign income tax has been paid in relation to the CFC from which the attributed income is derived, but neither by the CFC nor by the person with the attributed CFC income. This could occur, for example, if both the CFC and the person are seen as transparent by the CFC's home jurisdiction or if there is another entity interposed between the person and the CFC. As a result, foreign income tax may in reality be paid by the person's parent company or another member of the person's group, but no credit would be available under section LK 1(1).

Key features

This Act inserts section LK 1(1B) into the Income Tax Act 2007 to provide a foreign tax credit when a member of the person with attributed CFC income's group has paid foreign income tax in relation to the CFC from which the attributed income is derived. This ensures that a foreign tax credit is available when foreign income tax has been paid by a person who is part of the same functional economic unit as the person with the attributed CFC income.

Under section LK 1(1B), the foreign tax credit is provided to the group company that has paid the foreign income tax, rather than the person with the attributed CFC income. The group company is then able to make the foreign tax credit available to the person with the attributed CFC income under section LK 6, which provides for the use of credits by group companies in certain situations.

Generally, in order to make a credit available to another group company under section LK 6, residence requirements in section IC 7 must be met. This is intended to protect the integrity of the tax system. However, an exception has been introduced for foreign tax credits that arise under section LK 1(1B) in new section LK 1(1C), so that the requirements in section IC 7 do not apply to disallow the transfer of the credit. This is intended to ensure that the credit is able to be transferred to the person with the attributed CFC income, because it is possible that the group company may not be resident in New Zealand.

Section LK 2(4) has been inserted to ensure that when a tax credit does arise under section LK 1(1B), the amount of the credit is correctly calculated.

Application date

The amendments are treated as coming into force on 1 July 2009.

OTHER REMEDIAL AMENDMENTS RELATING TO FOREIGN TAX CREDITS

Sections LK 1(4) and LK 2(3)

Background and key features

Section LK 1(1)(d) was inserted as a rewrite issue in the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013, to ensure that a foreign tax credit is available when a foreign income tax is paid by the person with attributed CFC income in relation to the CFC from which the income is derived.

An amendment has been made to section LK 1(4) in this Act to ensure that a tax credit under section LK 1(1)(d) also includes amounts of tax withheld on behalf of the person.

In addition, section LK 2(3) has been inserted to ensure that the amount of the foreign tax credit available is correctly calculated.

Application date

The amendments apply for the 2008-09 and later income years.

NON-ATTRIBUTING AUSTRALIAN CFCs: UNIT TRUSTS

Section EX 22

Section EX 22 of the Income Tax Act 2007 has been amended to ensure that an Australian unit trust is a non-attributing Australian CFC where the unit holder is an Australian resident CFC and Australian income tax has been paid because the unit trust is treated as part of the head company of a consolidated group subject to income tax under Australian law, or because the unit holder is subject to tax on the income it is presently entitled to.

Background

Section EX 22 of the Income Tax Act 2007 contains an exemption from attribution under the CFC rules for certain Australian CFCs. The rationale behind this exemption is that any income derived in Australia would have been subject to tax in a similar manner as it would have been if that income were derived in New Zealand.

An amendment in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 excluded Australian unit trusts from this exemption on the basis that unit trusts are generally flow through in nature so where the unit holder is not resident in Australia, not all of the unit trust's income would therefore be subject to tax in Australia. Under the Australian trust regime only a low rate of tax is withheld from passive income; under the New Zealand CFC or non-portfolio FIF regime that income is exempt. In addition, no Australian tax is paid on non-Australian sourced income to which a New Zealand-resident beneficiary is presently entitled.

That amendment did recognise that a unit trust itself can be subject to income tax under Australian law on its income in the same way as a company. However, it did not take account of the situation where an Australian resident company is interposed between the trust and the New Zealand investor, so Australian income tax is paid by that Australian resident company rather than the trust (for example, because the Australian unit trust forms part of an income tax consolidated group or the head company is subject to tax on the income it is presently entitled to as the unit holder).

Key features

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 amends section EX 22(1)(c) to expand the definition of non-attributing Australian CFC to cover certain situations where a unit trust is not itself taxed as a company, but instead the unit holder is an Australian resident and is comprehensively taxed on the unit trust's income. This is in line with the overall policy intent that the non-attributing Australian CFC exemption should be available where the CFC's income is subject to comprehensive income tax in Australia.

A unit trust is a non-attributing Australian CFC under section EX 22(1)(c)(iii) if the units in the unit trust are owned by an Australian-resident entity as described in section EX 22(1)(a)(iii) and the unit holder is subject to Australian income tax on the unit trust's income either because it is presently entitled to the income from the unit trust or the unit trust is treated as part of the head company of a consolidated group which is subject to Australian income tax.

Application date(s)

This amendment applies to income years beginning on or after 1 July 2014.

INSURANCE BUSINESS CFCS

Section 91AAQ of the Tax Administration Act 1994

Section 91AAQ of the Tax Administration Act 1994 provides that the Commissioner of Inland Revenue may determine that an overseas insurance business is a non-attributing active CFC. The amendment removes the requirement that the CFC must have been owned prior to 30 June 2009 for a determination to be issued under section 91AAQ, which allows overseas insurance businesses acquired after 30 June 2009 to qualify.

Background

Under the CFC rules, income from insurance is treated as passive income and therefore must be attributed to the New Zealand shareholder. As a result, New Zealand insurance companies with foreign subsidiaries operating active insurance businesses in foreign markets do not pass the active business test and are required to attribute income back to New Zealand under the CFC rules.

Several constraints, including the complexity of the issues involved precluded the drafting of special rules for financial institutions (including insurance companies), it was not possible to do so at the same time the active income exemption was introduced. This work was due to be taken forward in the second phase of the international tax review, alongside the work on non-portfolio FIFs and offshore branches. Legislation for the extension of the active income exemption for non-portfolio FIFs was enacted in 2012 and work on the application of the active business test to financial institutions would have followed the work on offshore branches, but for other priorities.

A transitional measure was introduced at the same time as the active income exemption, which allows the Commissioner to issue a determination under section 91AAQ of the Tax Administration Act 1994. This measure allows a New Zealand insurance company to pass the active business test in relation to an offshore active insurance business if it can demonstrate that the offshore insurance business is an active business. The determination facility was not made available for other types of financial institutions because the boundary between active and passive income is less apparent.

Prior to the enactment of this Bill, section 91AAQ included a requirement that before 30 June 2009, the offshore insurance business must have been controlled by a New Zealand resident and it must have operated a business of insurance in its country of residence. This date requirement was deemed necessary as the determination facility was only intended to be a transitional measure until further work could be completed on extending the active business test to financial institutions more generally. At this time, it is not certain when this work will be progressed.

Key features

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 removed the 30 June 2009 requirement in sections 91AAQ(2)(c) and (3)(a). This allows New Zealand insurance companies with offshore insurance subsidiaries to apply for a determination under section 91AAQ to deem the subsidiary a non-attributing active CFC, regardless of when it was acquired.

Other requirements remain unchanged to protect the integrity of section 91AAQ and the CFC rules more generally, including the requirement that "all or nearly all" of the income must be from premiums from insurance contracts (excluding reinsurance) covering risks located in the same jurisdiction where the CFC is located and proceeds from investment assets having a total value commensurate with the value of those insurance contracts.

Application date

The amendment is treated as coming into force on 1 April 2017.

MISCELLANEOUS TECHNICAL AMENDMENTS

GST

Sections 10(14), 20H(1), 25AB(1)(d), 53(1)(ca), 54B(1)(d), (4), (5) and (6) of the Goods and Services Tax Act 1985

Some remedial amendments have been made to the GST legislation as follows:

- The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 resulted in some amendments to sections 10(14) and 54B of the Goods and Services Tax Act 1985 having two different potential application dates. Subsequent amendments confirm the intended application date for the change to the section 10(14) is 1 April 2012, while the intended application date for the changes to section 54B(1)(d), (4), (5) and (6) is 1 April 2014.
- A recent change ensures that the rules dealing with changes in consideration for a supply apply correctly to deductions claimed by GST-registered purchasers of secondhand goods; however, the original drafting of the provision was wider than what was intended. Further, the provision incorrectly referred to a "debit note" instead of a credit note. An amendment clarifies that new section 25AB only applies to secondhand goods acquired by a GST-registered person when a deduction was claimed by the purchaser in line with the GST rules for secondhand goods.
- Section 20H(1) of the Goods and Services Tax Act 1985 contained an incorrect cross-reference to section 20(3)(hc) of the same Act. Section 20H(1) has therefore been amended to correctly refer to new section 20(3)(hd).
- Section 53(1)(ca) contained an outdated cross-reference to former section 15(4)(b). The section has therefore been amended to correctly refer to section 15(4).

Application date

The amendments apply on and after 30 March 2017 (being the date on which the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 received the Royal Assent), except for the amendment to section 20H(1) which is treated as having come into force on 1 April 2017, and the amendment to section 53(1)(ca) which came into force when this Bill received Royal Assent on 29 March 2018.

CLOSELY HELD COMPANY REMEDIALS

Sections CB 32C, DB 11, EW 29, EW 47B, HG 4, HZ 4E, MD 9, MD 15, RD 3B, RD 3C, RD 36, YA 1

Background

A number of remedial amendments have been made to correct provisions in the recent Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017.

Key features

The amendments:

- update the Income Tax Act's list of continuity provisions to include the qualifying company continuity provisions. This ensures that the death of a qualifying company shareholder does not result in a breach of continuity and that multiple trustees are treated as a single notional person;
- correct an error whereby, for the purposes of the look through company (LTC) "entry tax" formula, a company was effectively not getting the benefit of an imputation credit for income tax that was payable for an earlier income year but was not due to be paid until after the date of entry into the LTC regime;
- ensure the self-remission provisions work as intended when a LTC converts to an ordinary company as a result of a liquidation or similar event, or a partnership is dissolved, by ensuring there is an effective base price adjustment for the lender at the time of conversion;

NEW LEGISLATION

- ensure the transitional rule for companies affected by the changes to the LTC eligibility criteria only applies to LTCs that lose their LTC status in the income year the new eligibility rules commence;
- simplify the rules that enable variable employment income to be subject to PAYE, provisional tax, or a combination of both, by removing the "anti flip-flop" rule. The rule is considered unnecessary as the recently enacted provisional tax interest avoidance arrangement rule can be relied on instead;
- clarify that a shareholder-employee has choice over the method used to determine the extent to which PAYE will apply to their income.
- clarify the drafting of section RD 36, which enables income to be backdated to clear employment related loans when certain conditions are met;
- update various cross-references that referred to the old sections RD 3(2)-(4); and
- clarify the section YA 1 definitions of "grandparented charity" and "look-through company".

An amendment has also been made to correct an unintentional narrowing of the provisions for PAYE and shareholder salaries that arose out of the rewrite of the Income Tax Act.

Application date(s)

The amendments apply from the same periods that the original amendments they are intended to correct apply from. This is generally either the 2017-18 and later income years or 1 April 2017 (unless otherwise indicated).

Detailed analysis

Qualifying company continuity provisions

An amendment to section HA 6 was made in the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 which provided that qualifying company status will cease if there is a change in control of the company.

A remedial amendment has been made to include, as intended, section HA 6 in the list of continuity provisions in the Income Tax Act 2007 to ensure that sections YC 8 to YC 19B apply when considering qualifying company shareholder continuity. This means that continuity is not breached merely because a shareholding has transferred on the death of a qualifying company shareholder and that all trustees of a qualifying company are considered a single person for determining continuity.

This amendment applies for the 2017-18 and later income years.

Entry tax formula

The LTC entry tax formula is contained in section CB 32C and applies when a company elects to become a LTC. It triggers a tax liability on retained earnings of the company by deeming the company to have been liquidated immediately prior to conversion with those retained earnings being distributed to shareholders as a dividend and taxed at the owners' personal marginal tax rates.

This adjustment is intended to reflect the fact that retained earnings earned before becoming a LTC would have been taxable in the hands of shareholders if distributed before the company became a LTC. It provides a square-up or clean slate on entry given that any distributions by the LTC will be tax-free.

An error with this formula has been identified that results in a company which is converting to a LTC effectively not getting the benefit of an imputation credit for income tax payable for an earlier income year, but not due to be paid until after the date of entry into the LTC regime.

An amendment to section CB 32C has been made to ensure that the company's shareholders get the benefit of this credit when applying the entry tax formula. This is done by including any tax or refunds payable for the relevant income year but not due to be paid until a later year (for example a company's third payment of provisional tax or terminal tax), in the calculation of the reserves imputation credit in section CB 32C(5)(b).

Example 1

An ordinary company has one shareholder (who is in the 33% tax bracket). The company for the 2017-18 income year earns $100,000 of net income.

For its first two provisional tax payments, the company pays $20,000. It plans to pay $8,000 on its 3rd payment of provisional tax. Before this third payment, the company converts to a LTC and makes an entry tax calculation. The formula for the entry tax is:

(untaxed reserves + reserves imputation credit) * effective interest

The untaxed reserves are $72,000 as this is the amount of cash available to distribute after meeting its current income tax liabilities.

Under the new definition of reserves imputation credits the amount of reserves imputation credits are $28,000. This is calculated by taking the amount of credits in the company's imputation credit account ($20,000) and adding any income tax payable for an earlier income year but not paid before the relevant day ($8,000).

This creates a deemed dividend of $100,000 for the shareholder. The company may attach $28,000 of imputation credits to this deemed dividend.

This amendment applies on and from 1 April 2017, for the 2017-18 and later income years.

Self-remission when LTC converts to an ordinary company

Amendments made in the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 ensure that a LTC shareholder or a partner in a partnership do not have debt-remission income, when they lend money to the LTC or partnership which they subsequently remit. This 'self-remission' adjustment is achieved by providing the shareholder or partner a deduction (through a negative base price adjustment) that balances out any debt remission income they receive as a result of the look-through from their LTC or partnership interest (through a positive base price adjustment).

When a LTC converts to an ordinary company, HB 4(6) deems the owners of the LTC to have disposed of their property to a third party which is then reacquired once the LTC has converted to an ordinary company. This requires the LTC shareholders to perform a base price adjustment in their debtor capacity. When the LTC is insolvent this can result in income for the LTC shareholders, including those who have lent money to the LTC. A comparable outcome arises under section HG 4 for partners in partnerships.

Accordingly, the concept of 'self-remission' was extended to also include these situations. In particular, section EW 39 was amended to provide 'self-remission' treatment when there is income from a deemed disposal on a liquidation or similar event that arises due to money lent from a shareholder to a LTC. Section EW 39(4) was intended to address the effective self-remission through allowing the shareholder to reduce the amount of their respective base price adjustment by the amount of self-remission.

However, subsequent to the enactment of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 concerns were raised with officials that the amendment to section EW 39 did not achieve its purpose. This is because when a LTC converts to an ordinary company, the shareholders of the company who have lent money to the LTC are not required to perform a base price adjustment in their creditor capacity because they have not disposed of the financial arrangement and, therefore, do not get the benefit of self-remission.

The same issue can potentially arise when a partner has lent money to their partnership.

New base price adjustments for deemed disposals

Section EW 39(4) has, therefore, been replaced by new sections EW 29(14) and EW 47B.

Under section 29(14), a person that is a party to a financial arrangement in their capacity as owner or partner of a look-through company or a partnership must calculate a base price adjustment as at the date of disposal of the financial arrangement if they are also a party in a capacity other than as owner or partner (referred to as their private capacity). This applies when the disposal is under either sections HB4(3), HB4(6), or HG4 (those sections relating to cessation of LTCs and dissolution of partnerships).

Section EW 47B adjusts the amount of consideration for the shareholder of the LTC or partner of a partnership to ensure that any remission income attributed to them from the LTC is cancelled out by a corresponding negative base price adjustment.

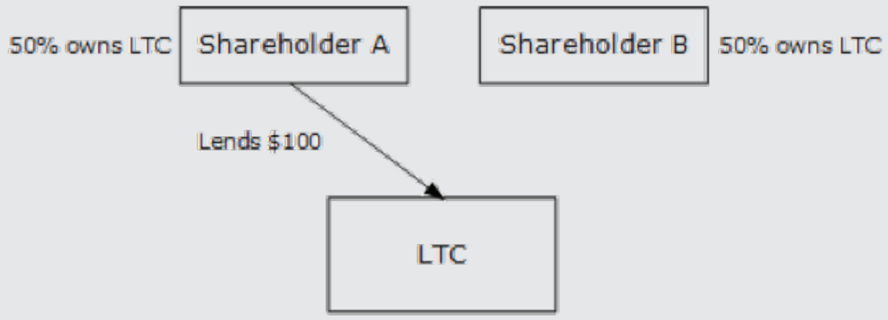
Section EW 47B provides that when section EW 29(14) applies, the shareholder or partner is deemed to have:

a) paid consideration for the financial arrangement (equal to the face value of the loan) multiplied by their owner's or partner's interest in the LTC; and

b) paid out consideration equal to the impaired value of the loan on the date of disposal multiplied by their owner's or partner's interest in the LTC.

Section DB 11(1C) ensures that any negative base price is deductible for a shareholder of a LTC or partner of a partnership in the above circumstances. The deduction can be no more than the amount under (a) above.

Example 2



A LTC is 50 percent owned by two shareholders – shareholder A and shareholder B. Shareholder A lends $100 to the LTC.

The LTC becomes insolvent and cannot repay its debts. As part of a restructure the shareholders decide to convert the LTC to an ordinary company.

Base price adjustment for owner's interests

As the shareholders of the LTC are deemed to dispose of their interests in the financial arrangement in their debtor capacity, they are required to perform a base price adjustment. As the market value of the asset is $0, there is income of $100 which is attributed equally to shareholder A and shareholder B.

Base price adjustment for shareholder A as lender

Under section EW 29(14) shareholder A must calculate a base price adjustment for the debt. This is because:

- the other parties to the financial arrangement have disposed of their interests in the financial arrangement;
- the disposal is due to the deemed disposal provisions in HB 4(3), HB 4(6) or HG 4; and
- shareholder A is a party to that financial arrangement other than as an owner (i.e. in their private capacity).

BPA calculation

Consideration in – consideration out – income + expenditure + amount remitted

Under section EW 47B shareholder A is deemed to have received 'consideration in' of the market value of the loan ($0) multiplied by their owner's interest (50%). As a result the 'consideration in' is $0.

Section EW 47B provides that the 'consideration out' is the face value of the loan ($100) multiplied by shareholder A's owner's interest (50%). As a result the 'consideration out' is $50.

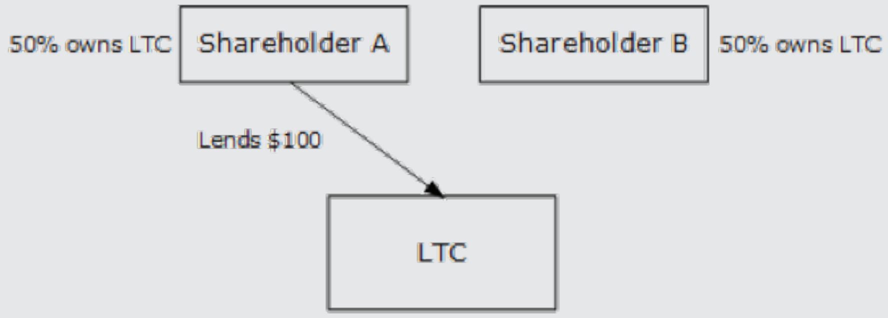
Shareholder A, therefore, has a negative base price adjustment of $50, which is allowed as a deduction under section DB 11(1C). It offsets the $50 of remission income so that shareholder A's net income is $0.

Base price adjustment for Shareholder B

Section EW 29(14) does not apply to Shareholder B as their interest in the financial arrangement arises only through their capacity as an owner of the LTC. As a result, shareholder B has income of $50 from its share of the remission income.

NEW LEGISLATION

Example 3



A LTC is 50 percent owned by two shareholders – shareholder A and shareholder B. Shareholder A lends $100 to the LTC.

As part of a restructure the shareholders decide to convert the LTC to an ordinary company. The LTC has few assets and can only realistically pay $25 of the loan if it was due at the date of conversion.

Base price adjustment for owner's interests

The LTC shareholders are deemed to dispose of their owner's interests in the financial arrangement and, therefore, a base price adjustment is required. As the market value of the asset is $25, both shareholder A and shareholder B receive income of $37.50 from this adjustment.

Base price adjustment for shareholder A as lender

Under section EW 29(14) Shareholder A must also calculate a base price adjustment for their interest as the creditor.

BPA calculation

Consideration in – consideration out – income + expenditure + amount remitted

Under section EW 47B shareholder A is deemed to have received 'consideration in' of the market value of the loan ($25) multiplied by their owner's interest (50%). As a result, the 'consideration in' is $12.50.

Section EW 47B provides that the 'consideration out' is the face value of the loan ($100) multiplied by shareholder A's owner's interest (50%). As a result, the 'consideration out' is $50.

Therefore, shareholder A has a negative base price adjustment of $37.50 ($50-$12.50), under section EW 47B, which is allowed as a deduction under section DB 11(1C). That deduction offsets the $37.50 of remission income so that their net income is $0.

Base price adjustment for Shareholder B

Shareholder B has no offsets so their income is $37.50 from their share of the remission income.

The above amendments apply from 1 April 2011.

Transitional rule for LTCs

The Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 provided a transitional rule for companies that lose LTC status as a result of the amendments to the eligibility criteria for LTCs. The transitional rule enables them to transition to being ordinary companies without triggering the exit adjustment requirements in section HB 4(6).

This transitional rule was intended only to apply for the first income year the LTC amendments came into force. However, it has been raised that under current drafting, the transitional rule could apply to LTCs that convert to ordinary companies in any year following the application of the amendments and not just the first year.

Accordingly, an amendment has been made to section HZ 4E to ensure that the transitional rule only applies if a company loses its LTC because it does not meet the revised criteria in the first income year that the new eligibility criteria apply.

The amendment achieves this by applying the transitional rule only when a LTC loses eligibility on the first day of application of the amendment to LTC eligibility in the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017. When a LTC loses LTC eligibility partway through an income year, section HB 1 treats the LTC as losing its LTC status for the entire income year. As a result, the transitional rule will apply if LTC eligibility is lost at any point during the first income year of application of the new eligibility rules.

Example 4

Co. X is a LTC with a 31 March balance date. Its sole shareholder is a trust. On 1 July 2017 the trust makes a distribution to a corporate. Under the amended definition of "look-through company" in section 288(59) of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 Co. X will no longer qualify as a LTC from the beginning of the 2017-18 income year.

Co. X is able to utilise the transitional rule in section HZ 4E. This is because section 288(59) of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 applies to the 2017-18 and later income years and Co. X was no longer eligible to be a LTC on the first day of application of the amendment's application.

Example 5

Co. Y is a LTC with a 31 March balance date. Its sole shareholder is a trust. On 1 July 2018 the trust makes a distribution to a corporate.

Co. Y will not be able to utilise the transitional rule in section HZ 4E. This is because Co. Y lost LTC eligibility from the beginning of the 2018-19 income year. The amendment to LTC eligibility for corporate shareholders applied from the beginning of the 2017-18 income year and so section HZ 4E does not apply.

Example 6

Co. Z is a LTC which is owned by foreign LTC holders and earns foreign-sourced amounts greater than $10,000, which make up most of its income. Co. Z has a 31 December balance date.

Co. Z loses its eligibility to be a LTC for the 2018-19 income year due to the amended definition of "look-through company" in section 288(60) of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017.

Co. Z is able to utilise the transitional rule in HZ 4E. This is because the amended definition of "look-through company" for foreign LTC owners in section 288(60) applies to income years beginning on or after 1 April 2017. Given that Co. Z has an early balance date the first day of application of this amendment is the first day of its 2018-19 income year (1 January 2018).

Shareholder salary "anti flip-flop" rule

In the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 an amendment was made to prevent shareholders from repeatedly switching between paying shareholder salary subject to PAYE and shareholder salary not subject to PAYE in order to avoid paying provisional tax.

This rule is now considered unnecessary as the recently enacted provisional tax interest avoidance arrangement rule would generally cover this same situation and remove the advantages of this "flip-flop" arrangement (see section 120KBB of the Tax Administration Act 1994). As a result, the rules have been simplified by removing this anti "flip-flop" rule, through repealing sections RD 3B(2) and RD 3C(2).

This amendment is backdated to 30 March 2017, the application date of the shareholder-salary amendments. The shareholder-salary amendments were originally intended to apply for the 2017-18 and later income years but due to a drafting oversight, instead apply from date of enactment (30 March 2017). Backdating the application of the removal of that rule should remove any concern that this could result in the anti "flip-flop" rule inadvertently applying retrospectively to the 2016-17 income year.

Clarifying there is choice

The words "if the person elects to apply this section" have been added to both section RD 3B(1) and RD 3C(1). This is to clarify that the chosen method for determining the extent to which PAYE will apply to a shareholder-employee's income will continue to apply until another is chosen, to avoid any impression that the shareholder-employee is locked into a method.

These amendments apply from 30 March 2017.

Unintentional narrowing of shareholder-salaries

As a result of the rewrite of the Income Tax Act an unintended error arose in the drafting of section RD 3. This error unintentionally tightened the requirements in section RD 3(2)(a)(ii) so that it would not apply when an employee receives 66% or more of their gross income through irregular payments of salary from the company. This section has been amended to correct this error, prospectively, in the equivalent replacement section RD 3B.

This amendment applies from 30 March 2017.

Cross-reference corrections

A number of sections in the Income Tax Act have been amended to update cross-references that referred to the previous sections RD 3(2)-(4), to reflect their replacement by sections RD 3B and RD 3C. References to sections RD 3(2)-(4) have been similarly updated in the Accident Compensation Act 2001, the Health and Safety at Work Act 2015 and the Live Organ Donors Act 2016.

Amendment to the definitions of "grandparented Māori authority" and "look-through company"

The definition of "grandparented charity" has been amended by replacing the reference to "a charity" with "a tax charity". This amendment simply matches the wording with that used in the definition of "look-through company" which allows for a look-through company to be owned by a grandparented tax charity.

The definition of "look-through company" has also been amended. An entity that has an owner that is a trustee of a trust cannot be a look-through company if that owner makes a distribution to a company that is a beneficiary of the trust. This limitation is designed to avoid the prohibition on corporates owning look-through companies being circumvented by interposing a trust between the look-through company and the corporate owner. The amendment to the definition of "look-through company" clarifies that the limitation on trustee distributions does not apply when the corporate beneficiary is a grandparented Māori authority, or a tax charity that has no control or influence in relation to the operation of the entity and no control or influence in relation to the distributions of the trust.

Section RD 36 redrafted

Section RD 36 has been redrafted to better clarify its meaning. That section enables income to be backdated to clear employment related loans when certain conditions are met. The section had previously been amended by the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017.

UPDATING THE STATE ENTERPRISES SCHEDULE

Schedule 36, part A of the Income Tax Act 2007

The following two state enterprises have been added to the list of state enterprises in schedule 36, part A of the Income Tax Act 2007:

- Animal Control Products Ltd
- Kordia Group Ltd

Background

The Income Tax Act 2007 exempts public authorities from income tax. State enterprises and mixed-ownership enterprises, however, are excluded from this exemption and are required to pay income tax. Schedule 36, part A of the Income Tax Act 2007 contains a list of state enterprises that are excluded from the public authority exemption.

Application date

The new insertions apply from 29 March 2018, the enactment date of the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act.

TRADING GAINS OF NON-RESIDENT INVESTMENT FUNDS

Sections CX 55B, DB 54C of the Income Tax Act 2007

Background

This amendment ensures consistency of tax treatment for foreign Portfolio Investment Entity (PIE) equivalents and other methods of inbound foreign portfolio investment in New Zealand, such as the foreign investor variable rate portfolio investment entity regime.

Key features

The proposed amendment clarifies that amounts derived by foreign PIE equivalents from the disposal of shares and financial arrangements are excluded income. It is also provided that foreign PIE equivalents are not entitled to a deduction for expenditure incurred in deriving that excluded income.

Application date(s)

The amendment is to have retrospective effect from 1 April 2012, the date in which the foreign investor variable rate PIE provisions came into effect.

PREVENTING UNINTENDED DEDUCTIONS FOR CONSOLIDATED GROUPS

Section DB 23B of the Income Tax Act 2007

New section DB 23B addresses an anomaly whereby a member of a consolidated group could have had a deduction for the cost of purchasing shares (or other excepted financial arrangements) as revenue account property in a company outside the group which subsequently joined the group. The amendment removes a deduction when the shares are cancelled (whether by redemption, amalgamation, liquidation or otherwise) and where at the time of cancellation, the issuer of the shares and the holder are members of the same consolidated group. Because the cancellation does not give rise to any income to the holder, removing the deduction results in a net nil position for income tax. This matches the economic reality.

Background

When a person acquires shares, or any other excepted financial arrangements, as revenue account property they are entitled to a deduction for the cost of the shares in the year they are acquired. If the shares are still held at the end of the year, they derive income equal to the cost of those shares, so there is no net deduction. In following years they are entitled to a deduction for the cost of the shares at the start of the year and if still held at the end of the year they derive income equal to the cost of the shares so again there is no net deduction. In the year the shares are disposed of or are cancelled the person derives income for the amount they receive from that transaction. In that final year the opening deduction (for the original cost of the shares) and income on disposal or cancellation result in net income or a net loss.

If the shares were issued by a company in a consolidated group to another company in that consolidated group, the consolidation provisions ensure no assessable income or deductions arise as all transactions are within that consolidated group.

However, previously, if a holder acquired shares (and so was entitled to a deduction as described above) and then entered a consolidated group with the issuer of the shares, the group will not derive income if the shares were cancelled, as that cancellation occurred entirely within the consolidated group. Through this process the consolidated group could have been entitled to a deduction with no corresponding income even though there was no economic loss to the group. The amendment aligns the law with the policy intent by preventing a deduction in this circumstance.

Key features

The anomaly addressed by section DB 23B arises when a company subscribes for shares in an entity that is not in the same consolidated group, then the two entities subsequently become members of the same consolidated group thus cancelling the shares. In this case the holder was previously still entitled to a deduction for the cost of the shares but the amount derived from the cancellation of the shares was excluded income under the consolidation regime.

The anomaly arose as the consolidation provision that eliminates the income only achieves the correct result if there has not already been a deduction. To address this anomaly, new section DB 23B denies the holder a deduction for the cost of the revenue account shares that cease to exist in that year as a result of a transaction or arrangement between two members of a consolidated group.

Where the shares are cancelled in the year they are acquired, the deduction denied is the expenditure incurred as the cost of revenue account property. When the shares are cancelled in a subsequent year the deduction denied is the value of the shares at the end of the previous income year calculated at their cost price.

Application date(s)

The amendment applies for the 2016–17 and later income years.

CHILD SUPPORT (PRISON WORK INCOME)

Sections 89D, 89F of the Child Support Act 1991

Amendments have been made to the Child Support Act 1991 to clarify that incentive payments earned by long-term prisoners (in prison for 13 weeks or more), who participate in prisoner employment activities are not considered income when determining a liable person's eligibility for exemption from paying child support.

Background

Under the Child Support Act 1991, long-term prisoners are eligible to seek an exemption from payment of financial support (child support and domestic maintenance) on the grounds that they have no income, or only a very small amount of income from investments.

The Department of Corrections makes small incentive payments to prisoners who participate in prisoner employment activities. Prisoners receiving these payments have historically qualified for an exemption as they were not considered to be "income."

However, Inland Revenue reviewed this position and determined that these payments were, in fact, income. This meant that prisoners receiving them were no longer eligible for the applicable exemption.

This result was inconsistent with the underlying policy intention which is to ensure that prisoners should be eligible for the exemption notwithstanding these small payments.

Key features

Long-term prisoners who receive income from incentive payments (under section 66 of the Corrections Act 2004) will be eligible for exemption from the payment of child support.

Prisoners who are receiving payments for other work, for example prisoners on work release programmes or who are in self-employment will continue to have their earnings treated as income, and be ineligible for an exemption.

Application date(s)

The amendments are treated as if coming into force from 1 April 2017.

TAX ON NET ASSETS OF DEREGISTERED CHARITIES – REMEDIAL AMENDMENTS

Section HR 12

Amendments have been made to the Income Tax Act to ensure that the net assets tax for deregistered charities also applies to non-registered entities exempt under section CW 42 of the Income Tax Act and which cease being "charitable" (as defined in the Act). The amendments also clarify that all entities that cease to be charitable must transfer their accumulated income and assets for charitable purposes.

Background

In 2014 new rules were introduced to address the tax consequences for deregistered charities. These rules ensure that any income or assets accumulated while an entity was exempt from tax as a registered charity are always destined for a charitable purpose.

Section HR 12 of the Income Tax Act 2007 taxes the net assets of deregistered charities. One year following the day of the final decision to deregister the entity, the accumulated assets and income of the organisation will be included as income of that organisation. Assets that were distributed or applied for charitable purposes, or in accordance with the entity's rules contained on the register, were not included in this calculation. Also excluded are assets received from the Crown in relation to a Treaty of Waitangi settlement claim, and non-cash assets which were gifted to the organisation.

The amendments ensure that the policy objectives are met by:

- amending section HR 12 so that it applies to any person who is not registered as a charity under the Charities Act 2005 but derives exempt income under section CW 42, and subsequently ceases to meet the requirements of section CW 42; and
- amending the wording of section HR 12 so that deregistered charities are required to "transfer" their assets for charitable purposes or in accordance with the entity's rules. The previous wording of section HR 12 required the assets to be "distributed or applied", which allowed deregistered charities to escape payment of the deregistration tax in circumstances contrary to the policy intent.

Key features

Amendments have been made to section HR 12 of the Income Tax Act 2007 to ensure the following:

- Tax on the net assets of deregistered charities applies to the accumulated assets and income of non-registered entities exempt under section CW 42 of the Income Tax Act that subsequently cease to meet the requirements of that exemption.
- Entities that cease to be charitable must transfer their accumulated income and assets for charitable purposes or in accordance with its rules as contained on the Charities Register.

Application date(s)

The amendments apply to charities that are deregistered on or after 6 April 2016.

LOCAL AUTHORITIES AND CONSOLIDATED GROUPS

Sections CX 60, FM 8(3)(d) and RE 2(5(g) of the Income Tax Act 2007.

Changes have been made to the Income Tax Act 2007 to clarify that a dividend derived by a local authority from a council controlled organisation remains taxable to the local authority, even if that local authority and the council controlled organisation (CCO) are in the same consolidated group of companies.

Background

Local authorities were originally excluded from the consolidation rules by making them ineligible to be a member of a consolidated group. This was to ensure that all dividends passing from a CCO to a local authority are taxable, as dividends passing between companies within a consolidated group are excluded income (i.e. not taxed).

However, an amendment to the definition of "eligible company" in the Taxation (Savings, Investment and Miscellaneous Provisions) Act 2006 inadvertently resulted in local authorities becoming eligible to form or join a consolidated group.

The purpose of that 2006 amendment to the definition of eligible company was to permit a dual-resident company to use the consolidated group rules only if the company was able to use the general loss grouping rules. This 2006 amendment was never intended to allow local authorities to access the consolidated group rules resulting in dividends from their CCOs not being taxed.

However, submissions on the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill identified that a number of local authorities had joined consolidated groups since 2006 and had experienced a significant reduction in compliance costs.

Key features

The amendments ensure that:

- the compliance cost savings experienced by local authorities from being part of a consolidated group are retained;
- all dividends passing from a CCO to a local authority are generally taxable from the 2019-20 income year; and
- these dividends continue to be subject to resident withholding tax under the RWT rules.

Application date(s)

The amendment to section FM 8 applies from the beginning of the 2019-20 income year.

However, a savings provision ensures that these amendments do not apply to a local authority that has a binding ruling made relating to the consolidation rules and their application to a local authority until the end of the year in which the binding ruling expires.

STATUTORY TRUSTEE COMPANIES AND RLWT

Section YA 1 – definition of "offshore RLWT person"

Background

Residential land withholding tax (RLWT) is a withholding tax deducted from some residential property sales. The RLWT rules will potentially apply if the seller of land is classified as an "offshore RLWT person", and they owned residential land for less than two years before selling it.

The definition of "offshore RLWT person" has been amended so that the status of a statutory trustee company will not cause a trust for which it acts as trustee to be an "offshore RLWT person" if it would not otherwise be one. Statutory trustee companies are a defined list of trustee companies in the Trustee Companies Act 1967.

Key features

Because of the definition of "offshore RLWT person", the RLWT rules will apply to a trust where (among other things) 25 percent or more of the trustees are offshore RLWT persons. If a trustee is a company, it will be an "offshore RLWT person" if more than 25 percent of its directors or ultimate shareholders are offshore RLWT persons (among other tests).

As a consequence, prior to the amendment if a statutory trustee company was an "offshore RLWT person", any trust with three or fewer trustees for which it acted would have been an "offshore RLWT person" and the RLWT rules would have applied to that trust. This was the case even where the settlors, beneficiaries, and other trustees were all New Zealand residents. This outcome does not align with the policy objectives underlying the RLWT regime, and unduly prejudices affected statutory trustee companies.

The definition of "offshore RLWT person" has therefore been amended so that the status of a statutory trustee company (as defined in section YA 1) will not cause a trust for which it acts as trustee to be an "offshore RLWT person" if it would not otherwise be one. The proposed amendment would not apply to all professional trustee companies, but only to statutory trustee companies – which are a defined list of trustee companies in the Trustee Companies Act 1967.

There has been a related remedial amendment made to the definition of "statutory trustee company" in section YA 1, so that it refers to the definition of "trustee company" in the Trustee Companies Act 1967, rather than to "statutory trustee company" which is not the defined term.

Application dates

The amendment to the definition of "offshore RLWT person" came into force on 1 July 2016 – the date the RLWT legislation came into force. The amendment to the definition of "statutory trustee company" came into force on the date of enactment – 29 March 2018, as it is just a clarification.

LOSSES FROM SPECIFIED ACTIVITIES

Sections IA 2(4)(g), IA 4(1), (1)(b), (1B), (1C), and IZ 1.

Amendments to the Income Tax Act 2007 repeal the restriction on the use of losses from "specified activities" and include any residual amount of those losses in the general rules for the use of a tax loss and the loss carry-forward rules.

Background

The specified activity loss rules were introduced in the early 1980s, at a time when the top personal marginal tax rate reached 66%. Their purpose was to discourage the use of a range of primary sector activities as tax shelters. Examples of primary sector activities subject to the specified activity loss rules included animal husbandry (other than bloodstock), bee farms, silviculture, viticulture, aquaculture, and land leasing or licensing.

The specified activity loss rules ensured that losses incurred from these primary sector activities that were not a taxpayer's main business activity were subject to a maximum tax deductible loss of $10,000 in each income year. Any loss exceeding that threshold was carried forward and offset, initially against any profit arising from the specified activity in the immediately following income year and then against income from other sources up to a maximum of $10,000. This process was repeated for each subsequent income year.

The reduction in the top marginal tax rates to 33% from the 1988-89 income year resulted in a significant decline in the use of these primary sector activities as tax shelters. As a result, no further specified activity loss arose from the 1990-91 income year and any existing specified activity losses were ring-fenced from the general loss rules.

The ring-fencing of these rules required any unabsorbed balance at the end of an income year to be carried forward and offset, initially against any profit arising from the specified activity in the 1990-91 income year and then against income from other sources up to a maximum of $10,000. This process was repeated in the 1991-92 and subsequent income years, until the loss was extinguished.

The specified activity loss rules are now largely spent, as there are a very low number of affected taxpayers and the amount of affected losses is immaterial. The amendments reflect the spent nature of these rules.

Key features

The current rule limiting the use of losses from specified activities to $10,000 in any one tax year is repealed.

Before this repeal, losses from specified activities were included in a person's loss balance (i.e. tax losses carried forward from one year to the next tax year) and able to be subtracted from their net income in the next tax year, subject to a $10,000 limitation on their use in any tax year.

From the 2018-19 tax year, all of a person's losses from specified activities carried forward from the 2017-18 income year in the loss balance must be subtracted from the person's net income for the 2018-19 tax year before subtracting any other part of the loss balance from the 2017-18 tax year.

If the amount of carried forward losses from specified activities at the end of the 2017-18 tax year exceeds the person's net income for the 2018-19 tax year, the excess amount is included in the person's tax loss and is no longer required to be identified separately. Consequently, section IZ 1 is repealed with effect from the beginning of the 2018-19 income year.

Example 1

At the end of the 2017-18 tax year, Alan has a loss balance of $21,000, comprising carried-forward loss from specified activities of $15,000 and other tax loss components of $6,000. Alan also has net income of $20,000 for the 2018-19 tax year.

Under section IA 4(a) and IA 4(1B), the carried forward loss from specified activities is subtracted from the net income before subtracting any of the other tax loss components included in the loss balance at the end of the 2017-18 tax year.

Net income 2018-19 tax year	$20,000
Less Alan's carried-forward losses from specified activities at end of 2017-18 tax year	($15,000)
	$5,000
Less remaining portion of Alan's loss balance carried forward from the 2017-18 tax year	($6,000)
Amount included in Alan's 2018-19 tax loss (section IA 2(2))	($1,000)

Example 2

At the end of the 2017-18 tax year, Liana has a loss balance of $25,000 consisting entirely of carried-forward losses from specified activities. Liana also has net income of $18,000 for the 2018-19 tax year.

Under section IA 4(1B), the carried forward loss from specified activities is subtracted from the net income for the 2018-19 tax year, and the amount of the loss that exceeds the net income ($7,000) is included in Liana's tax loss for the 2018-19 tax year.

Net income 2018-19 tax year	$18,000
Less carried-forward losses from specified activities at end of 2018-18 tax year	($25,000)
Amount included in Liana's 2018-19 tax loss (section IA 2(4)(g))	($7,000)

Application date

The repeal of the restrictions on the use of losses from specified activities applies from the 2018-19 income year. Practically the amendments apply to specified activity losses carried forward in a person's loss balance from the 2017-18 tax year to the 2018-19 tax year.

TAX RATE FOR EXTRA PAYS PAID TO NON-RESIDENT SEASONAL WORKERS AND EMPLOYEES ON NON-NOTIFIED TAX CODES

Sections RD 10(1), (2C) and (2D), and RD 17(1C), and schedule 2, part B, table 1 of the Income Tax Act 2007

Amendments have been made to the Income Tax Act 2007 to ensure that employers are required to withhold tax from extra pays paid to non-resident seasonal workers at 10.5% and to employees on non-notified tax codes at 45%.

Background

A non-resident seasonal worker is either employed by a recognised seasonal employer under the RSE scheme or is employed in line with Immigration instructions for the foreign crew of fishing vessels. These workers use the "NSW" tax code which attracts a withholding rate of 10.5% on their salary or wages. Non-resident seasonal workers are not required to file an income tax return, so the tax withheld is a final tax for them.

Non-resident seasonal workers are entitled to holiday pay under the Holidays Act 2003, which is either included in the worker's regular pay or paid as a lump sum at the end of the worker's employment.

If the holiday pay is paid as lump sum at the end of their employment, the amount is treated as an extra pay under the PAYE rules. Under the rules for taxing extra pays, tax was generally required to be withheld from non-resident seasonal workers at a higher rate than 10.5%. The taxation of extra pays paid to non-resident seasonal workers at a rate higher than 10.5% was contrary to the policy intent for this class of employee, which is that the 10.5% flat rate should apply to all their employment income and be full and final.

An employee who has not provided their tax code to their employer is taxed at a withholding rate of 45% on their salary or wages. Notifying their employer of their tax code also requires an employee to provide their name and IRD number to their employer. However, under the rules for taxing extra pays, tax was required to be withheld at a lower rate than 45%. The taxation of extra pays paid to employees who have not notified their employer of the required information at a rate lower than 45% was contrary to the policy intent for this class of employee, which is that all employment income paid to them should have tax withheld at a 45% rate.

Key features

New section RD 10(2C) and new row 1B of schedule 2, part B, table 1 provide that the amount of tax that an employer must withhold from an extra pay paid to a non-resident seasonal worker is to be calculated at a 10.5% rate.

New section RD 10(2D) and new row 5 of schedule 2, part B, table 1 provide that the amount of tax that an employer must withhold from an extra pay paid to an employee who has not notified their employer of their tax code is to be calculated at a 45% rate.

New section RD 17(1C) specifies that the general rule for calculating the amount of tax to withhold from an extra pay (that is, section RD 17) does not apply to extra pays paid to non-resident seasonal workers or employees who have not notified their employer of their tax code.

Application date

The amendments came into force on the date of Royal assent, 29 March 2018.

PAYE TREATMENT OF BACK-DATED REMEDIAL PAYMENTS OF EMPLOYMENT-RELATED ENTITLEMENTS

Section RD 7(3) to (5) of the Income Tax Act 2007 and sections 194(2) and 423 of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018

Retrospective amendments have been made to the Income Tax Act 2007 to clarify the PAYE treatment of back-dated remedial payments of entitlements under the Holidays Act 2003 and/or an employment agreement.

Background

As a result of apparently widespread miscalculation of entitlements under the Holidays Act 2003, numerous employers across the public and private sectors have made, or will soon be making, remedial lump sum payments to affected employees and former employees.

Inland Revenue recently considered how the law applied to such payments and concluded that the character of a back-dated payment (that is, whether it is "salary or wages" or an "extra pay" for the purposes of the PAYE rules) should follow that of the original incorrectly calculated payment. This view was inconsistent with common employer practice and the policy intent, and would have given rise to a number of undesirable implications, including that:

- it would have been difficult for employers to implement;
- it would be more likely to result in employees having tax over-withheld than if all back-dated remedial payments were treated as extra pays; and
- it would have meant more individuals would have needed to contact Inland Revenue to obtain tax refunds.

To respond to this issue on a timely basis, the Income Tax (Employment-related Remedial Payments) Regulations 2017 were made to declare such payments to be an "extra pay" for the purposes of the PAYE rules on a prospective basis. These regulations came into force on 18 August 2017.

Key features

Section RD 7 of the Income Tax Act 2007 has been amended, with retrospective effect, to categorise remedial payments made to a person in respect of their entitlements under the Holidays Act 2003 and/or an employment agreement as an "extra pay" (consistent with how employers likely treated them and the original policy intent).

Section 194(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 is a "savings" provision which protects the position of employers who applied the PAYE treatment that was correct according to Inland Revenue's legal view prior to the Income Tax (Employment-related Remedial Payments) Regulations 2017 coming into force.

The Income Tax (Employment-related Remedial Payments) Regulations 2017 have been revoked.

For the avoidance of doubt, the amendments are not intended to change the law from that which applied while the Income Tax (Employment-related Remedial Payments) Regulations 2017 were in force, other than to make that law apply retrospectively, subject to the "savings" provision.

Application dates

The amendments to section RD 7 of the Income Tax Act 2007 came into force on 1 April 2008.

The "savings" provision applies for tax positions taken between 1 April 2008 and 17 August 2017.

The Income Tax (Employment-related Remedial Payments) Regulations 2017 were revoked on the date of Royal assent, 29 March 2018.

Detailed analysis

Remedial payments covered by the amendments

New section RD 7(3) provides that a remedial payment made in relation to one or more of a person's entitlements under the Holidays Act 2003, or an employment agreement, or both, is treated as an extra pay if all of the following conditions are met:

- the payment is made to a person in connection with their employment;
- but for this subsection, the payment would be a payment of salary or wages, or an extra pay, or a combination of both; and
- the payment is made to the person to meet all or part of a shortfall in one or more previous payments to the person who has an entitlement under the Holidays Act 2003, or an employment agreement, or both.

This means that the amendments cover more than just remedial payments of holiday pay. They also cover a payment made to correct the underpayment of other types of entitlements under the Holidays Act 2003 (for example, sick leave) and entitlements under an employment agreement (for example, long service leave).

However, new section RD 7(4) excludes the first of any payments made to a person to address (in full or in part) a failure to pay the person any salary or wages for a pay period from the definition of a remedial payment under new section RD 7(3) (for example, an initial payment of wages for a pay period that is made late).

Meaning of "employment agreement"

New section RD 7(5) defines, for the purposes of new section RD 7(3), "employment agreement" as having the meaning given by its definition in section 5 of the Employment Relations Act 2000 (ERA), subject to two exceptions. That is, employment agreement means a contract of service, and includes an employee's terms and conditions of employment in:

- a collective agreement; or
- a collective agreement together with any additional terms and conditions of employment; or
- an individual employment agreement.

The two exceptions are that "employment agreement", for the purposes of new section RD 7(3):

- includes an individual employment contract continued in force by section 242(1) of the ERA; and
- excludes a contract for services between an employer and a homeworker.

"Savings" provision

Section 194(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 provides that the amendments to section RD 7 do not apply to a person in relation to a tax position taken by them:

- in the period from 1 April 2008 to 17 August 2017;
- relating to the tax treatment of a remedial payment made in relation to an entitlement under the Holidays Act 2003 or an employment agreement; and
- relying on the treatment of the entitlement under the PAYE rules according to the character that the payment would have had if the entitlement had been paid at the time at which it should have been paid.

Examples

Example 1

An employee (**A**) was paid $1,500 in annual holiday pay under the Holidays Act 2003 for pay period 1 and $1,500 in annual holiday pay for pay period 2 (a total of $3,000). A's employer later discovers that the payments were incorrectly calculated and A should have been paid $1,600 for each pay period (a total of $3,200). A's employer pays A $200 to satisfy the difference. The payment of $200 is a remedial payment that falls within the scope of section RD 7(3) and is not excluded by section RD 7(4). It is therefore an extra pay under the Income Tax Act 2007.

Example 2

An employee (**B**) was paid $300 in sick leave under the Holidays Act 2003 and $1,700 in long service leave under B's employment agreement (a total of $2,000). B's employer later discovers that both payments were incorrectly calculated. B should have been paid $350 in sick leave and $2,000 in long service leave (a total of $2,350). The difference between the amounts paid to B and B's actual entitlements is $350. B's employer pays B $200 to satisfy part of the difference. The payment of $200 is a remedial payment that falls within the scope of section RD 7(3) and is not excluded by section RD 7(4). Later, B's employer pays B $150 to satisfy the remainder of the difference. The payment of $150 is a separate remedial payment that falls within the scope of section RD 7(3) and is not excluded by section RD 7(4). Each of the remedial payments is therefore an extra pay under the Income Tax Act 2007.

Example 3

A person (**C**) was employed by Company D for 2 years. C was paid $6,000 in annual holiday pay under the Holidays Act 2003 during C's employment and $2,000 in annual holiday pay upon termination of C's employment (a total of $8,000). Company D later discovers that C should have been paid $6,500 in annual holiday pay during C's employment and $2,500 upon termination of C's employment (a total of $9,000). Company D pays C $1,000 to satisfy the difference. The payment of $1,000 is a remedial payment that falls within the scope of section RD 7(3) and is not excluded by section RD 7(4). It is therefore an extra pay under the Income Tax Act 2007.

Example 4

An employer (**E**) fails, on the regular payday of one of its employees (**F**), to pay any of the $1,000 in wages owed to F for the relevant pay period. E later makes a payment of $1,000 to F to address the failure to pay F's wages on F's regular payday. The payment of $1,000 is excluded by section RD 7(4) from being a remedial payment under section RD 7(3).

Example 5

An employer (**G**) fails, on the regular payday of one of its employees (**H**), to pay any of the $1,000 in wages owed to H for the relevant pay period. G later makes a payment of $800 (**payment 1**) to H to address the failure to pay H's wages on H's regular payday, but a shortfall of $200 remains outstanding. Payment 1 is excluded by section RD 7(4) from being a remedial payment under section RD 7(3).

Sometime later still, G makes a further payment of $200 (**payment 2**) to H to address the shortfall in payment 1. Payment 2 is a remedial payment that falls within the scope of section RD 7(3) and is not excluded by section RD 7(4). Payment 2 is therefore an extra pay under the Income Tax Act 2007.

RWT ON NON-CASH DIVIDENDS

Sections CD 15(1), LB 3(1), RE 14(1)(b), and RE 14C

The amendments ensure that the taxation of non-cash dividends derived from overseas is the same irrespective of whether the dividend is derived:

- directly by an individual resident in New Zealand; or
- by an intermediary acting on behalf of an individual resident in New Zealand.

The dividend rules are consequently amended to confirm that the amount of a dividend includes any withholding tax paid or withheld in relation to that dividend.

Background

When a non-cash dividend is derived directly by a New Zealand resident individual from a foreign company, the amount of that dividend is not subject to resident withholding tax (RWT). In contrast, when a non-cash dividend is derived from a foreign company by an intermediary on behalf of a New Zealand resident individual and later is distributed to that person, the distribution is resident passive income and subject to the RWT rules.

Prior to this amendment, the RWT rules required the intermediary to account for RWT on that non-cash dividend. As the intermediary would have no funds to account for the withholding tax, this imposition of RWT generally resulted in the withholding tax being funded by the individual person receiving the non-cash dividend distributed by the intermediary.

As a result, the RWT rules could result in different tax imposts on non-cash dividends ultimately derived by a New Zealand resident natural person, depending on whether the dividend is derived directly or indirectly via an intermediary.

Key features

A New Zealand-resident intermediary will not be required to account for RWT on a distribution of a non-cash dividend derived from overseas provided that:

- the non-cash dividend is distributed to a New Zealand resident individual; and
- the distribution of the dividend occurs in the same income year that the intermediary derives the non-cash dividend

The meaning of the amount of a dividend is clarified to ensure that this amount includes RWT paid on a non-cash dividend. In addition, section LB 3 is clarified to ensure that the amount of the RWT tax credit a person has for a tax year includes the amount of RWT paid for a non-cash dividend. Both of these clarifications reflect the Commissioner's ongoing application of the law.

Application dates

The amendments to the RWT rules apply to non-cash dividends distributed during the 2017-18 and later income years. The clarifications to the amount of a dividend and the amount of a RWT tax credit apply from the date of Royal assent, 29 March 2018.

MEMORANDUM ACCOUNTS: OPENING BALANCES

Sections OA 2, OA 7, OP 3(4), OP 4(3) and tables of credits and debits in memorandum accounts

The amendments clarify that, for all memorandum accounts:

- the opening balance of a memorandum account as at 1 April for any tax year is equal to the closing balance of that memorandum account on the immediately preceding 31 March; and
- the amount of the opening balance of a memorandum account is no longer treated as a credit to the account; and
- original debit or credit dates are retained for all debit or credit amounts included in the opening and closing balances of a memorandum account for each tax year.

The amendments also correct unintended legislative changes relating to calculating the opening balance for certain imputation groups.

Background

New Zealand's imputation system allows the benefit of tax paid at the corporate level to be passed through to shareholders (as tax credits attached to dividends paid) so that a shareholder's tax liability on dividends is limited to the shareholder's marginal rate of tax.

The most common form of memorandum account is the imputation credit account. This is used to record tax paid by or refunded to the company (credits and debits to the imputation credit account) and also to record when the benefit of the tax is passed through to shareholders (debits to the imputation credit account). In general, the use of imputation credits by a company is governed by a "first-in, first-out" basis and is subject to the company satisfying shareholder continuity rules.

Under New Zealand's imputation system, resident companies (and some Australian companies) are required to maintain memorandum accounts. These memorandum accounts are balanced annually to ensure that companies do not over-distribute tax credits to shareholders.

As part of the original policy and legislative framework, a memorandum account's balance at 31 March of any year was carried forward and became the opening balance on the next day (1 April). The amount of the opening balance was created by a new credit (or debit) to the memorandum account on 1 April.

A recent review of the rules for memorandum accounts identified some issues that could be interpreted in a manner inconsistent with the policy intention of the memorandum account rules.

Under that interpretation, for any year ending 31 March, the earliest date for a credit or debit to a memorandum account would always be determined by the credit or debit on the preceding 1 April for the opening balance (except when applying the shareholder continuity rules to imputation credits).

Key features

These amendments clarify that the purpose of defining the amount of an opening balance of a memorandum account is:

- a necessary element in the annual check of whether a company has over-distributed imputation credits to shareholders for a year ending 31 March; and
- is not intended to reset the effective date of a credit or debit made to the memorandum account in an earlier year.

Consequently, the references to a debit or credit for an opening balance of a memorandum account are omitted from all tables in the memorandum account rules.

In addition, amendments to sections OA 7, OP 3(4) and OP 4(2) correct an unintended change arising in the rewrite of these provisions. These amendments ensure that the 2007 Act provisions reflect their corresponding provisions in the Income Tax Act 2004 in determining the opening balance of an imputation credit account for an imputation group when:

- two or more consolidated imputation groups choose to combine to form or to join an imputation group;
- companies that are part of an imputation group choose to convert their status to that of a consolidated group that is a consolidated imputation group; and
- the group is a resident imputation subgroup associated with a trans-Tasman imputation group.

Application date(s)

The amendments apply from the beginning of the 2008-09 income year.

NEW LEGISLATION

Rewrite remedials

AVAILABLE CAPITAL DISTRIBUTION AMOUNT AND DISREGARDED DIVIDENDS

Sections CD 36, CD 44, CX 57B, and EX 59

Amendments to the Income Tax Act 2007 clarify that dividends and gains that are disregarded in calculating foreign investment fund (FIF) income are treated as excluded income for the purpose of calculating taxable income for a tax year.

A consequential amendment in section CD 44 applies to realised gains from the disposal of a FIF interest to ensure that in some circumstances, that realised gain may be distributed as a capital gain amount (and not taxed as a dividend).

Background

Some offshore investments by New Zealand residents are taxed under the FIF rules. There are four methods that can be used to calculate FIF income:

- the comparative value method;
- the deemed rate of return method;
- the fair dividend rate method; or
- the cost method.

Because FIF interests are effectively taxed on an accruing basis, actual dividends derived by the investor from an interest in a FIF, and gains from disposing of the interest, are disregarded for income tax purposes.

However, under the rewritten core provisions, an amount derived by a New Zealand resident is excluded from the calculation of taxable income only if that amount is either excluded income or exempt income. In the rewrite of the FIF rules, this relationship with the core provisions was not made clear when stating that distributions or gain arising from an interest in a FIF are disregarded when calculating the person's income tax liability.

This has resulted in a question being raised about whether a disregarded amount derived by a corporate investor from a FIF is treated as a capital amount and able to be included in the available capital distribution amount, which, in some circumstances, is able to be later distributed tax-free.

Key features

The amendments to section CD 35, CX 57B and EX 59 provide for an improved alignment with the core provisions. This assists in understanding the policy for dividends and gains that are disregarded in calculating FIF income.

The amendments to section CD 44 ensure that when a company distributes a realised gain arising from the disposal of a FIF interest, that distribution is:

- a taxable dividend in full if the company calculated FIF income for that FIF interest using either of the comparative value or deemed rate of return methods; and
- a capital gain amount to the extent that the realised gain exceeds total FIF income derived from that FIF interest, which was calculated under either of the fair dividend rate or cost methods.

Application date

The amendments apply from the date of Royal assent, 29 March 2018.

AVAILABLE CAPITAL DISTRIBUTION AMOUNT AND DEPRECIABLE ASSETS

Section CD 44(9)(a)

This amendment corrects an error in section 23(2) of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 that amended section CD 44 of the Income Tax Act 2007 (2007 Act).

Background

Section 23 of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 amended the calculation of the available capital distribution amount that is not taxed on distribution from a company. The available capital distribution amount is the net difference between total capital gains and total capital losses of a company over its life.

NEW LEGISLATION

That amendment works correctly for depreciable assets that do not give rise to a depreciation loss on disposal (for example, a building) but does not work correctly for other depreciable assets.

This error could result in the available capital distribution amount taking into account depreciation losses arising on disposal of a depreciable asset, and would result in unintended double taxation.

Key features

Section CD 44(9)(a) of the 2007 Act is amended to clarify that, for the purpose of calculating the available capital distribution amount, a capital loss does not include losses on disposal that are treated as an allowable deduction under the depreciation rules.

Application date

The amendment applies from the beginning of the 2008-09 income year, to align with the application date of section 23(2) of the Taxation (Annual Rates for 2016-19, Closely Held Companies, and Remedial Matters) Act 2017.

USE OF PRE-CONSOLIDATION IMPUTATION CREDITS

Section OP 22

This amendment ensures the law works as intended by addressing an unintended change arising from the rewrite of the rules concerning the use of pre-consolidation imputation credits.

Background

An interpretation of section OP 22 of the 2007 Act was that the amount of pre-consolidation credit that could be transferred to the imputation credit account (ICA) of a consolidated group was not restricted to the extent of the amount of debit arising in the group's ICA after taking into account credits to the group ICA.

Following enactment of the imputation group rules, the policy for transferring pre-consolidation imputation credits to a consolidated group's ICA was explained on pages 56 of *Tax Information Bulletin* 16/1 as follows:

> The pre-grouping balances of the members' individual imputation credit accounts are not transferred to the imputation group's imputation credit account, but remain separate until such time as the group's imputation credit account has a debit to its account which it cannot offset by an existing credit. In such a case, and subject to shareholder continuity being maintained, a credit may be transferred from one of the members' individual imputation credit account to the imputation group's imputation account, to the extent of the debit balance.

Similar policy observations on the use of pre-consolidation credits were made in that *Tax Information Bulletin* on pages 56–57, in relation to consolidated groups forming an imputation group, and a trans-Tasman imputation group.

Under this policy, pre-consolidation imputation credits could only be transferred to a consolidated group ICA at a point in time when the group ICA had a debit balance. A debit balance would arise at any point in a tax year if a debit made to the group ICA is greater than the sum of the opening balance of the group ICA and new group credits to the group ICA between 1 April and the debit to the account.

Key features

The amendment to section OP 22 corrects the unintended change arising in the rewrite by ensuring that the amount of pre-consolidation credit that may be transferred to a group ICA at a point in time is restricted to the amount of a debit balance in the group ICA at that time.

Due to the amendments in sections OA 2, OA 7, and the tables of credits and debits in memorandum accounts, necessary consequential amendments are made to section OP 22 to ensure the effect of the law remains consistent with the policy intent set out in TIB 16/1.

Application date(s)

The amendment applies from the beginning of the 2008-09 income year.

Detailed analysis

The outcome given by the amendments can be illustrated by the following example.

Example

Company A is in a consolidated group and pays a dividend on 30 September 2016 with $50,000 imputation credits attached.

Prior to paying the dividend on 7 September 2016, the consolidated group's ICA credit balance was $10,000 (originally credited to the group ICA after a payment of tax on 7 April 2015).

Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance at 1 April 2016 of $70,000. This amount was originally credited to Company B's ICA for a payment of tax ($70,000) on 7 September 2014.

No other transactions occur in the group ICA during the year to 31 March 2017.

Correct policy outcome under law after amendments

Date	Group ICA	Member Company Company B
7 September 2014 (credit carried forward to 1 April 2015 and 1 April 2016 under section OA 7(1))		70,000
7 April 2015 (credit carried forward to 1 April 2016 under section OA 7(1))	10,000	
7 September 2016 (dividend paid by Company A)	(50,000)	
7 September 2016 (transfer from Company B)	40,000	(40,000)
31 March 2017 (calculated balance)	0	30,000

ELIGIBILITY TO FORM A CONSOLIDATED GROUP

Section FN 4

An amendment to section FN 4 of the Income Tax Act 2007 addresses an unintended legislative change arising from its rewrite.

Background

The rewrite of the consolidated group rules into the Income Tax Act 2007 resulted in an unintended legislative change relating to the meaning of "eligible company" for imputation group purposes.

The issue relates to a member of a consolidated group (company X) electing to leave the imputation group (that consisted of companies X, Y and Z) but remaining within the consolidated group. The consolidated group consists of companies X, Y and Z. The unintended change resulted in the following differences between the two Acts:

- Under the 2004 Act, Company X's election to leave the imputation group would not affect the eligibility of Companies Y and Z to be in the imputation group.
- Under the 2007 Act, Company X's election to leave the imputation group resulted in companies Y and Z no longer being eligible to be in the imputation group.

Key features

The amendment to section FN 4 ensures that a company leaving an imputation group does not affect the continuance of that imputation group.

Application date

The amendment applies from the beginning of the 2008-09 income year.

TRUSTEE'S REQUIREMENT TO FILE INCOME TAX RETURNS FOR A TRUST

Section HC 2 (Income Tax Act 2007)

A cross-reference in section HC 2 is corrected to refer to section HC 33(1).

Background

Before this amendment, section HC 2 identified section 42(1)(a) of the Tax Administration Act 1994 (TAA) as the relevant provision imposing an obligation on a trustee to file a return of income each year for a trust.

NEW LEGISLATION

The Limited Partnerships Act 2008 repealed and replaced section 42 of TAA. The replacement section 42 omitted any reference to an obligation of a trustee to file a return of income each income year for a trust. It was intended that the general return filing requirements of the TAA would apply instead.

However, the cross reference to section 42 in section HC 2 of the Income Tax Act 2007 was not updated in the Limited Partnerships Act 2008 and this amendment corrects the cross-reference.

Key features

The amendment clarifies that the general return filing requirement for a return of income (section 33(1) of the TAA) applies to a trustee of a trust.

Application date

The amendment applies from the date of Royal assent, 29 March 2018.

ALLOCATION OF RESIDENT WITHHOLDING TAX CREDITS BY TRUSTEES

Sections HC 6(1C), (2)(c), (d), LB 3(4)–(8)

The tax credit rules for resident withholding tax (RWT credits) relating to trustees, beneficiaries, and RWT substitution payments are clarified to ensure they work as intended. The intent is to permit trustees to allocate RWT credits to other beneficiaries or to the trustee, in circumstances where the trustee has not elected, with the agreement of the Commissioner, to forego the agency obligations for payment of tax on beneficiary income.

Background

A recent review of an Inland Revenue publication relating to trusts found that the RWT substitution rules enacted in 2011 (but applying from the beginning of the 2008–09 income year) did not achieve their policy intent.

The RWT substitution payment rules are intended to allow a trustee, in their capacity as agent for a beneficiary, to more efficiently manage the trustee's agency obligation to pay income tax on beneficiary income. In particular, the amendments permit the trustee, in calculating the total tax payable under this agency obligation, to take into account each beneficiary's marginal rate of tax.

Because RWT credits are refundable credits, the RWT substitution payment rules, as originally enacted, were intended to permit a trustee, as an agent for the beneficiary, to either:

- retain the benefit of RWT credits attached to distributions to beneficiaries, for use in satisfying the trustee's income tax obligation on trustee income or to obtain a refund;
- re-allocate refundable RWT credits attached to resident passive income (interest and dividends) between beneficiaries for use by the trustee in satisfying the trustee's obligation to pay income tax on beneficiary income; or
- a combination (at the discretion of the trustee) of the options set out in the two bullet points above.

This was expected to have a similar effect to the trustee of a trust requesting the Commissioner to transfer a refund of tax due to one beneficiary to another beneficiary or to the trustee. However, the current law does not allow the trustee to re-allocate the RWT credits, as was originally intended.

Key features

The amendments to section LB 3 ensure that a trustee may, at the trustee's discretion, elect to detach an amount of a RWT credit from resident passive income distributed to a beneficiary, provided a RWT substitution payment is made (under section RE 2(7)) to that beneficiary equal to the amount of the detached tax credit and either:

- retain the benefit of those detached RWT credits to satisfy the income tax liability of the trustee on trustee income;
- re-allocate the detached RWT credits to another beneficiary to satisfy the trustee's agency obligation to pay income tax on beneficiary income; or
- a combination of the above two bullet points.

The ability to make this election to detach a RWT tax credit from resident passive income distributed to a beneficiary is restricted to those situations where the trustee is the agent of the beneficiary for the payment of tax on beneficiary income.

If a trustee and beneficiary agree that the trustee is not an agent of the beneficiary – which requires the agreement of the Commissioner of Inland Revenue – the beneficiary must receive the full amount of RWT credits attached to distributions of resident passive income as beneficiary income.

Consequential to the new provisions in sections LB 3(4) and (5), the amount of the RWT tax credit detached from a distribution:

- reduces the total amount of RWT credits available to the beneficiary who received that distribution; and
- is treated as a RWT credit of the person to whom the RWT credit is allocated (either another beneficiary or the trustee or a combination of beneficiary and trustee).

Notification of the election to detach RWT from one beneficiary and re-allocate that credit to either the trustee or a beneficiary (or a combination of the trustee and a beneficiary) is required. This notice must be made by disclosing the detaching and re-allocation of RWT credits in a return of income for the tax year in which the RWT is detached and re-allocated, for example, by attaching a schedule showing the detached credit and the reallocation of the RWT credit.

In addition, consequential amendments are made to the definition of beneficiary income in section HC 6 to ensure that:

- a RWT substitution payment is included in beneficiary income as originally indicated in section RE 2(8) of the Income Tax Act 2007;
- beneficiary income that includes a distribution of resident passive income is reduced by the amount of the RWT credit that is detached from that resident passive income; and
- beneficiary income does not include the amount of a tax credit re-allocated to a beneficiary by the trustee under section LB 3(5).

The amount of a tax credit reallocated to the trustee or a beneficiary is not income derived by the trustee under any provision in Part C of the Act. However, section LB 3(5) ensures that the amount of the detached credit is treated as a RWT credit and is available for use in satisfying the income tax liability of the trustee or beneficiary depending on who is allocated the benefit of the detached tax credit.

Example

Resident passive income of $1,000 is derived by a trustee of a trust, being cash of $670 and $330 of RWT. The trust is a discretionary trust and one of the beneficiary's (Beneficiary A) has a marginal rate of tax of 17.5% and another beneficiary (Beneficiary B) is a charitable trust.

	Trustee		Beneficiary A		Beneficiary B	
	Cash	Tax credits	Cash	Tax credits	Cash	Tax credits
Marginal tax rate	33%		17.5%		0%	
Trustee derives interest income of $1000:	670.00	330.00				
Trustee distributes (cash) resident passive income to Beneficiary A (including RWT credits)	(670.00)	(330.00)	335.00	165.00	335.00	165.00
Trustee makes RWT substitution payment (s. RE 2(7))	(242.50)		77.50		165.00	
Trustee reallocates tax credits		242.50				
Tax credit of beneficiaries reduced by amount of RWT substitution payment (s. LB 3(6))				(77.50)		(165.00)
Income Tax Liability	0		87.50		0	
Available RWT tax credits to satisfy income tax liability/refund		242.50		87.50		0
(Terminal tax)/ refund due)	242.50		0			
Net after-tax cash position	**0**		**412.50**		**500.00**	

Analysis

Total taxable income	$1000.00
Tax paid on taxable income	$330.00

RWT tax credit of $330 used/refunded as follows:

Trustee refund	$242.50
Beneficiary A tax credit	$87.50
Beneficiary B credit/refund	$0

Application date

The amendments apply from the beginning of the 2008-09 income year, consistent with the application date for the original enactment of the RWT substitution rules. The savings provision also ensures that tax positions taken that are consistent with the outcomes in the amendments in section LB 3 are validated and also ensure that a trustee cannot seek an amended assessment to re-allocate RWT credits retrospectively.

TECHNICAL AMENDMENT - CHANGE TO PENALTY AND INTEREST RULE WHERE OUTSTANDING TAX IS $100 OR LESS

Section 183F of the Tax Administration Act 1994

An amendment has been made to section 183F, which sets out when a taxpayer is not liable for a late payment penalty, interest or a shortfall penalty for not paying employee deductions (imposed under section 141ED), if the amount of outstanding tax after the due date is $100 or less.

Background

In 2009, as part of a broader set of legislative changes, an unintended legislative change was made to section 183F, that meant some taxes were inadvertently removed from the coverage of the rule.

This remedial amendment reinstates these taxes back into this concessionary rule, retrospectively to when the inadvertent error was made. While the error was made in law, Inland Revenue's operational practice did not change and this concession was applied under its original definition.

Key features

The amendment replaces "amount of income tax or ancillary tax" with "amount of tax" where appropriate.

Application date(s)

The amendment applies from 6 October 2009, the date this provision was inadvertently changed.

ANNUALISED EQUIVALENT INCOME AMOUNTS FOR WORKING FOR FAMILIES TAX CREDITS

Schedule 31

A minor amendment has been made to schedule 31 to correct a numerical error following the amendments to the Working for Families tax credit abatement threshold in the Families Package (Income Tax and Benefits) Act 2017.

Background

The Income Tax Act 2007 prescribes how the Commissioner must estimate family scheme income in order to calculate Working for Families tax credit instalments. A person's instalments are based on an estimate of their annual family scheme income, which is then adjusted in accordance with schedule 31 by locating the estimated amount within an income band (for example $44,000-$45,500), and setting the income estimate at the top of that band. The adjustment is intended to provide a protective margin to cater for unexpected pay rises that may occur during the year, which might otherwise result in an overpayment of Working for Families tax credits.

The Families Package (Income Tax and Benefits) Act 2017 increased the abatement threshold for Working for Families tax credits from $36,350 to $42,700. The corresponding amendments to schedule 31 were overlooked.

Key features

Schedule 31 is amended to remove income bands between $36,350 and $42,700 as they are no longer required.

Application date

The amendment applies from 1 July 2018, which is the date from which the increase in the abatement threshold applies.

CROSS REFERENCE IN LB 4 (TAX CREDITS FOR FAMILIES)

Section LB 4

A minor amendment has been made to section LB 4 to include a reference to the Best Start tax credit in the list of tax credits for families, following the introduction of a new Best Start tax credit in the Families Package (Income Tax and Benefits) Act 2017.

Application date

The amendment applies from 1 July 2018, the application date of the Best Start tax credit.

EMPLOYEE TAX CODES SECONDARY TAX CODE - REMEDIAL ITEM

Error in secondary tax code

Section 24B(3)(c) of the Tax administration Act 1994

Due to an oversight the lower bound of the "S" tax code was described in section 24B(3)(c) as applying to secondary employment earnings for an employee whose annual income "is not more than $48,000". The range has been corrected to read as "is more than $14,000 but not more than $48,000".

RECIPROCAL SHIPPING EXEMPTION

Section YD 6(3) of the Income Tax Act 2007

Section YD 6(3) of the Income Tax Act 2007, the reciprocal shipping exemption, has been amended to correct an unintended change arising from the 2007 rewrite of the income tax legislation.

Background

Prior to the rewrite, the reciprocal shipping exemption referred to a New Zealand resident shipping operator either being "*not liable to, or exempt from*" income tax in the other country. The original policy intent of the provision was for it not to matter whether the income is generally not liable to tax in the first instance or if it is subject to a specific exemption.

During the rewrite, however, the words "*not liable to*" were omitted. The removal of "*not liable to*" may have inadvertently narrowed the scope of the reciprocal exemption.

Key features

The exemption applies on the basis of reciprocity. That is, New Zealand will agree not to tax the income of a shipping operator of another country if in reciprocal circumstances a New Zealand resident shipping operator will not be taxed by that other country. The amendment ensures that a reciprocal exemption can be applied in cases where the other country does not tax New Zealand resident shipping operators.

Application date

The amendment applies from 1 April 2008, being the date from which the Income Tax Act 2007 had effect.

AIRCRAFT OVERHAUL EXPENSES

Sections EE 60(2)(e) and EZ 23BA(4)

Amendments to the Income Tax Act 2007 correct a cross-reference error in provisions relating to the calculation of a transitional deduction for aircraft under the new timing rules that apply to the allocation of deductions for aircraft engine overhaul expenses.

Background

The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 contained amendments to the timing of tax deductions for aircraft engine overhaul expenses.

One of the amendments related to a transitional deduction which allowed a faster deduction for an aircraft engine overhaul component. As a result of the transitional deduction, the historic cost and accumulated depreciation of the aircraft needed to be adjusted. Sections EE 60(2) and EZ 23BA(4) provided for adjustments to the historic cost and accumulated depreciation of an aircraft and these two provisions contained incorrect cross-references.

Key features

The following provisions are amended to ensure that the legislation cannot be interpreted to mean that an aircraft would have a zero tax depreciated value at the start of the 2017–18 income year:

- Section EE 60(2)(e) is amended to refer to section EZ 23BA(4) (replacing a reference to section EZ 23BA(3)).
- Section EZ 23BA(4) is amended to apply for the apply for the purpose of section EE 60 (replacing a reference to section EE 56).
- Section EZ 23BA(4) is also amended to clarify that the adjustment is equal to the difference between the two amounts referred to in section EZ 23BA(2) and (3) (replacing a reference to increasing the amount of total deduction for the aircraft).

Application date

The amendments apply from the beginning of the 2017-18 income year, to align with the application date for the new timing rules applying to aircraft engine overhaul expenses.

Maintenance and minor rewrite items

MAINTENANCE AMENDMENTS

Summary of proposed amendments

The following amendments reflect minor technical maintenance items arising from both the rewrite of Income Tax legislation and other business-as-usual matters. As stated in the following table, all the amendments are to the Income Tax Act 2007 (2007 Act) or the Tax Administration Act 1994 (TAA).

Application dates

Applications dates for all maintenance amendments are listed in the following table.

Minor maintenance items

The following amendments relate to minor maintenance items to correct any of the following:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions

Maintenance table

Section	Enactment	Amendment	Commencement date
BF 1, defined terms list	2007 Act	Omit redundant readers' aid	2 June 2016
DU 7(1B)	2007 Act	Improve drafting consistency	2008-09 income year
DV 2(8B)	2007 Act	Replace heading with updated terminology	1 April 2008
EA 2(1)(e)	2007 Act	Improve drafting consistency	1 April 2008
EE 7	2007 Act	Omit redundant cross-reference	1 April 2014
EE 34(7)	2007 Act	Correct minor drafting error	2015–16 income year
EJ 22	2007 Act	Omit redundant cross-reference	2008–09 income year
EW 13(2)	2007 Act	Correct grammar	1 April 2009
EW 15H(1)(e)	2007 Act	Correct cross-references	1 April 2011
EW 31(7)(b)	2007 Act	Correct cross-references	1 April 2008
EX 21B(2)(b)	2007 Act	Correct cross-references, drafting consistency	29 March 2018
FM 36(2), FM 37(c), FM 38(2), FM 40(1)-(4)	2007 Act	Omit redundant wording	1 April 2008
GB 52(1)	2007 Act	Correct grammar	1 October 2015
HC 33	2007 Act	Omit redundant wording	2008–09 income year
HM 30	2007 Act	Correct cross-reference	29 March 2018
HR 10(1)	2007 Act	Correct grammar	1 June 2010
IA 8, defined terms list	2007 Act	Omit redundant term	1 April 2008
IC 3(3), (4)	2007 Act	Correct cross-references	1 April 2008
MX 1(1)	2007 Act	Insert a subsection heading	1 April 2015
MX 4	2007 Act	Insert a subsection heading	1 April 2015
RC 19(2)	2007 Act	Correct cross-reference	1 April 2008
RD 23(3)(c)	2007 Act	Correct cross-reference	2 June 2016

Section	Enactment	Amendment	Commencement date
YA 1 charitable purpose (b)(ii)	2007 Act	Improve drafting for clarity	1 April 2008
YA 1 distinctive work clothing	2007 Act	Correct cross-reference	1 July 2013
YA 1 dwelling	2007 Act	Correct minor drafting error	1 April 2011
YA 1 goods	2007 Act	Correct minor drafting error	1 April 2015
YA 1 high-priced livestock (a)	2007 Act	Correct minor drafting error	1 April 2015
YA 1 savings product policy	2007 Act	Correct minor drafting error	1 July 2010
YA 1 settlement of relationship property	2007 Act	Omit redundant definitions	1 April 2011
YC 4(1)	2007 Act	Correct minor drafting error	1 April 2008
YD 4 compare note	2007 Act	Correct minor drafting error	1 April 2008
Schedule 2, Part A, Clause 3	2007 Act	Correct cross-reference	2 June 2016
3(1) exempt person	TAA	Correct cross-reference	1 April 1995
15F(2)	TAA	Correct minor drafting error	1 April 2008
25(2) proviso	TAA	Update terminology	1 April 2008
32E(2)(k)	TAA	Correct cross-reference	1 April 2008
33(1D)	TAA	Correct inadvertent drafting error	1 April 2008
70(2)	TAA	Update terminology	1 April 2008
74(1)(b)(iii)	TAA	Correct minor drafting error	1 April 2003
80A(1)(b)	TAA	Correct cross-reference	9 December 2009
85(6) debtor (c)	TAA	Correct minor drafting error	21 December 2004
85H(2)	TAA	Update terminology	26 April 2005
91FD(1)(bb)	TAA	Correct minor drafting error	7 September 2010

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 (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

Product Ruling - BR Prd 18/02: Harbour Fund III GP Limited

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 Harbour Fund III GP Limited.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BD 1(4), BD 1(5), BG 1 and YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by the Harbour Fund III Limited Partnership (the Fund) of proceeds (Proceeds) pursuant to individual funding agreements (the Funding Agreement) that the Fund will enter into with litigation claimants (the Claimants) to a proposed class action against Carter Holt Harvey Limited and the other Carter Holt Harvey entities, under which the Fund will agree to pay all legal and other costs incurred by the Claimants, in return for a share of the Proceeds.

Further details of the Arrangement are set out in the paragraphs below.

The offshore parties to the Arrangement

1. The Fund is situated in the Cayman Islands and has been established to make litigation and arbitration funding available for all types of claims other than personal injury, divorce or defamation proceedings.
2. Under the law of Cayman Islands, the Fund does not have separate legal personality from its partners. The Fund is not the beneficial owner of its assets, which are held by Harbour Fund III GP Limited (the General Partner), in accordance with the terms of the Fund's limited partnership agreement.
3. The Fund provides funding for litigation claimants all around the world who have met certain criteria. The criteria include the creditworthiness of the defendant, the legal merits of the case, the expertise of the legal team and the likely legal fees.
4. The Fund is advised by Harbour Litigation Cayman Limited (the Investment Advisor) a company incorporated in the Cayman Islands. The Investment Advisor has been contracted by the General Partner under an investment advisory agreement to perform investigation, evaluation and due diligence services in respect of potential claims for which funding is sought.
5. Preliminary investigation and due diligence services have in turn been subcontracted by the Investment Advisor to Harbour Litigation Funding Limited (the Sub-Advisor) which is a company incorporated in England and Wales, under a sub-advisory agreement.
6. Details of the activities undertaken by the Investment Advisor and by the Sub-Advisor (together the Advisors) when investigating and evaluating potential claims are set out below.

Summary of the normal investment procedure

7. The Advisors ensure that the business of the Fund is known to interested parties. However, the Advisors do not actively or routinely seek to identify and locate specific claims for which funding might be provided.
8. Once a request for funding is received a confidentiality agreement is entered into, and the Advisors conduct a preliminary assessment. Information is gathered regarding the claim, and an immediate analysis is conducted to assess whether the claim is likely to satisfy the Fund's criteria. If the claim is unlikely to satisfy the criteria, it will generally be rejected at this stage.

9. If a claim passes the first stage of analysis, the Fund will, if appropriate, enter into a letter of intent, usually with the claimant directly, but in the case of a class/group action, with the legal representative seeking funding on behalf of the claimants. This procedure has been adopted because there are too many claimants to execute separate documents with and they may not yet have been identified. The Sub-Advisor will then conduct a more detailed due diligence to ascertain whether the claim would be likely to meet the criteria for funding.
10. An Investment Committee established by the Investment Advisor then meets every few weeks to evaluate the legal merits of the cases for which funding is sought which satisfy the Fund's criteria. The Investment Committee reviews updates on the progress of existing funded claims.
11. At the conclusion of each meeting the Investment Committee, where appropriate, make a formal recommendation to the Board of the Investment Advisor, about investing in proposed new claims. The Investment Committee also reports to the Board of the Investment Advisor on existing funded claims if there have been material adverse developments in the case of existing funded claims.
12. The Board of the Investment Advisor then considers the recommendations made by the Investment Committee at its monthly meeting. Where the Board of the Investment Advisor considers that a proposed claim is likely to meet the Fund's criteria for funding, a recommendation is made by the Board of the Investment Advisor to the Board of the General Partner, which has the authority to invest in claims on behalf of the Fund.
13. The Board of the General Partner then meets to consider the recommendations made by the Board of the Investment Advisor.
14. Where the Board of the General Partner (on behalf of the Fund) considers that a recommended claim is meritorious, the Fund will make funds directly available for the claim by entering into a funding agreement or funding agreements with the claimants.

How the decision to fund this Claim was made

15. The Sub-Advisor was approached in January 2017, via email, by Adina Thorn in relation to the possible funding of a representative action in relation to cladding supplied and fitted in buildings throughout New Zealand. The potential claim, would be based in negligence and breach of statutory duties, and was expected involve over 200 Claimants with a claim for damages in excess of NZD $40m (the Claim).
16. In accordance with normal procedure summarised above, this approach for funding was subjected to the preliminary review and assessment process. It was subsequently concluded that the Claim could potentially satisfy the Fund's criteria.
17. Due diligence was then undertaken by the Advisors, and ultimately a recommendation was made to the Board of the General Partner that the Claim be approved for funding.
18. At its March 2017 meeting in the Cayman Islands, the Board of the General Partner approved the Claim for funding.
19. The parties then attended to the finalisation of anticipated timetables and funding amounts, and appropriate documentation was prepared for the Fund to record the terms on which funding would be provided to Claimants.
20. A draft of the Funding Agreement was prepared, to record the terms on which the Fund will make funding available to Claimants for their legal and other costs incurred in relation to the Claim. A draft relationship agreement (Relationship Agreement) was prepared to record the various invoicing and reporting requirements that will apply to Adina Thorn lawyers acting for the funded Claimants throughout the proceedings.
21. The Relationship Agreement was finalised and entered into on 26 May 2017 by the Fund and Adina Thorn lawyers. The Funding Agreement was finalised at the beginning of February 2018 with Claimants progressively entering into the Funding Agreement from that time.

Funding Agreement

22. The Funding Agreement records the terms on which the Fund agrees to make funds available to Claimants (i.e., individuals or groups who have suffered damage within the scope of the Claim) for Claimants Legal Costs. The phrase Claimants Legal Costs is defined in clause 20.1 of the Funding Agreement. It includes legal fees incurred in relation to the Claim, and any costs incurred by the Claimants (subject to certain exclusions) should the Claimants be ordered to pay the legal costs of the defendant or any other party involved in the Claim. Pursuant to the terms of clause 9, the Claimants have agreed that in the event that the Claimants are successful, the Fund will receive the Proceeds.

23. The Claimants will comprise individuals, groups of individuals and companies (or their respective representatives, such as liquidators or administrators) that are home and building owners, affected by defects in cladding used in the construction of their homes and buildings. Some of these Claimants are unable to bring a claim under the Weathertight Homes Resolution Services Act 2006 (WHRS Act) on account of their buildings having been constructed outside the 10 year limitation period imposed by the WHRS Act.
24. While the Claimant group is located in both New Zealand and other countries, including Australia and the United Kingdom, it is the applicant's understanding that all the properties to which the Claim relates are located in New Zealand. This Ruling only considers or rules on the Arrangement to the extent it relates to New Zealand properties.

Funding process

25. Funding for the Claimants Legal Costs will be made available under the Funding Agreement in two stages. The first stage comprises the point up to which all the pre-conditions for full funding are satisfied, and a statement of claim has been filed.
26. The Applicant advised that due to the process of confirming claimants taking time, Claimants will be confirmed as being part of the Claimant group on a progressive basis during the first stage of funding. Claimants will continue to be confirmed up until (and potentially after) the time that the statement of claim is filed. It is possible that Claimants could be confirmed and enter into the Funding Agreement after the second stage of funding has commenced.
27. During the first stage, legal fees will be incurred for work which will benefit all Claimants including Claimants who are accepted towards the end of the first stage. The definition of Claimants Legal Costs (clause 20.1 of the Funding Agreement) overcomes a potential problem associated with the timing of, and allocation of, legal costs, which were incurred before a Claimant entered into the Funding Agreement. This clause provides that Claimants will agree that each Claimant's proportionate share will be allocated by reference to the value of their claim, regardless of when each Claimant entered into the Funding Agreement.
28. Provided that the Claim satisfies the preconditions for full funding, the Fund will, after the completion of the first stage, fund the second stage of the Claim. Funding will be provided for the second stage of the Claim until such time as the Fund terminates its obligations under the Funding Agreements or the proceedings are concluded (whether by settlement or judgment of the courts).

Fund's entitlement to Proceeds

29. In the event that the Fund funds stage one and two of the Claim, and the Claim is successful, the Fund will be entitled to receive the Proceeds. The amount of the Proceeds will be calculated on the basis set out in the Funding Agreement. Clause 9.1 (a)(i) to (vi) outlines how the Proceeds will be allocated between the Fund and the Claimants.
30. In accordance with the Funding Agreement, Adina Thorn lawyers will receive and hold any damages, costs and settlement sums received in respect of a Claim on bare trust for the Fund and the Claimants in the proportions agreed until such time as the relevant amounts are paid to the Fund and to the Claimants. All amounts received from the defendant must first be paid to the Fund who will be paid in priority to the Claimants, who shall each receive such sum as is equal to their share of the remaining damages, costs or settlement sum.

Control of Claim

31. Control of the Claim will rest with the Claimants. The Fund will have no ability to instruct Adina Thorn lawyers or dictate how the proceedings are to be conducted. Clause 5 of The Funding Agreement expressly acknowledges that the Fund has no control over or right to make decisions about the proceedings. Only the Claimants, through the Representative Claimant (the Representative Claimant) may instruct Adina Thorn lawyers and determine, for example, that the claims that will be pursued and what actions will be taken or decisions made on a day to day basis in respect of the conduct of the proceedings.
32. Clause 6.1 (e) of the Funding Agreement provides that at any time Claimants will be entitled to change Adina Thorn lawyers. While the prior written agreement of the Fund is required, this clause provides that the Fund's consent to such a change is not to be unreasonably withheld. However, in order to continue to receive funding under the Funding Agreement, the Claimants will be required to ensure that the new lawyers executes a deed in favour of the Fund under which the new Adina Thorn lawyers agrees to be bound by the terms of the Relationship Agreement as if they were the lawyers.

33. Clauses 5, 6 and 13 outline the Claimants obligations under the Funding Agreement. They include taking certain actions and to provide certain instructions to Adina Thorn lawyers in relation to certain anticipated future events including: in relation to the pursuit of an appeal should the Fund wish to provide funding for an appeal, and in relation to settlement decisions should settlement be recommended or not recommended (as the case may be) by Adina Thorn lawyers.

34. The Applicant states that because this is a class action, Claimants will also agree on entering into the Funding Agreement the manner in which the proceedings will be conducted and the representative claimant will instruct Adina Thorn lawyers. This is to ensure that the funded Claimants agree at the outset how the proceedings will be conducted, and so that the Fund can be confident that the proceedings are being conducted in an optimal manner.

Termination

35. Clause 1 of the Funding Agreement contains an initial cooling off period of 20 days. Clause 12 provides that a Claimant will not be able to unilaterally terminate its obligations under the Funding Agreement. Claimants will only be entitled to actively terminate their obligations if there has been a material breach by the Fund which has adversely affected the Claimant's interests and which has not been remedied by the Fund within 30 days.

36. Clause 12 of the Funding Agreement enables a Claimant to opt out of the class action if the Claimant gives instructions to Adina Thorn lawyers or otherwise exercises a right to opt out of the proceedings. However if the Claim is subsequently successful the Fund is still entitled to recover its share of the Proceeds as if the Claimant had not opted out of the class action.

37. Clause 11 of the Funding Agreement provides that the Fund will have the right at any time to terminate its obligation to contribute to future legal costs in respect of the Claim.

Key contractual terms relating to process

38. Claimants will agree to take certain actions and provide certain instructions to Adina Thorn lawyers in relation to the manner in which the proceedings will be conducted, and in relation to certain potential future events. These obligations are contained in the following clauses:

- Clause 5: Conduct of Proceedings.
- Clause 6: Claimant's Obligations.
- Clause 9: Application of Proceeds.
- Clause 13: Settlement Decisions.
- Clause 19: General Provisions.

39. Pursuant to clause 6 of the Funding Agreement, each Claimant will agree:

- That the Representative Claimant will determine in consultation with Adina Thorn lawyers what claims will be pursued [clause 5.1 (a)].
- That the Representative Claimant will give day to day instructions to Adina Thorn lawyers and will make binding decisions on behalf of Claimants [clause 5.1 (b)].
- That the Claimant will provide all information and documents required by Adina Thorn lawyers, will deal promptly with all requests made by Adina Thorn lawyers and will co-operate generally with Adina Thorn lawyers [clause 6.1 (m)].
- That the Claimant will act reasonably and commercially in the prosecution of the proceedings and in accordance with the advice of Adina Thorn lawyers [clause 6.1 (d)].
- That the Claimant will accept and follow Adina Thorn lawyers reasonable legal advice including in relation to settlement [clause 6.1 (i)].
- That the Representative Claimant is authorised to make or take any action constituting a settlement decision provided that Adina Thorn lawyers has advised such action is reasonable [clause 13.1].
- That Adina Thorn lawyers are authorised to and instructed to accept on the Claimant's behalf, any settlement proposed where the Claimant has not initially wanted to act in accordance with the advice of Adina Thorn lawyers and the matter has been referred to independent counsel for opinion, with the independent counsel having recommended that Adina Thorn lawyer's advice is reasonable in all the circumstances [clause 13.3 and 13.4].

40. In addition, each Claimant will agree under the Funding Agreement that the Fund is entitled to communicate directly with Adina Thorn lawyers, and that the Fund is entitled to receive any information which has or may have a material impact on the Claim or the proceedings [clause 6.1 (c)].

The Relationship Agreement between Adina Thorn Lawyers and the Fund

41. The terms and conditions in the Relationship Agreement are consistent with the above provisions in the Funding Agreement. The Relationship Agreement provides that Adina Thorn lawyers must at all times comply with the following terms and conditions:
    - Act consistently with all authorisations and instructions given by the Claimant as contemplated in the Funding Agreement, subject to having received such instructions or authorisations [clause 2.4].
    - Only enter into a Relationship Agreement with a Claimant if the Claimant gives Adina Thorn lawyers all the authorisations and instructions contemplated and referred to in the Funding Agreement [clause 2.5].
    - Ensure the Claimant is given all necessary information to facilitate informed instructions [clause 8.2 (e)].
    - Keep the Fund fully informed by providing a monthly report in the form set out in the Relationship Agreement [clause 8.1 (a)].
    - Give the Fund access to, and when requested provide the Fund with copies of, all material documents produced by or for the Claimants in relation to the proceedings [clause 8.1 (b)].
    - Immediately inform the Claimant, and in accordance with the Claimant's instructions as contemplated in the Relationship Agreement and the Funding Agreement, notify the Fund if Adina Thorn lawyers becomes aware of any information which has or may have a material impact on the Claim [clause 8.2 (b)].
    - Immediately notify the Fund in the event that the Claimant receives a settlement offer, and prepare for the Claimant a written recommendation on whether to accept such an offer and provide a copy of that recommendation to the Fund [clause 8.1 (f)].

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) None of the General Partner, the limited partners of the Fund, nor the Investment Advisor or Sub-Advisor is resident in New Zealand for income tax purposes.

b) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor own or lease any property located in New Zealand.

c) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor has any employees based in New Zealand.

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:

a) Amounts received by the Fund and the Limited Partners under the Arrangement are not “interest” as defined in s YA 1.

b) Amounts received by the Fund and the Limited Partners under the Arrangement are “non-residents' foreign-sourced income” pursuant to s BD 1(4).

c) Amounts received by the Fund and the Limited Partners under the Arrangement are not assessable income pursuant to s BD 1(5).

d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 15 February 2018 and ending on 15 February 2021.

This Ruling is signed by me on the 23rd day of February 2018.

Howard Davis
Director (Taxpayer Rulings)

Product Ruling - BR Prd 18/03: Bank of New Zealand (BNZ)

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 Bank of New Zealand (BNZ).

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of:

(a) ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 6, RE 10, RF 1, RF 2, RF 3 and RF 4; and

(b) ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

The Arrangement to which this Ruling applies

The Arrangement is a product (TotalMoney) that BNZ offers to its customers. These customers may only be individuals, companies, or trusts.

TotalMoney involves the creation of new types of accounts that must be in a group of accounts, and the facility to elect to group up to 50 of these new types of accounts into one or more groups to either "pool" or "offset" the account balances.

"Pooling" involves the aggregation of account credit balances to determine the tiered interest rate that will apply to the calculation and crediting of interest to each account balance. "Offsetting" involves the aggregation of account balances to calculate the amount of interest debited to a lending facility account balance.

The Arrangement is set out in the documents listed below, copies of which were received by the Taxpayer Rulings Unit, Inland Revenue, on 22 January 2018:

- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Personal and Sole Trader Customers;
- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies and Trusts;
- Bank of New Zealand Home Loan Facility Master Agreement;
- Letter of Advice – TotalMoney Home Loan;
- Facility Document – TotalMoney Business Term Loan;
- BNZ Business Lending Master Terms and Conditions; and
- Confirmation of New Terms and Conditions (for customers converting to TotalMoney).

Further details of the Arrangement are set out in paragraphs 1 to 28 below.

1. TotalMoney is a package of accounts and loans that BNZ offers to its customers. These customers may be only individuals, companies, or trusts.
2. Customers, in general, have a range of accounts with BNZ, including transaction accounts, savings accounts, and various loan accounts. Loan accounts may be only table, non-table, tailored, principal and interest, interest only, fixed or floating home loan accounts, or business loan accounts.
3. TotalMoney allows customers to group or aggregate these accounts for the purposes of either "pooling" or "offsetting" the account balances.

Primary features of TotalMoney

4. The primary features of TotalMoney are the "pooling" and "offsetting" features. These features operate in the manner described below.

Pooling

(a) The pooling aspect of TotalMoney operates when several transaction accounts with credit balances exist. Interest on these credit balance accounts is calculated and paid having regard to the cumulative credit balance of all transaction accounts in the group. Interest-bearing accounts usually attract interest based on interest rate brackets that apply to the balance of each relevant individual account.

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(b) The cumulative credit balance is calculated so BNZ can ascertain the relevant interest rate tier applicable to the relevant accounts. The separate funds are not actually transferred to one account before the interest is calculated. BNZ calculates interest at the applicable interest rate tier that applies to the accumulated balance.

Offsetting

(a) With the offset feature of TotalMoney, interest on a lending facility or facilities within the group is calculated and paid by the customer on the difference between the lending facility balances and the credit balances of transaction accounts in the group. Under the terms and conditions agreed between BNZ and its customers for TotalMoney, BNZ pays no interest on the credit balances that are "offset" against the lending facility.

(b) The "offsetting" is only to calculate the balance of the lending facility or facilities on which interest is payable or, where the credit balances of transaction accounts exceed the balance of the lending facility or facilities in the group in which the credit balances are "offset" against, the balance of the excess credit balances on which interest is receivable. There is no actual transfer of funds, no set-off or netting of funds together in an account, and no transfer of any interest in or entitlement to funds.

5. Every transaction account in a TotalMoney group is automatically either set to "pool" or "offset". If a customer has any lending facilities within their TotalMoney group, the customer's transaction accounts with credit balances are "offset" against their lending facilities. Interest is payable by the customer if the balance of their lending facilities exceeds the balance of their transaction accounts with credit balances, and interest is payable by BNZ if a customer's transaction accounts with credit balances exceeds the balance of their lending facilities. Where the customer has no loan account(s), a customer's TotalMoney accounts will automatically "pool".

6. TotalMoney does not provide a facility for existing accounts. TotalMoney involves the creation of a new type of account. To participate in TotalMoney, a customer must open specific TotalMoney accounts that are particular to the TotalMoney product. Customers may convert an existing non-TotalMoney transaction or savings account that they have with BNZ to a new TotalMoney account. However, the customer must agree that the existing terms and conditions that apply to those accounts cease to apply, and are replaced by the TotalMoney Terms and Conditions.

7. For new TotalMoney accounts, the account will either "offset" or "pool", depending on whether the customer has any lending facilities within the same TotalMoney group.

Pooling – further detail

8. BNZ has a contractual obligation to pay interest if either a customer's transaction accounts with credit balances exceeds their lending facilities within a TotalMoney group, or a customer only has transaction accounts with credit balances (and no lending facilities) within a TotalMoney group. The interest payable is based on the applicable interest rate tier that applies based on the total credit balance being "pooled" or "offset" against any lending facilities in the TotalMoney group. Following usual business practice, BNZ makes a separate determination for withholding tax on each interest payment made to each account.

9. The benefit of the "pooling" feature for customers is that they can earn more interest by combining smaller balances and reaching higher interest-rate tiers and still maintain their money in separate accounts for separate purposes. The customer may consider this an advantageous way to manage their money.

10. Account owners have full deposit and withdrawal access to their transaction accounts. Overdraft facilities may be available in relation to these accounts. However, any overdraft balance is ignored for "pooling" purposes. BNZ charges debit interest on the overdrawn balance of any account. The overdrawn balance does not reduce the "pooled" balance of the credit balance accounts when BNZ is calculating interest for to those accounts.

Offsetting – further detail

11. Where one loan account is in the group, the interest payable on the loan account is calculated on the balance of the loan account less the credit balances of accounts in the group. This will be the case as a matter of law (in terms of TotalMoney documentation) and as a matter of practice (in terms of BNZ's computer system). There is no actual set-off, netting, or transfer of funds, or transfer of any interest in or entitlement to funds. "Offsetting" occurs before debit or credit interest is calculated.

12. For example, in the case of a loan account that would otherwise be the same as a standard variable rate table home loan facility over 20 years with a "minimum payment", there will be no provision for the amount of interest saved under "offsetting" to reduce the "minimum payment". The effect of "offsetting" is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the "minimum payment". In either case, the term of the loan is reduced because the principal portion of the payment is effectively increased. In the case of a non-table loan, interest payments will be reduced by "offsetting", principal repayments will not change, and the loan term will not reduce. In the case of interest only loans, repayments comprise solely interest, so the impact of "offsetting" will be to reduce the interest amount and therefore reduce the "minimum payment".

13. Where there is more than one loan account in the group, the loan accounts in the group are given a default priority; namely, the oldest loan account in the group will receive the highest priority. However, the customer may elect two or more of those loan accounts to be prioritised for "offsetting" purposes. The loan account with the highest priority will receive the benefit of "offsetting" first. It is only where the credit balances of transaction accounts in the group exceed the balance of that highest priority loan account that the next highest priority loan account balance is offset, and so on.

14. If the total credit balances of the transaction accounts are greater than the total debit balance of the loan accounts in a group, credit interest will be applied to the difference and paid on a prorated basis to the credit balance accounts in accordance with the balance of those accounts (essentially in line with the "pooling" feature of TotalMoney).

15. BNZ calculates interest daily. If, during a month, BNZ has both an entitlement to receive interest (that is, the balance of participating loan accounts exceeds the balance of all transaction accounts in a group) and, at another point in the month, BNZ has an obligation to pay interest (that is, the balance of transaction accounts in a group exceeds the balance of the relevant loan accounts), then the two interest payments are made and are not set-off.

16. The "offsetting" feature of TotalMoney essentially offers the same benefits to customers as offered by a revolving credit loan (such as BNZ's "Rapid Repay" product) in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a primary perceived disadvantage of a revolving credit loan because it allows customers to retain separate account balances (which customers may prefer when managing their finances).

17. Where a customer has a TotalMoney loan account, this account must be grouped with at least one other TotalMoney transaction account.

18. No arrangement must exist between the customers who have grouped their accounts that provides for the loan account owner(s) to make a payment(s) to the transaction account owner(s) in consideration for the transaction account owner(s) "offseting" their accounts under TotalMoney.

Business purposes

19. When TotalMoney was established, customers were contractually prohibited from using TotalMoney for business purposes. BNZ has now removed the prohibition on the business use of TotalMoney. BNZ extended the availability of TotalMoney to business customers to give them the same tools for managing their financial affairs as it gives to personal customers.

20. Under the terms and conditions applicable to TotalMoney, customers are able to use TotalMoney accounts for business purposes, which means that, customers are able to group business and non-business product accounts. This means that a sole trader, for example, is able to group their business and non-business accounts.

Terms and Conditions for the TotalMoney home loan products

21. Each of BNZ's home loans is explained in a collection of documents. These documents include primarily a Home Loan Facility Master Agreement (which is a standard form master document that contains generic provisions that apply to all BNZ home loan facilities), and a Letter of Advice for Home Loans (which contains particular and specific provisions for the home loan facility being made available to the customer and overrides the Loan Facility Master Agreement in case of any inconsistencies). The Letter of Advice is produced from a computer system that contains a master list of possible provisions that can apply to BNZ's home loans. Under this system, the provisions applicable to a particular home loan are selected, collated, and produced in a document.

22. The TotalMoney product home loans are also documented in a Home Loan Facility Master Agreement and Letter of Advice for Home Loans.

23. Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the payments later in the term comprise repayments of the principal. Non-table loans have two separate repayments, one of interest and one of principal. Customers repay the same amount of principal each time and interest is charged separately.

24. The documentation for a TotalMoney standard variable rate table home loan facility over 20 years will largely be the same as that for current BNZ home loan facilities that are standard variable rate table home loans over 20 years. The only differences are; branding (the name on the Letter of Advice), the interest calculation (which provides for the effect of the "offset"), and, in relation to table loans, the provision stating that where the loan has the benefit of the "offset" to reduce the interest cost, the "minimum payment" specified for the loan will not decrease because of any interest savings but instead the loan term will reduce. Under a non-table loan, any interest saving (whether as a result of a reduction in the applicable interest rate because of a general decrease in interest rates or because of the offset feature), would result in either a reduction of the interest repayment of the loan or a reduction in the loan term (if the original repayment amount is maintained despite the interest saving). In relation to a TotalMoney product home loan that is a table home loan, a reduction is only allowed in the loan term. Under a TotalMoney product interest only loan, any interest saving (whether as a result of a reduction in the applicable interest rate because of a general decrease in interest rates, or because of the offset feature) would result in a reduction of the interest repayment.

Terms and conditions for TotalMoney business loan products

25. Each of BNZ's business loans is also documented under a collection of documents. These include primarily the Business Lending Master Terms and Conditions (a standard form "Master" document which contains primarily generic provisions that apply to BNZ's business loan facilities) and a Business Term Loan Facility Document (which contains particular and specific provisions for the loan facility that is being made available to a TotalMoney business customer). To the extent that there are any inconsistencies between the documentation, BNZ has the sole discretion to resolve the inconsistency.

Groups

26. TotalMoney is based on a group of participating accounts. Groups can be comprised of only of the following categories:
    (a) Natural persons:
        (i) The accounts of an individual, or the individual and joint accounts of married, de facto, and civil union couples, and any of their children may be combined as part of one group of accounts.
        (ii) For example, the various accounts of one natural person, Jane, or, the various accounts (individual or joint) of Jane and her husband John and their child Joe. The group is not limited to residents of New Zealand, although the group may not include both residents and non-residents.
    (b) One company or one trust:
        (i) Multiple accounts of one company (including a qualifying company or look through company) or one trust may be combined as part of a group. Only one entity can be in a group at any time.
        (ii) Accounts of different entities (including the entity and any related individual) cannot be pooled or offset.
27. Accounts may only be included in one group. An individual may have accounts in three groups, through membership in one as an individual customer, the second as a joint customer and in the third as a sole trader. A group may not include more than one sole trader's accounts.
28. A customer may be a resident or non-resident of New Zealand for tax purposes. However, where a group of accounts consists of accounts owned by more than one legal person, BNZ will obtain representations from the owners of those accounts that they do not have different tax residence status. That is, where more than one legal person is participating in a group of accounts, either all persons must be residents of New Zealand for tax purposes or all persons must be non-residents of New Zealand for tax purposes.

BNZ's objectives

29. BNZ's objectives in providing TotalMoney are to:
    (a) increase its market share, particularly for home loans and transaction-type accounts;
    (b) increase customer satisfaction and customer retention; and
    (d) improve its brand awareness and be seen as a market leader.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following condition:

(a) All interest rates related to the TotalMoney product are arm's length market interest rates.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the condition stated above, the Taxation Laws apply to the Arrangement as follows:

Financial arrangements rules

(a) When a credit balance of a transaction account and a debit balance of a loan account are "offset", there is no amount of consideration paid or payable because of that "offset" for the calculation of income and expenditure under ss EW 15 and EW 31 of the "financial arrangements rules" (as defined in s EW 1(2)).

Resident Withholding Tax (RWT), Non-Resident Withholding Tax (NRWT) and Approved Issuer Levy (AIL)

(b) Under the "pooling" feature of TotalMoney:

  (i) RWT (as defined in s YA 1) and NRWT (as defined in s YA 1) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);

  (ii) For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to s 86I of the SCDA.

(c) Under the "offsetting" feature of TotalMoney:

  (i) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balances of participating transaction accounts in a group, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the combined credit balance of those accounts exceeds the combined debit balance of the lending facility accounts.

  (ii) To the extent that interest is credited to participating transaction accounts in a group:

   – RWT (as defined in s YA 1) and NRWT (as defined in s YA 1) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);

   – For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to ss 86F and 86I of the SCDA.

Section CC 7

(d) No income arises under s CC 7 for BNZ or its customers in relation to the Arrangement.

Section BG 1

(e) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2018 and ending on 31 March 2022.

This Ruling is signed by me on the 29 March 2018.

James Mulcahy
Group Lead, Customer Compliance – Significant Enterprises

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 18/08: Binding Rulings – Effect of the Commissioner changing her mind in relation to the application of s BG 1

This Question We've Been Asked (QWBA) is about Part 5A of the Tax Administration Act 1994 and will be of interest to anyone who has been issued a binding private or product ruling for an ongoing arrangement on the application of a general anti-avoidance provision.

This QWBA relates to an issue previously considered by the Taxpayer Rulings Unit and is not connected to the Commissioner's review of the Interpretation Statement on Tax Avoidance.

Key term

General anti-avoidance provision means s BG 1 of the Income Tax Act 2007 and/or s 76 of the Goods and Services Tax Act 1985

Question

The Commissioner has issued a binding ruling that a general anti-avoidance provision does not apply to an ongoing arrangement. She later identifies some concerns that the conclusion may be incorrect and that the anti-avoidance provision may apply.

Can the Commissioner take a different view on the application of a general anti-avoidance provision to an ongoing arrangement when a binding ruling that applies in relation to the general anti-avoidance provision expires?

Answer

Yes. The Commissioner can apply a new interpretation of the anti-avoidance provision to any period following the expiry of the ruling, as long as this does not have the effect of reversing the tax outcomes in the period covered by the ruling. The general anti-avoidance provisions do not require a different approach from other provisions.

Explanation

1. This item considers the situation where a binding private or product ruling has been issued for an ongoing arrangement, and the Commissioner's view of how the legislation applies to the arrangement subsequently changes.
2. It is clear that if a binding ruling exists, the Commissioner cannot change her mind and apply a different interpretation of the taxation laws to the arrangement *during the period of the ruling*, as long as the ruling has not ceased to apply for another reason. This is the case whether the Commissioner has formally withdrawn the ruling or not.
3. It is also clear that the Commissioner can, as a general matter, apply a different interpretation of the taxation laws *to any period after the ruling expires* where her view of the legislation has changed.

Binding rulings legislation

4. The binding rulings regime was enacted in 1995 to give taxpayers more certainty about their tax affairs through public rulings and taxpayer-specific private and product rulings. Where a binding ruling has been issued that applies to a taxpayer, that taxpayer, by following the binding ruling, can be certain about how the Commissioner will apply the law. An application for a binding private or product ruling must disclose all relevant facts and documents relating to the arrangement for which the ruling is sought.
5. The legislation relating to binding rulings is found in Part 5A. The binding nature of private rulings is in s 91EA(1):

   Notwithstanding anything in any other Act, if—

   (a) a private ruling on a taxation law applies to a person in relation to an arrangement and a tax type for an arrangement; and

   (b) the person applies the taxation law for the tax type in the way stated in the ruling,—

   the Commissioner must apply the taxation law in relation to the person, the tax type, and the arrangement in accordance with the ruling.

6. Section 91EB(1) sets out when a private ruling applies:

   A private ruling on a taxation law for a tax type applies to a person in relation to an arrangement—

   (a) only if the taxation law is expressly referred to in the ruling; and

   (b) only for the period or tax year for which the ruling applies.

7. Section 91EB(2) sets out when a private ruling does not apply. This item does not apply if one of the situations in s 91EB(2) applies.

8. Equivalent provisions apply for product rulings (ss 91FA(1) and 91FB).

9. In addition, s 91G provides that a binding ruling does not apply from the date a taxation law is repealed or amended to the extent that the repeal or amendment changes the way the taxation law applies in the ruling.

10. These provisions provide that a binding ruling applies only for the period set out in the ruling. Nothing in the Act deems the approach in the ruling to be correct. The legislation merely requires the Commissioner to apply the tax laws to the person and the arrangement in accordance with the ruling for the period specified in the ruling.

11. As such, the general position is that the Commissioner is required to follow the approach set out in the ruling only for the period of the ruling. Once the term of the ruling has expired, the Commissioner may apply a different interpretation of the taxation laws to future years, if her view has changed, even for an ongoing transaction. The Commissioner will not make the decision to change her mind on an issue covered by a binding ruling lightly. This means that the decision to adopt a different interpretation must be made at an appropriate level in Inland Revenue, which in many cases will require involvement of the Office of the Chief Tax Counsel. The Commissioner's escalation policy and any relevant care and management factors also need to be taken into account, where appropriate.

12. The existence of a binding ruling does not mean that the conclusion in the ruling is (necessarily) correct; rather, the ruling binds the Commissioner as to how she will apply the taxation laws during the period of the ruling.

Effect of anti-avoidance provisions

13. It might be argued that this general position should not apply in the context of general anti-avoidance provisions, on the basis that the effect of the general anti-avoidance provisions is that a "tax avoidance arrangement" is void against the Commissioner.

14. The general anti-avoidance provisions apply to an entire "arrangement" and not to specific income years or a specific part of the "arrangement". Therefore, it could be argued that where the Commissioner has ruled that a general anti-avoidance provision does not apply, albeit for a set period, the effect of s 91EA(1) is that the entire arrangement that is the subject of the ruling is treated as not being void against the Commissioner, even if the Commissioner changes her mind.

15. The Commissioner considers that such an argument is inconsistent with the provisions of the Act that apply to rulings and the policy behind the rulings regime. One purpose of the binding rulings regime, as set out in s 91A, is to provide taxpayers with certainty about the way the Commissioner will apply taxation laws. As discussed above, a binding ruling provides certainty to a taxpayer only for the period stated in the ruling. This is consistent with comments made by officials in the 1994 document *Binding Rulings on Taxation: A discussion document on the proposed regime* that the Commissioner is bound by a ruling only while it remains in force.

16. Binding rulings are not law, but are the Commissioner's interpretation of the law in a form that binds the Commissioner for the period of the ruling. The legally binding nature of a ruling means that even if the Commissioner considers the ruling's conclusion to be incorrect, she is precluded from applying the correct interpretation to the transaction for the period of the ruling.

17. However, the existence of a ruling stating that a general anti-avoidance provision does not apply to an arrangement does not mean that the transaction is not a "tax avoidance arrangement". Despite the existence of a favourable ruling, s BG 1 or s 76 may have always applied to void the relevant arrangement. Following expiry of the ruling, the Commissioner is not prevented from treating the arrangement as void in accordance with the relevant anti-avoidance provision, as long as she follows the approach in the ruling for the period that it applied. As noted above, the decision that the anti-avoidance provision applies must be made at the appropriate level in Inland Revenue, and the Commissioner's escalation policy needs to be taken into account.

18. Judicial review concepts, such as estoppel and legitimate expectation, also do not apply to prevent the Commissioner from being able to change her mind where she has issued a binding ruling in relation to a general anti-avoidance provision. In general, the courts have held that these concepts have limited application to the Commissioner and that the Commissioner

cannot be estopped because of a legitimate expectation based on the Commissioner's past statements or actions. The only exception to this is where a taxpayer has a binding ruling that applies to a particular arrangement and the relevant period, which the courts have accepted is the only way in which to bind the Commissioner (see, for example, *Westpac Banking Corp v Commissioner of Inland Revenue* (2008) 23 NZTC 21,694).

19. An argument that the existence of a binding ruling for a certain period gives rise to a legitimate expectation that the Commissioner will continue to apply the same approach following expiry of the ruling must fail, as the binding rulings regime is quite clear about the scope and application of rulings.

20. Therefore, nothing in the binding rulings legislation suggests that the general position will not apply in relation to the general anti-avoidance provisions.

Application of the new position and shortfall penalties

21. It is clear that the Commissioner is not able to apply the new position retrospectively to the period to which the ruling applied. The new position can only ever take effect following the expiration of the ruling. This means that care needs to be taken to ensure that applying the new position to the subsequent period does not have the effect of reversing the tax outcomes in the period that was covered by the ruling. In some situations, this may be difficult (if not impossible) to achieve.

22. Legally, the Commissioner is required to follow the approach set out in the ruling only for the period of the ruling. To obtain certainty on whether the same interpretation will apply in future years of an ongoing transaction, a taxpayer should apply for a reissue of the ruling.

23. Once the term of the ruling has expired, the Commissioner is legally permitted to apply a different interpretation of the taxation laws to any period that is not covered by the ruling. However, in specific cases the Commissioner may determine that it is appropriate to only apply the new interpretation prospectively, taking into account the particular circumstances of the case and relevant care and management factors. This would need to be considered on a case by case basis.

24. Where the Commissioner has issued a binding ruling based on a particular interpretation of the law, it would be very difficult to argue that that interpretation was not "as likely as not to be correct". Accordingly, where a taxpayer relies on an interpretation in a ruling, they will not have taken an "unacceptable tax positon" and shortfall penalties will not apply.

25. If the taxpayer continues to apply the same interpretation following expiry of the ruling, it is highly unlikely that a "shortfall penalty" would apply, unless, for example the ruling has ceased to be valid due to factual or legislative changes, there have been relevant developments in case law or the Commissioner has advised the taxpayer of a change in interpretation (either specifically or through a public statement). This would need to be considered on a case by case basis.

Other matters

26. It might be considered that the Court of Appeal decision in *Simunovich Fisheries Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17,456 (CA) requires a different outcome from the position outlined above. In that case, the Court of Appeal held that it was inconsistent for the Commissioner to treat an asset of the taxpayer as having a different character on sale from its characterisation at the time of purchase in a situation where the statute linked the treatment between the two.

27. There may be rare situations involving particular types of legislative provisions where parallels can be drawn with *Simunovich* and the existence of a ruling means the Commissioner cannot apply a different approach in the future. This is more likely to be the case if there were a statutory requirement to carry over a treatment from one period to another, such as in the trading stock and loss carry forward provisions. However, the general anti-avoidance provisions do not contain or give rise to such a requirement, so the principle in *Simunovich* does not require a different outcome.

28. The position outlined above for the general anti-avoidance provisions would also generally apply for *specific anti-avoidance provisions*, although its application is slightly more complex and will depend on the nature of the specific provision. For specific anti-avoidance provisions that apply to ongoing arrangements (such as s GB 35(2) of the ITA), the Commissioner will be bound for only the period of the ruling. For specific anti-avoidance provisions that apply to a single event or a set point in time (such as s GB 21 of the ITA), the existence of a ruling that applies for that point in time will have the practical effect that the Commissioner is unable to change her mind.

29. The following examples are included to help in explaining the application of the law.

Examples

Example 1: Commissioner changing view on application of s BG 1 of the Income Tax Act 2007 following expiry of a ruling

The Commissioner has issued a ruling that s BG 1 does not apply to a complex financing transaction. The period of the ruling is three years, but the transaction is ongoing. The applicant did not apply for a reissue of the ruling.

In year five, following the expiry of the ruling, the Commissioner determines that the transaction is a "tax avoidance arrangement" and that s BG 1 should apply. The Commissioner can apply s BG 1 to the periods following expiry of the ruling, including year four, as long as doing so does not change the treatment for the period to which the ruling applies.

Example 2: impossible to apply new interpretation

An applicant has entered into an ongoing management agreement, under which they pay a lump sum fee on day one. The Commissioner has issued a ruling that an amount is deductible in full when it is paid, which results in the taxpayer having a loss to carry forward.

Following the expiry of the ruling, the Commissioner determines that s BG 1 applies to the Arrangement, and that the amount should have been treated as not being deductible, with the effect that the taxpayer should not be able to carry forward the loss.

As denying the loss carry forward would have the effect of reversing the decision in the ruling, the Commissioner is unable to do so.

References

Subject references

anti-avoidance
private rulings
product rulings

Legislative references

Goods and Services Tax Act 1985 – s 76
Income Tax Act 2007 – ss BG 1, GB 21 and GB 35(2)
Tax Administration Act 1994 – ss 91A, 91EA(1), 91EB(1), 91FA(1), 91FB(1) and 91G

Case references

Simunovich Fisheries Ltd v Commissioner of Inland Revenue (2002) 20 NZTC 17,456 (CA)
Westpac Banking Corp v Commissioner of Inland Revenue (2008) 23 NZTC 21,694

Other references

New Zealand Government, *Binding Rulings on taxation: A discussion document on the proposed regime* (1994)

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 S58: Application of the financial arrangement rules to a public-private partnership

This Determination may be cited as *Special Determination S58: Application of the financial arrangement rules to a public-private partnership*.

1. Explanation (which does not form part of the determination)

1.1 This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of asset management and facilities maintenance services in respect of a Facility by a limited partnership (the Partnership) under a public-private partnership agreement (the Project Agreement) with the Crown. The sole limited partner in the Partnership will be Holdings LP.

1.2 The limited partners in Holdings LP are:

- a limited partnership (Limited Partner A), with two limited partners, one of which is a limited liability company (Limited Partner A1) and the other of which is itself a limited partnership (Limited Partner A2) with multiple limited partners, some of whom are exempt from income tax;
- a limited partnership (Limited Partner B), with multiple limited partners, some of whom are exempt from income tax; and
- a limited liability company (Limited Partner C).

1.3 Limited Partner C, Limited Partner A1, and each limited partner of Limited Partner A2 and Limited Partner B that is not exempt from income tax, are together referred to as the Taxable Limited Partners. This determination only applies to the Taxable Limited Partners and does not apply to those limited partners that are exempt from income tax.

1.4 The Project Agreement comprises three basic components:

- A design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the D&C Payment), payable on completion of the D&C Phase;
- A Facility Lease which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and
- An asset management and facilities maintenance phase (the AM/FM Phase) under which the Partnership will provide asset management and facilities maintenance services to the Crown over a 25 year term in consideration for monthly payments (the Unitary Charge).

1.5 The Partnership will enter into:

- A Design and Construction Contract with the D&C Contractor, under which the D&C Contractor will design and construct the Facility (the D&C Subcontract); and
- An Asset Management and Facilities Maintenance Contract with the AM/FM Contractor, under which the AM/FM Contractor will provide the on-going asset management and facilities maintenance services (the AM/FM Subcontract).

1.6 The Partnership will raise external debt from a range of third party financiers (the Senior Debt).

1.7 Limited Partner C will provide investment support (Sponsor Support) during the D&C Phase in the form of a letter of credit (Letter of Credit).

1.8 Holdings LP will receive funding from Limited Partner A and Limited Partner B during the D&C Phase in the form of Equity Subordinated Notes (ESNs). The application of the financial arrangements rules to the ESNs is set out in *Determination S59: Equity Subordinated Notes in respect of a Limited Partnership in a Public-Private Partnership*.

1.9 The Partnership will enter into Interest Rate Swaps in respect of the Senior Debt.

1.10 The Facility Lease, AM/FM Phase of the Project Agreement, D&C Subcontract and AM/FM Subcontract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Senior Debt, Letter of Credit, and Interest Rate Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements and the ESNs, is a wider financial arrangement.

1.11 The Project is subject to, and described more fully in, the Private Rulings.

1.12 This determination prescribes:

- the amount of consideration that is solely attributable to the Facility Lease;
- how the financial arrangements rules apply to the AM/FM Phase of the Project Agreement, the D&C Subcontract and the AM/FM Subcontract; and
- the method for spreading the payments made under the Senior Debt, Interest Rate Swaps and the Letter of Credit.

2. Reference

This determination is made under ss 90AC(1)(bb), 90AC(1)(d) and 90AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

3.1 This determination applies to the Partnership in respect of the Project, including the following arrangements:

- The D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the D&C Payment) for the Facility once the Facility is ready for operation.
- The AM/FM Phase of the Project Agreement, under which the Partnership will provide on-going asset management and facilities maintenance services to the Crown in consideration for quarterly payments for the period following completion of the Facility for 25 years until 2044.
- The Facility Lease, under which the Partnership will lease the Facility from the Crown for a period following completion of the Facility until 2044 and will make the Rental Prepayment to the Crown. The Rental Prepayment will be equal to and will offset the D&C Payment.
- A D&C Subcontract, under which the D&C Subcontractor will design and construct the Facility in consideration for payments.
- An AM/FM Contract with the AM/FM Subcontractor following completion of the Facility, under which the AM/FM Subcontractor will provide the on-going asset management and facilities maintenance services in consideration for payments under the AM/FM Contract.
- Senior Debt, under which the Partnership will borrow an agreed sum from external lenders for a term of approximately five years from financial close of the Project (Financial Close). The Senior Debt will include a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date. It is expected that the Senior Debt will be refinanced within 5 years of Financial Close and every 5 years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this Determination), the Senior Debt (and any subsequent re-financings) will initially be recognised at fair value less directly attributable transaction costs, and subsequently measured at amortised cost using the effective interest method (regardless of whether hedge accounting is applied). Broadly, from a practical perspective, this means the principal, integral fees and interest payments will be spread over the term of the Facility in line with accounting. The Senior Debt (and any subsequent re-financings) will not be treated as a hedge of another financial arrangement.
- Interest Rate Swaps, under which the Partnership will pay a fixed rate of interest to the swap counterparties, and receive a floating rate in return.
- ESNs under which Limited Partner A and Limited Partner B provide funding to Holdings LP. The application of the financial arrangements rules to the ESNs is set out in *Determination S59: Equity Subordinated Notes in respect of a Limited Partnership in a Public-Private Partnership* issued on 3 April 2018.
- A Letter of Credit under which Limited Partner C will provide investment support in consideration of a Sponsor Support Fee of 2.5% per annum of the current amount of Sponsor Support. The Sponsor Support Fee will be calculated daily and payable monthly in arrears.

3.2 Limited Partner A, Limited Partner A2, Limited Partner B and Limited Partner C use IFRSs to prepare financial statements and to report for financial arrangements. Any Taxable Limited Partner that does not use IFRSs to prepare financial statements and to report for financial arrangements will use the same spreading method as Limited Partner A or Limited Partner B, as relevant.

3.3 The Taxable Limited Partners will recognise income derived from the Crown and will deduct expenditure incurred, under the relevant provisions of the Act to the extent that the financial arrangement rules do not apply to those amounts.

3.4 This determination is made subject to the continued application of the Private Rulings.

4. Principle

4.1 The Facility Lease is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(2) to (16) is not an amount that is taken into account under the financial arrangements rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Facility Lease that are not taken into account under the financial arrangements rules.

4.2 The AM/FM Phase, the D&C Subcontract and the AM/FM Subcontract are "short-term agreements for sale and purchase" as defined in section YA 1, and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in ss EW 5(17) to (25) that is part of a financial arrangement is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Partnership in respect of these excepted financial arrangements are required to be spread under the financial arrangements rules.

4.3 The D&C Phase, Senior Debt, Interest Rate Swaps and the Letter of Credit are "financial arrangements" under s EW 3. This determination specifies that the payments made to or by the Taxable Limited Partners, in proportion to their share in Holdings LP, under the Senior Debt, Letter of Credit, and Interest Rate Swaps must be spread under the financial arrangements rules in accordance with this determination.

5. Interpretation

In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
- Capitalised terms have the same meaning as set out in the Project Agreement.
- **ESNs** means the unsecured equity subordinated notes, in a denomination of $1.00 issued by the Holdings LP to the Subscriber.
- **IFRS** means International Financial Reporting Standards as defined in s YA 1.
- **Private Rulings** means Private Rulings BR Prv 18/45 and BR Prv 18/46, issued on 3 April 2018, and includes any Rulings issued to replace those Rulings, provided that the change to the relevant Ruling does not affect the application of this determination.
- **Project Agreement** is a public-private partnership agreement between the Partnership and the Crown.
- **Taxable Limited Partners** has the same meaning as in the Private Rulings.

6. Method

6.1 The amounts that are solely attributable to the Facilities Lease and not taken into account under the financial arrangement rules are:

- The Rental Prepayment; and
- The property interest granted to the Partnership under the Facility Lease.

6.2 The Taxable Limited Partners do not have any amounts to spread under the financial arrangements rules in respect of the:

- AM/FM Phase of the Project Agreement;
- D&C Subcontract;
- AM/FM Subcontract.

6.3 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Senior Debt (including any refinancing) and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.

6.4 None of the mandatory spreading methods in ss EW 15H or EW 15I apply to the Interest Rate Swaps. Over the term of the Interest Rate Swaps, income or expenditure may be allocated using either:

- the expected value method in s EW 15F (other than for "non-contingent fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which the "fair value method" is used; or
- the IFRS financial reporting method in s EW 15D (other than for "non-integral fees" as defined in s YA 1) provided that the swaps are not treated as a hedge of other financial arrangements for which a method other than the IFRS financial reporting method is used;

provided that each Taxable Limited Partner uses the same method for the entire term of the Interest Rate Swaps.

6.5 The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than "non-integral fees" as defined in s YA 1) over the term of the Letter of Credit, provided the Letter of Credit is not treated as a hedge of another financial arrangement. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.

6.6 This determination does not affect each Taxable Limited Partner's obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps and Senior Debt.

7. Example

This example illustrates the application of the method set out in this determination.

This example is based on the following parameters:

Commencement of D&C Phase	7 April 2018
Completion of D&C Phase	1 February 2020
Completion of AM/FM Phase	9 December 2044
D&C Payment from the Crown	$1,000
Aggregrate payments to the D&C Subcontractor	($850)
Facility Lease prepayment	($1,000)
Monthly payments from the Crown during the AM/FM Phase	$30
Monthly payments to the AM/FM Subcontractor	($15)
Annual interest on the Senior Debt	($85)
Annual Sponsor Support Fee during the D&C Phase	($15)
Annual net payments in respect of the Interest Rate Swaps	($7)

The Taxable Limited Partners are not required to spread any amounts under the financial arrangements rules in respect of the Facility Lease, AM/FM Phase of the Project Agreement, D&C Subcontract and AM/FM Subcontract.

The amounts that must be spread under the financial arrangement rules are:

- Interest on the Senior Debt (including any subsequent re-financings) calculated in accordance with the IFRS financial reporting method in s EW 15D;
- Payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F or the IFRS financial reporting method in s EW 15D (as relevant); and
- Payments made and amounts received in respect of the Letter of Credit (including the Sponsor Support Fee) calculated in accordance with the IFRS financial reporting method in s EW 15D.

This Determination is signed by me on the 3rd day of April 2018.

Howard Davis
Director, Taxpayer Rulings

Special Determination S59: Equity Subordinated Notes in respect of a Limited Partnership Interest in a Public–Private Partnership

This Determination may be cited as *Special Determination S59: Equity Subordinated Notes in respect of a Limited Partnership Interest in a Public–Private Partnership*.

1. Explanation (which does not form part of the determination)

1.1 This determination relates to the issue of equity subordinated notes (ESNs) by a limited partnership (Holdings LP) to two of its limited partners (the Subscribers). The ESNs will be deemed to be repaid at a single, or several, nominated date(s) in the future, with the proceeds used to satisfy the Subscribers' obligation to contribute a total of 60% of the required capital of Holdings LP. The timing of the partnership contributions will match those made by the other limited partner in Holdings LP (Limited Partner C, a limited liability company).

1.2 The Subscribers are both limited partnerships. The first (Limited Partner A) has two limited partners, one of which is a limited liability company (Limited Partner A1) and the other of which is itself a limited partnership (Limited Partner A2) with multiple limited partners, some of whom are exempt from income tax. The second (Limited Partner B) is a limited partnership with multiple limited partners, some of whom are exempt from income tax

1.3 Limited Partner C, Limited Partner A1, and each limited partner of Limited Partner A2 and Limited Partner B that is not exempt from income tax, are together referred to as the Taxable Limited Partners. This determination only applies to the Taxable Limited Partners and does not apply to those limited partners that are exempt from income tax.

1.4 The ESNs will earn a fixed rate of interest that is payable monthly (Coupon Interest Payments) until the ESNs are repaid or deemed to have been repaid. The Coupon Interest Payments will be capitalised on each interest payment date, with additional ESNs issued in satisfaction of the interest payments.

1.5 The interest rate on the ESNs will be approximately 6.22% per annum. No fees are payable by Holdings LP or the Subscribers in relation to the ESNs.

1.6 This Determination prescribes the method for determining the amounts that are solely attributable to the excepted financial arrangement, as well as the method for spreading the income and expenditure under the financial arrangements rules.

2. Reference

This determination is made under ss 90AC(1)(bb), 90AC(1)(d) and 90AC(1)(h) of the Tax Administration Act 1994.

3. Scope of determination

3.1 This determination applies to the ESNs issued by Holdings LP to the Subscribers as part of a wider transaction entered into by the parties. That wider transaction is the subject of the Private Rulings.

3.2 The terms of the ESNs are as follows:

(a) The ESNs will be drawn in full at Financial Close and will have a face value equal to 60% of the total capital requirement of Holdings LP.

(b) The ESNs will earn a fixed rate of interest that is capitalised monthly until the ESNs are repaid or deemed to be repaid (the Coupon Interest Payments).

(c) Additional ESNs will be issued in satisfaction of the Coupon Interest Payments.

(d) The interest rate payable under the ESNs will not exceed the arm's length rates that would have been agreed between wholly unrelated parties having regard to the terms of the convertible notes and applying orthodox pricing methodologies.

(e) No fees are payable by Holdings LP or the Subscribers in relation to the ESNs.

(f) On issue of a Call Notice from Holdings LP for the contribution of partnership capital, the requisite number of ESNs will be deemed to be repaid to meet the Subscribers' funding obligation under the Call Notice. The amount payable on repayment of the ESNs will be offset against the obligation to contribute capital to Holdings LP.

4. Principle

4.1 The ESNs are a financial arrangement (as defined in section EW 3). An interest in a partnership is an excepted financial arrangement (section EW 5(11)). Therefore, the ESNs are a financial arrangement that includes an excepted financial arrangement.

4.2 Under section EW 6(2), an amount that is solely attributable to an excepted financial arrangement is not taken into account under the financial arrangements rules.

4.3 Any amount that is not solely attributable to an excepted financial arrangement is required to be taken into account under the financial arrangements rules and spread in accordance with those rules.

4.4 Under section EW 14(3), an amount calculated for, and allocated to, an income year under a spreading method will either be expenditure incurred or income derived by the person.

4.5 *Determination G1A: Apportionment of Income and Expenditure on a Daily Basis* sets out a method for calculating and allocating income and expenditure on the basis of daily apportionment.

5. Interpretation

In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
- **ESNs** means the unsecured equity subordinated notes, in a denomination of $1.00 issued by the Holdings LP to the Subscriber.
- **Private Rulings** means Private Rulings BR Prv 18/45 and BR Prv 18/46, issued on 3 April 2018, and includes any Rulings issued to replace those Rulings, provided that the change to the relevant Ruling does not affect the application of this determination.
- **Taxable Limited Partners** has the same meaning as in the Private Ruling.

6. Method

6.1 Any change in the market value of the interest in Holdings LP (between the issue date of the ESNs and any deemed repayment of those ESNs and associated capital contribution to Holdings LP) will be solely attributable to the excepted financial arrangement.

6.2 The Coupon Interest Payments are not solely attributable to an excepted financial arrangement, and therefore must be spread under the financial arrangements rules. There will be no other amounts of income or expenditure under the financial arrangements rules in relation to the ESNs.

6.3 Under section EW 14(3), the Coupon Interest Payments will be:

(a) expenditure incurred by the Taxable Limited Partners; and

(b) income derived by Limited Partner A1 and the limited partners of Limited Partner A2 and Limited Partner B that are not exempt from income tax.

6.4 Income and expenditure in respect of the ESNs will be calculated by daily apportionment of the Coupon Interest Payment to income years in accordance with *Determination G1A: Apportionment of Income and Expenditure on a Daily Basis*.

7. Example

This example illustrates the application of the method set out in this determination.

On 1 April 2018, ESNs are issued to the Subscribers for $1,000. The ESNs will be deemed to have been repaid when a call is made by Holdings LP for partnership capital (on 31 March 2023).

The Coupon Interest Payments will be set at a market interest rate of approximately 6.22% and will be capitalised on each monthly interest payment date, with additional ESNs issued.

The annual sum of Coupon Interest Payments as at 31 March, from 2019 to 2023, is:

Date	Amount
31 March 2019	$64.00
31 March 2020	$68.10
31 March 2021	$72.46
31 March 2022	$77.10
31 March 2023	$82.03
	$363.69

On the date of issue, the market value of a 60% partnership interest in the Partnership is $1,000. Any change in the market value between the date of issue and 31 March 2023 will be solely attributable to an excepted financial arrangement.

The amounts that must be spread under the financial arrangements rules are the Coupon Interest Payments, which shall be apportioned using the method outlined in *Determination G1A: Apportionment of Income and Expenditure on a Daily Basis*.

This Determination is signed by me on the 3rd day of April 2018.

Howard Davis
Director, Taxpayer Rulings

Determination DET 09/02: Standard-cost household service for childcare providers

In accordance with the provisions of Determination DET 09/02, as published in *Tax Information Bulletin* Volume 21, Number 4 (June 2009), Inland Revenue advises that, for the 2018 income year:

(a) The variable standard-cost component will be $3.55 per hour per child; and

(b) The administration and record keeping fixed standard-cost component will be $347 per annum, for a full 52 weeks of childcare services provided.

The above amounts have been adjusted as a consequence of the annual movement of the Consumers Price Index for the twelve months to March 2018, which showed an increase of 1.1%. For childcare providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2017 to 31 March 2018.

Determination DET 05/03: Standard-cost household service for boarding service providers

In accordance with the provisions of Determination DET 05/03, as published in *Tax Information Bulletin* Vol 17, No 10 (December 2005), Inland Revenue advises that, for the 2018 income year:

(a) The weekly variable standard-cost for one to two boarders will be $266 each; and

(b) The weekly variable standard-cost for third and subsequent number of boarders will be $218 each.

The above amounts have been adjusted as a consequence of the annual movement of the Consumers Price Index for the twelve months to March 2018, which showed an increase of 1.1%. For boarding service providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2017 to 31 March 2018.

Foreign currency amounts – conversion to New Zealand dollars (for the 12 months ending 31 March 2018)

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company ("CFC") and foreign investment fund ("FIF") rules for the 12 months ending 31 March 2018.

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 2018 – 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 2018 – 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.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

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 the transaction is required to be measured or calculated (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 by 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 2018 – 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 2018 – 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 2018 – 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.

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 2017. Its opening market value on 1 October 2017 or its closing market value on 30 September 2017 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 ÷ 36.6797 = $9,542.06

(In this example, the rate selected is the month-end rate for September 2017 for PHP. Refer to the table "**Currency rates 12 months ending 31 March 2018 – month end**".)

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 2017. Its opening market value on 1 October 2017 or its closing market value on 30 September 2017 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 ÷ 36.6797 = $9,542.06

(In this example, the rate selected is the month-end rate for September 2017 for PHP. Refer to the table "**Currency rates 12 months ending 31 March 2018 – month end**".)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 31 December 2017. Attributed CFC income for the period 1 January 2017 to 31 December 2017 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 5.5468 = $36,056.83

(In this example, the rate selected is the rolling 12-month average rate for December 2017 for HKD. Refer to the table "**Currency rates 12 months ending 31 March 2018 – rolling 12-month average**".)

Example 3

A resident individual with a 31 October 2017 accounting period acquired a FIF interest in a Japanese company on 1 November 2016 for 10,500,000 yen. The interest is sold in October 2017 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 ÷ 80.2425 = $130,853.35

JPY 10,000,000 ÷ 80.2425 = $124,622.24

(In this example, the rolling 12-month rate for October 2017 for JPY has been applied to both calculations. Refer to the table "**Currency rates 12 months ending 31 March 2018 – rolling 12-month average**".)

Example 4

A CFC resident in Singapore was formed on 19 April 2017 and has a balance date of 30 September 2017. During the period 1 May 2017 to 30 September 2017, 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 2017:

   0.9621 + 0.9974 + 1.0074 + 0.9893 + 0.9812 = 4.9374

   4.9374 ÷ 5 = 0.98748

2. Round exchange rate to four decimal places: 0.9875

3. Conversion to New Zealand currency:

SGD 500,000 ÷ 0.9875 = $506,329.10

(In this example, the rates are from the table "**Currency rates 12 months ending 31 March 2018 – mid-month actual**", from May to September 2017 inclusive for SGD.)

Currency rates 12 months ending 31 March 2018 – rolling 12-month average

Currency	Code	15/04/17	15/05/17	15/06/17	15/07/17	15/08/17	15/09/17	15/10/17	15/11/17	15/12/17	15/01/18	15/02/18	15/03/18
Australia Dollar	AUD	0.9405	0.9403	0.9404	0.9403	0.9391	0.934	0.9320	0.9292	0.9258	0.9229	0.9226	0.9242
Bahrain Dinar	BHD	0.2673	0.2676	0.2682	0.2689	0.269	0.2689	0.2692	0.2686	0.2684	0.2689	0.2695	0.2702
Britain Pound	GBP	0.5528	0.558	0.5638	0.5656	0.5658	0.5645	0.5611	0.5571	0.5536	0.5489	0.5444	0.5401
Canada Dollar	CAD	0.9313	0.9365	0.9405	0.941	0.9403	0.9342	0.9312	0.9247	0.9215	0.9192	0.9175	0.9186
China Yuan	CNY	4.7934	4.8195	4.8425	4.8593	4.8631	4.8539	4.8491	4.8229	4.8010	4.7830	4.7624	4.7429
Denmark Kroner	DKK	4.844	4.8617	4.8754	4.8725	4.855	4.8298	4.8057	4.7566	4.7071	4.6615	4.6070	4.5676
Euporean Community Euro	EUR	0.6512	0.6536	0.6555	0.6551	0.6528	0.6494	0.6462	0.6396	0.6329	0.6267	0.6192	0.6138
Fiji Dollar	FJD	1.4675	1.4704	1.4724	1.4761	1.4762	1.4743	1.4759	1.4729	1.4703	1.4683	1.4688	1.4691
French Polynesia Franc	XPF	77.6914	77.972	78.1873	78.1644	77.8866	77.4882	77.1029	76.3195	75.5127	74.7647	73.8813	73.2281
Hong Kong Dollar	HKD	5.5017	5.5105	5.524	5.5421	5.5479	5.5501	5.5588	5.5469	5.5468	5.5620	5.5777	5.5973
India Rupee	INR	47.3746	47.277	47.2123	47.1287	47.0019	46.8226	46.7393	46.4779	46.2371	46.0440	45.9765	46.1238
Indonesia Rupiah	IDR	9,391.29	9,399.39	9,417.71	9,446.43	9,471.74	9,477.75	9,509.8383	9,493.0092	9,498.1858	9,518.1250	9,558.1258	9,623.8542
Japan Yen	JPY	77.0656	77.4703	77.9207	78.5923	79.182	79.6986	80.2425	80.2483	79.8803	79.8005	79.4809	79.2749
Korea Won	KOR	813.2473	811.0438	810.4484	812.0254	814.5903	814.9008	815.1530	809.4473	803.5104	798.4346	795.7892	794.4119
Kuwait Dinar	KWD	0.2152	0.2156	0.2162	0.2168	0.2169	0.2169	0.2170	0.2163	0.2160	0.2161	0.2162	0.2165
Malaysia Ringit	MYR	3.0113	3.0313	3.0482	3.0736	3.0937	3.0967	3.0995	3.0820	3.0574	3.0331	3.0073	2.9891
Norway Krone	NOK	5.9479	5.9754	5.9995	5.9976	5.9842	5.9594	5.9459	5.9193	5.8990	5.8733	5.8510	5.8199
Pakistan Rupee	PKR	74.2825	74.3675	74.5532	74.7943	74.8425	74.8914	75.0317	74.8514	75.0888	75.5904	76.1078	76.7008
Phillipines Peso	PHP	34.3028	34.5127	34.7947	35.0783	35.4072	35.6224	35.8181	35.8276	35.8310	35.9396	36.1697	36.4273
PNG Kina	PGK	2.2484	2.2523	2.2579	2.2649	2.2658	2.2668	2.2705	2.2666	2.2678	2.2758	2.2841	2.2953
Singapore Dollar	SGD	0.9849	0.9876	0.9915	0.9955	0.9972	0.9959	0.9945	0.9886	0.9826	0.9782	0.9736	0.9710
Solomon Islands Dollar*	SBD	0.0907	0.0907	0.091	0.0912	0.0912	0.0913	0.0914	0.0912	0.0912	0.0915	0.0919	0.0923
South Africa Rand	ZAR	9.9113	9.7985	9.6784	9.6113	9.615	9.5481	9.4950	9.4811	9.4253	9.3714	9.3113	9.2820
Sri Lanka Rupee	LKR	105.1407	105.6618	106.316	106.9987	107.486	107.88	108.3570	108.3570	108.5456	108.9484	109.4689	109.9781
Sweden Krona	SEK	6.2192	6.2602	6.2986	6.2981	6.2767	6.2438	6.2070	6.1464	6.0897	6.0478	6.0005	5.9760
Swiss Franc	CHF	0.7033	0.7055	0.7077	0.7084	0.7086	0.7077	0.7076	0.7049	0.7022	0.7009	0.6973	0.6963
Taiwan Dollar	TAI	22.3705	22.2494	22.172	22.1301	22.0754	21.9763	21.8997	21.7385	21.6122	21.5329	21.4693	21.4467
Thailand Baht	THB	24.9035	24.8869	24.8604	24.8526	24.7814	24.6669	24.5578	24.3513	24.1466	23.9846	23.8065	23.6396
Tonga Pa'anga*	TOP	1.5527	1.5568	1.5616	1.5668	1.564	1.5622	1.5638	1.5601	1.5613	1.5614	1.5635	1.5648
United States Dollar	USD	0.709	0.7098	0.7113	0.7132	0.7134	0.7133	0.7141	0.7122	0.7118	0.7132	0.7148	0.7167
Vanuatu Vatu	VUV	77.0382	77.2266	77.2763	77.4798	77.4798	77.2795	77.3284	77.0910	76.8967	76.7966	76.8478	76.8478
West Samoan Tala*	WST	1.7822	1.7841	1.7843	1.789	1.7818	1.7786	1.7784	1.7729	1.7757	1.7806	1.7821	1.7857

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

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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 2018 – mid-month actual

Currency	Code	15/04/17	15/05/17	15/06/17	15/07/17	15/08/17	15/09/17	15/10/17	15/11/17	15/12/17	15/01/18	15/02/18	15/03/18
Australia Dollar	AUD	0.9231	0.9284	0.9511	0.9384	0.9252	0.9115	0.9097	0.9061	0.9146	0.9165	0.9322	0.9332
Bahrain Dinar	BHD	0.2639	0.2595	0.2719	0.2771	0.2729	0.2751	0.2705	0.2598	0.2635	0.2750	0.2793	0.2743
Britain Pound	GBP	0.5589	0.5337	0.5652	0.5608	0.5623	0.5368	0.5402	0.5221	0.5248	0.5293	0.5254	0.5221
Canada Dollar	CAD	0.9322	0.9382	0.9563	0.9289	0.9231	0.8897	0.8950	0.8778	0.9000	0.9073	0.9245	0.9499
China Yuan	CNY	4.8165	4.736	4.9038	4.9663	4.8316	4.7716	4.7132	4.5561	4.6171	4.6995	4.7025	4.6000
Denmark Kroner	DKK	4.9043	4.6645	4.8096	4.7638	4.5852	4.5439	4.5168	4.3404	4.4306	4.4341	4.4120	4.4056
Euporean Community Euro	EUR	0.6595	0.6271	0.6469	0.6406	0.6166	0.6106	0.6072	0.5832	0.5950	0.5953	0.5923	0.5914
Fiji Dollar	FJD	1.4512	1.4535	1.4865	1.5044	1.476	1.4775	1.4686	1.4320	1.4445	1.4747	1.4892	1.4704
French Polynesia Franc	XPF	78.6816	74.7829	77.1679	76.4226	73.5517	72.8358	72.4471	69.5866	70.9615	71.0096	70.6991	70.5911
Hong Kong Dollar	HKD	5.4459	5.3593	5.6205	5.7335	5.6605	5.7031	5.6054	5.3678	5.4606	5.7115	5.7925	5.7065
India Rupee	INR	45.1176	44.2484	46.4928	47.078	46.674	46.6179	46.3780	45.0545	45.0035	46.2579	47.2027	47.3605
Indonesia Rupiah	IDR	9280.77	9162.51	9604.05	9759.28	9739.27	9626.41	9644.7300	9314.3100	9534.0000	9714.6300	10043.2800	10063.0100
Japan Yen	JPY	76.005	78.307	79.964	82.674	80.079	80.88	80.3110	77.6180	78.7550	80.6930	78.6180	77.3950
Korea Won	KOR	795.4585	769.9819	815.2848	829.9303	822.2786	826.4691	808.4762	760.3899	761.4774	776.4654	788.2768	778.4538
Kuwait Dinar	KWD	0.2134	0.2095	0.2189	0.2225	0.2185	0.2198	0.2167	0.2078	0.2111	0.2195	0.2217	0.2184
Malaysia Ringit	MYR	3.0808	2.9831	3.0826	3.1415	3.1319	3.0472	3.0167	2.8767	2.8716	2.8836	2.8849	2.8690
Norway Krone	NOK	6.008	5.8855	6.1328	6.0134	5.7601	5.7249	5.6643	5.6688	5.8581	5.7549	5.7535	5.6141
Pakistan Rupee	PKR	73.5294	71.9424	75.7576	77.5194	76.3359	76.9231	75.7576	72.4638	76.9231	80.6452	81.9672	80.6452
Phillipines Peso	PHP	34.6469	34.2185	35.9449	37.0087	37.4736	37.2607	36.7372	35.0698	35.4488	36.6805	38.6152	38.0222
PNG Kina	PGK	2.2279	2.1895	2.2941	2.3371	2.2967	2.3314	2.2909	2.2057	2.2493	2.3601	2.3942	2.3671
Singapore Dollar	SGD	0.9783	0.9621	0.9974	1.0074	0.9893	0.9812	0.9694	0.9329	0.9431	0.9647	0.9697	0.9559
Solomon Islands Dollar*	SBD	0.0898	0.0874	0.0925	0.0939	0.0927	0.0939	0.0924	0.0882	0.0900	0.0951	0.0965	0.0946
South Africa Rand	ZAR	9.3965	9.0731	9.2839	9.5633	9.6337	9.6107	9.5117	9.9000	9.1601	8.9844	8.6075	8.6595
Sri Lanka Rupee	LKR	106.383	105.2632	109.8901	112.3596	111.1111	111.1111	109.8901	105.2632	107.5269	112.3596	114.9425	113.6364
Sweden Krona	SEK	6.3343	6.076	6.3066	6.105	5.8408	5.8093	5.8247	5.7970	5.9419	5.8506	5.8746	5.9517
Swiss Franc	CHF	0.7037	0.6858	0.703	0.7077	0.7037	0.7004	0.6999	0.6796	0.6929	0.7030	0.6830	0.6924
Taiwan Dollar	TAI	21.2701	20.6789	21.8227	22.2499	21.9264	21.9549	21.5755	20.6845	20.9582	21.5666	21.4551	21.2176
Thailand Baht	THB	24.048	23.7758	24.4778	24.8	24.0942	24.1466	23.7318	22.6957	22.7261	23.3095	23.1632	22.7060
Tonga Pa'anga*	TOP	1.5497	1.5505	1.5808	1.6066	1.5344	1.564	1.5604	1.5134	1.5520	1.5883	1.6001	1.5780
United States Dollar	USD	0.6998	0.6881	0.7208	0.7347	0.7236	0.7299	0.7181	0.6877	0.6993	0.7300	0.7407	0.7278
Vanuatu Vatu	VUV	76.9231	76.3359	77.5194	79.3651	76.9231	76.3359	76.9231	74.0741	75.1880	76.9231	78.7402	76.9231
West Samoan Tala*	WST	1.7266	1.7659	1.8056	1.8396	1.74	1.8143	1.7872	1.6983	1.7817	1.8116	1.8295	1.8282

Notes to table:

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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 2018 – month end

Currency	Code	30/04/17	31/05/17	30/06/17	31/07/17	31/08/17	30/09/17	31/10/17	30/11/17	31/12/17	31/01/18	28/02/18	31/03/18
Australia Dollar	AUD	0.9171	0.9536	0.9548	0.9388	0.9032	0.9202	0.8944	0.9028	0.9091	0.9143	0.9289	0.9426
Bahrain Dinar	BHD	0.2588	0.2672	0.2767	0.2834	0.2706	0.272	0.2583	0.2578	0.2676	0.2777	0.2718	0.2730
Britain Pound	GBP	0.5302	0.5496	0.5631	0.5686	0.5551	0.5381	0.5155	0.5051	0.5252	0.5190	0.5240	0.5164
Canada Dollar	CAD	0.9377	0.9564	0.9503	0.9377	0.896	0.8989	0.8824	0.8810	0.8913	0.9069	0.9252	0.9333
China Yuan	CNY	4.7294	4.8312	4.9722	5.0509	4.734	4.7837	4.5402	4.5117	4.6222	4.6317	4.5646	4.5547
Denmark Kroner	DKK	4.6876	4.6873	4.7715	4.7185	4.4818	4.5413	4.3751	4.2706	4.4048	4.4150	4.4031	4.3789
Euporean Community Euro	EUR	0.6301	0.63	0.642	0.6346	0.6027	0.6103	0.5878	0.5739	0.5910	0.5933	0.5912	0.5876
Fiji Dollar	FJD	1.4284	1.4663	1.5081	1.5115	1.4603	1.4702	1.4207	1.4251	1.4558	1.4780	1.4702	1.4813
French Polynesia Franc	XPF	75.213	75.248	76.6512	75.7532	71.9419	72.8247	70.1458	68.4945	70.6055	70.7864	70.5309	70.2591
Hong Kong Dollar	HKD	5.3418	5.5198	5.7265	5.8682	5.6166	5.6321	5.3411	5.3352	5.5305	5.7616	5.6423	5.6825
India Rupee	INR	44.16	45.842	47.417	48.0847	45.6256	47.1454	44.3069	44.1128	45.4765	47.0769	47.0073	47.1707
Indonesia Rupiah	IDR	9154.08	9455.79	9785.19	9984.71	9553.47	9715.85	9281.84	9248.75	9643.37	9882.48	9951.41	9949.23
Japan Yen	JPY	76.54	78.48	82.377	82.824	78.94	81.119	77.7920	76.8760	79.9380	80.4090	76.9200	76.9110
Korea Won	KOR	781.5113	793.1562	840.3612	841.0128	807.3655	825.5441	765.8137	743.4658	757.2857	788.0933	782.4492	768.3707
Kuwait Dinar	KWD	0.2093	0.2149	0.2226	0.2268	0.2165	0.2178	0.2072	0.2061	0.2142	0.2207	0.2166	0.2168
Malaysia Ringit	MYR	2.9809	3.0376	3.1479	3.2058	3.0595	3.045	2.8956	2.7951	2.8795	2.8773	2.8368	2.8002
Norway Krone	NOK	5.8882	5.9759	6.1215	5.9089	5.5724	5.7421	5.5930	5.6833	5.8229	5.6814	5.6971	5.6775
Pakistan Rupee	PKR	71.9424	74.0741	76.9231	79.3651	75.7576	75.7576	71.9424	71.9424	78.1250	81.3008	80.0000	84.0336
Phillipines Peso	PHP	34.4078	35.3607	37.003	37.8207	36.6633	36.6797	35.2836	34.4467	35.4679	37.8909	37.7316	37.8374
PNG Kina	PGK	2.1796	2.2538	2.3341	2.3907	2.2912	2.3037	2.2006	2.1946	2.2838	2.3775	2.3384	2.3552
Singapore Dollar	SGD	0.9595	0.9797	1.0088	1.0181	0.9731	0.9788	0.9331	0.9211	0.9491	0.9663	0.9554	0.9489
Solomon Islands Dollar*	SBD	5.3595	5.5304	5.724	5.8425	5.5378	5.6069	5.3277	5.3137	5.5205	5.7282	5.5911	5.5522
South Africa Rand	ZAR	9.181	9.2729	9.6014	9.9037	9.3358	9.7762	9.6757	9.3668	8.7908	8.7251	8.5036	8.5736
Sri Lanka Rupee	LKR	104.1667	108.6957	112.3596	114.9425	109.8901	109.8901	105.2632	105.2632	108.6957	113.6364	112.3596	112.3596
Sweden Krona	SEK	6.0802	6.1542	6.1822	6.0627	5.699	5.8735	5.7361	5.7229	5.8065	5.8047	5.9779	6.0402
Swiss Franc	CHF	0.6832	0.6855	0.7023	0.7264	0.6883	0.698	0.6830	0.6719	0.6914	0.6858	0.6811	0.6899
Taiwan Dollar	TAI	20.7448	21.3415	22.3039	22.7026	21.6731	21.8715	20.6563	20.4986	21.0532	21.4953	21.1611	20.9873
Thailand Baht	THB	23.7503	24.1159	24.804	25.0185	23.8145	24.021	22.7491	22.3021	23.1125	23.0819	22.6999	22.5779
Tonga Pa'anga*	TOP	1.5354	1.5704	1.5914	1.6049	1.5489	1.5504	1.5151	1.5119	1.5533	1.5855	1.5715	1.5764
United States Dollar	USD	0.6866	0.7085	0.7333	0.7512	0.7178	0.7209	0.6847	0.6832	0.7098	0.7365	0.7212	0.7237
Vanuatu Vatu	VUV	75.188	77.5194	78.7402	78.7402	75.7576	75.7576	73.5294	73.5294	75.1880	76.3359	76.3359	76.9231
West Samoan Tala*	WST	1.7518	1.7928	1.8342	1.8505	1.7575	1.7942	1.6904	1.7142	1.7812	1.8186	1.8004	1.8179

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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, 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.

Company liquidator who misapplied GST refund ordered to pay compensation

Case	Commissioner of Inland Revenue v Stuart Douglas Robertson [2018] NZHC 696
Decision date	17 April 2018
Act(s)	Companies Act 1993 ss 301, 310; Companies Act 1955 s 315; Goods and Services Tax Act 1985 s 46; Interest on Money Claims Act 2016 cl 1 of Schedule 1; Judicature Act 1908 s 87; Senior Courts Act 2016 s 182; Judicature (Prescribed Rate of Interest) Order 2011 cl 4.
Keywords	Liquidator, misapplication of company funds, repay money, GST refund, mistaken payment

Summary

Mr Robertson was appointed liquidator of a company by resolution of the sole director and shareholder. The company was under audit by the Commissioner of Inland Revenue ("the Commissioner") and a GST refund of $159,910.58 which had been claimed by the company was held back. When the Commissioner's audit was completed it was clear that a net debt was owed by the company to the Commissioner. However when the audit was completed the system automatically lifted the halt on payments and the GST refund was paid out to Mr Robertson. Mr Robertson proceeded to disburse the funds. The ultimate recipients of the refund were: a trust with which Mr Robertson was associated; the former shareholder/director of the company; and Mr Robertson's former business associates/employees. The High Court found that Mr Robertson had misapplied company funds and ordered Mr Robertson to repay the money to the Commissioner pursuant to s 301 of the Companies Act 1993 ("the CA").

Impact

The decision is a useful authority in the application of s 301 of the CA where a liquidator has misapplied company funds.

Facts

Mr Stuart Robertson was appointed liquidator of Hukatere Coastal Trustees Limited ("Hukatere") when on 14 April 2010 the company's director Roy Brown resolved Hukatere was unable to pay its debts as they fell due. Mr Robertson consented to the appointment.

Mr Robertson's first report as Hukatere's liquidator, dated 22 April 2010, explained the company acted as a bare trustee of an unnamed trust. From Mr Robertson's inspection of Hukatere's records, it appeared "the only remaining asset due to the trustee could be a GST refund being withheld by the Inland Revenue Department". He proposed to dispense with any creditors' meeting, as any funds recovered would not exceed the $44,000 owed to the secured creditor. He also identified Isolve Accounting (Mr Robertson's former accounting practice, now operated by his former employee Ms Phillimore) as a creditor for less than $800.

On 7 May 2010, the Commissioner lodged proof of debt for some $214,000 in unpaid GST, advising the company was the subject of investigation. At the same time, the Commissioner sought to replace Mr Robertson as liquidator.

Mr Robertson refused to resign and rejected the Commissioner's proof of debt, observing his expectation of an ultimate reimbursement due "to the trust". The Commissioner responded, insisting the proof of debt was admissible, being certain notwithstanding refunds may be offset against it.

On 25 June 2010 the Commissioner issued her statement of position. Following expiry of the response period and the consequent deemed acceptance of the Commissioner's position, the Commissioner advised Mr Robertson on 16 September 2010 that the audit had been completed. On 24 September and 19 October 2010 two cheques were disbursed to Mr Robertson totalling $159,910.58 ("the GST Refunds") which Mr Robertson banked into his trust account. The payments were made as a result of the IRD system automatically lifting the halt on payments when the audit was completed.

Mr Robertson issued his second report as Hukatere's liquidator on 12 November 2010 for the period to 14 October 2010 stating "[t]here have been no realisations, no distributions and no Liquidator remuneration during the period".

Mr Robertson asserted that in June 2010 there was some correspondence between Mr Brown, Ms Phillimore and Mr Robertson which purportedly advised Mr Robertson that Hukatere was no longer the trustee of the WBR Trust and had been discharged from its trustee obligations. Another letter purporting to be from Ms Phillimore to Mr Robertson dated 21 December 2010, stated Mr Robertson was holding funds for WBR Trust, and requested the funds be released to Ms Phillimore. The Commissioner questioned whether the correspondence was genuine and objected to its admissibility in evidence.

On 21 December 2010 $150,000 was paid from Mr Robertson's Trust account to Ms Phillimore's client funds account and was on the same day disbursed from that account. $30,000 was split in equal shares and paid to Ms Phillimore's practice account and to a trust which Mr Robertson was involved with. The remaining amount was paid as $100,000 to "E Krasniqi" (a former employee of Mr Robertson and for whose companies Mr Robertson may have acted as liquidator), $10,000 to "S Cannon" (Mr Brown's personal assistant) and $10,000 to Mr Brown.

Mr Robertson eventually resigned as a liquidator of Hukatere in January 2012 following a court application by the Commissioner to disqualify him from acting as a liquidator.

Decision

Admissibility of documents

Jagose J upheld the Commissioner's objection to the admissibility of certain correspondence on grounds that the correspondence was inconsistent with Mr Robertson's repeated assertions stating Hukatere was a trustee of the WBR Trust. His Honour further noted that the Commissioner's objection to the incorporation of those documents in the common bundle begged evidence to be called from at least Mr Brown and it could be inferred from the fact Mr Brown was not called that his evidence would not have assisted Mr Robertson.

Recovery under s 301

Given Mr Robertson's acceptance that he had failed in his duties of care and skill as a liquidator, Jagose J had little difficulty finding Mr Robertson was caught by the provisions of s 301. His Honour rejected the argument that something more than mere negligence was required and disposed of the defendant's assertion that *Re Avon Chambers Ltd* [1978] 2 NZLR 638, (1977) 1 BCR 149 applied, noting that Casey J in that case was concerned with the wording of the predecessor to s 301. Jagose J found that the Commissioner's loss was directly caused by Mr Robertson paying away the GST Refunds in circumstances in which he was responsible to retain them for set-off under s 310 of the CA. His Honour could see no factor giving rise to a lesser award for compensation.

Affirmative defence of estoppel

Mr Robertson was unsuccessful in claiming a defence of estoppel, asserting that the Commissioner had represented that the GST Refunds were the Commissioner's final position. Jagose J did not see how any of the Commissioner's actions amounted to such a representation.

Alternative causes of action

Although not necessary to consider the alternative causes of action, Jagose J noted that he would equally have found Mr Robertson liable to repay the GST Refunds to the Commissioner on the alternative grounds plead. Under the rule in *Ex parte James; In re Condon* (1874) LR 9 Ch App 609, liquidators are "obliged to act in a manner consistent with the highest principles" and Mr Robertson had conceded his conduct in disbursing the GST Refunds without taking advice was not consistent with those principles. On the same basis the 'unconscionability' ground was established which disentitled Mr Robertson to a defence of change of position in respect of the cause of action claiming restitutionary relief from a mistaken payment.

Notice of claim struck out for not complying with procedural requirements of Tax Administration Act 1994

Case	TRA 013/17 [2018] NZTRA 04
Decision date	20 April 2018
Act(s)	Tax Administration Act 1994 ss 89AB(4)(a), 138B, 138D(1) and (2), and 138H
Keywords	Strike-out

Summary

The Taxation Review Authority ("the TRA") upheld an application by the Commissioner of Inland Revenue ("the Commissioner") to strike out the disputant's notice of claim on the basis that the proceedings were not commenced by the disputant within the response period under s 138B of the Tax Administration Act 1994 ("the TAA"), and that the disputant did not establish exceptional circumstances to allow the disputant to commence the proceedings after the response period pursuant to s 138D(1) of the TAA.

Impact

This decision confirms that the procedural requirements for commencing challenge proceedings must be strictly adhered to. It also follows the decision of *Muir v Commissioner of Inland Revenue* [2017] NZHC 2082 which stands for the proposition that it is not possible to file amending documents where there is no underlying claim.

Facts

The Disputes Review Unit ("the DRU") sent a letter to the disputant on 13 April 2017 enclosing its adjudication report following determination of the disputant's tax dispute in relation to the 2012 and 2013 income tax years.

On 24 April 2017, the investigator wrote to the disputant's accountant referring to the adjudication report, and stating that the DRU had accepted the disputant's proposed adjustments in part and had directed that a further adjustment be made on the basis of the conclusion in the adjudication report. Enclosed with the letter was a notice of assessment dated 24 April 2017.

The Commissioner's computer-generated notices of assessment dated 10 July 2017 were received on or about 14 July 2017.

The director of the disputant company emailed a completed notice of claim form to the Tribunals Unit on 21 June 2017 ("the initial notice of claim"). In a reply email dated 21 June 2017, the Registry stated it could not accept filing by email and that it would be necessary for the disputant to file 3 copies of the notice of claim and relevant documents by courier or post. Details of the street and postal addresses were provided together with the form to be completed for payment of the fee by credit card.

In an email to the Registry dated 22 June 2017, the director stated that he would not be able to obtain the additional information which was held by his accountant who was overseas and whom he understood would be back on or about 1 or 2 July 2017. The director observed that he would not like to work out what paperwork his accountant had prepared for this claim without his permission. He went on to say:

> "I could just go to his office and look through the file and hopefully find it, he had written a (sic) extensive letter for my lawyer to go over before he left but for some reason believed I had more time to reply as no assessments had been loaded on the tax system, I will address this with him on his return."
>
> "My lawyer was the one who rang me on Tuesday night to ask if I was filing a claim for the mistakes in the assessments. I told him I had not received any assessments and that no changes had been made on a tax system to indicate assessments had been issued."
>
> "He informed me that even though no assessments had been forwarded to me nor that they had been loaded on the IRD system, it was the letter dated 24 April that was the time frame I had to act on."

The director stated that he then forwarded the initial notice of claim by overnight courier and included a payment form for payment by credit card. He sent an email to the Tribunals Unit on 23 June 2017 advising the Registry of this and noting that he would send the additional information as soon as he had access to it.

A notice of claim was subsequently filed on 18 September 2017 by the disputant's accountant. The notice was dated "21/6/17 (updated/amended 11/9/17)". This notice of claim was served on the Commissioner.

Decision

The Judge found that the notice of claim was not filed within the prescribed time in compliance with s 138B of the TAA.

The Judge was satisfied that the Commissioner issued a notice of assessment on 24 April 2017. Accordingly, the two-month period in which the disputant was required to file the proceedings in the TRA started on 24 April 2017 and ended on 23 June 2017.

The Judge noted that it was apparent from the director's email of 21 June 2017 that he was aware that the time period commenced on 24 April 2017. Furthermore, the notice of claim was eventually filed on 18 September 2017 so that even if the two-month period commenced from the date of the computer-generated notices, the proceedings were still commenced outside the requisite two-month period.

The disputant, relying on rr 1.8 and 2.6(2) of the District Court Rules 2014, contended that the initial notice of claim was filed within the prescribed time and that the subsequent filing was an amendment to the original filing. The Judge rejected this argument. Regulation 4 of the Taxation Review Authorities Regulations 1998 ("the Regulations") states that to the extent that they are not inconsistent with these Regulations, or the provisions of the Taxation Review Authorities Act 1994 or the TAA, the District Court Rules 2009 (now the District Court Rules 2014) apply to the commencement, interlocutory steps and conduct of proceedings in the Authority as if these proceedings were civil proceedings in the District Court.

The Judge noted that the requirements for the filing and service of the notice of claim set out in the Regulations are mandatory. The disputant did not file and serve within the statutory time period three copies of the notice of claim containing the documents required under reg 8, together with payment of the filing fee as required. Furthermore, the initial notice of claim was not served on the Commissioner.

The Judge referred to *Muir v Commissioner of Inland Revenue* [2017] NZHC 2082 and stated that it is not possible to file amending documents where no underlying claim in fact exists.

The Judge also found that there were no exceptional circumstances under s 138D(2) of the TAA.

In the disputant's notice of opposition, it asserted that exceptional circumstances existed in that the act or event causing the delay was beyond the control of the disputant. In the director's first affidavit, he referred to "ongoing health issues, accountant away and who also had health issues" as reasons why the disputant could not review the initial notice of claim and presumably ensure that it was properly filed.

In the disputant's submissions, the events or circumstances relied upon were identified as being that the disputant did not have in its possession all the necessary documents to file the claim, the documents being either with the disputant's accountant or withheld by the Commissioner. Further, the disputant's accountant was out of New Zealand at the time of filing and when he returned he had work commitments and health issues.

The disputant contended that the unique feature of this case is that the disputant did commence its challenge within the required time "as best it was able". The director filed an initial notice of claim which he knew would need to be amended. Further, the disputant would have filed the additional documents if they had been in its possession, and accordingly, this provides reasonable justification.

The Judge did not accept that any of these matters amounted to extraordinary circumstances in the context of s 138D (1) and (2) of the TAA. The Judge noted that the events and circumstances relied upon appeared to relate to the period around the end of June 2017 and subsequent. No evidence had been given as to why the notice of claim could not have been filed prior to that time.

The Commissioner's application under s 138H to strike out the notice of claim in its entirety was granted.

Dr Muir's summary judgment appeal dismissed in long-standing 'trinity' dispute

Case	*Garry Albert Muir v Commissioner of Inland Revenue* [2018] NZCA 129
Decision date	30 April 2018
Act(s)	Tax Administration Act 1994 ss 3, 109, 138D, 138P, 138I and 142F; High Court Rules 2016 r 15.1
Keywords	Summary judgment, assessment, disputable decisions deemed correct except in proceedings, Associate Judge, exceeding jurisdiction, part 8A challenge

Summary

The appellant in these proceedings, Dr Garry Albert Muir ("Dr Muir") appealed the High Court decision of Associate Judge Bell (in *Commissioner of Inland Revenue v Muir* [2017] NZHC 1413, (2017) 28 NZTC 23-019) granting summary judgment in favour of the respondent, the Commissioner of Inland Revenue ("the Commissioner"). The summary judgment application consisted of unpaid income taxes, interest and penalties for the years ended 31 March 1997 to 31 March 2010 totalling $8,179,830.94. The Court dismissed Dr Muir's appeal.

Impact

It is a decision for the Court, where there are collateral proceedings seeking to challenge an assessment, whether to proceed with summary judgment or adjourn until the collateral proceedings are resolved.

Facts

The tax assessments arise out of a scheme (more commonly known as the 'trinity scheme') devised by Dr Muir. Under the scheme, Dr Muir invested in a loss-attributing qualifying company Redcliffe Forestry Venture Ltd ("Redcliffe"). Redcliffe claimed substantial deductions under subpart EG of the Income Tax Act 1994 ("ITA"), that it passed onto Dr Muir. Dr Muir offset these deductions against his taxable income which were subsequently disallowed by the Commissioner.

Dr Muir had previously challenged the Commissioner's assessments with the courts on the whole, upholding the Commissioner's position. On the basis he had exhausted his challenge rights, the Commissioner sought summary judgment for unpaid taxes, interest and penalties. Summary judgment was subsequently granted on 23 June 2017 and the subject of this appeal.

Dr Muir contended that AJ Bell exceeded his jurisdiction on the summary judgment application. He argued:

> Only a hearing authority as defined in the Tax Administration Act 1994 ("TAA") can determine if there are extant challenge proceedings under Part 8A (the challenge provisions) of the TAA.
>
> If the Court of Appeal found the amended claims could be filed, then the effect of AJ Bell's decision is to find payable tax which the hearing authority is charged with determining *de novo*.
>
> Dr Muir further contended that the earlier courts proceeded on the mistaken basis that the trinity scheme continued in existence after 2009 when it had not.

Decision

Did the Associate Judge exceed his jurisdiction by entering summary judgment for Dr Muir?

The Court (reasons given by Mallon J) did not accept that Associate Judge Bell exceeded his jurisdiction. The Court noted that the arguable defence Dr Muir raised to the summary judgment was that his challenge proceedings had not been finally determined. The Court noted that AJ Bell was considering whether it was reasonably arguable that Dr Muir's challenge proceedings were at an end following the Supreme Court's decision of 26 August 2016 (*Muir v Commissioner of Inland Revenue* [2016] NZSC 113, (2016) 27 NZTC 22-067 at [11]).

The Court did not accept Dr Muir's arguments regarding challenge proceedings and his reliance on *Tannadyce Investment Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153 ("*Tannadyce*"). Mallon J noted that *Tannadyce* was about bringing and determining challenge proceedings, and further about what a taxpayer must do if he or she wishes to challenge an assessment.

Mallon J noted that AJ Bell's decision did not determine any challenge proceeding or make any procedural or preliminary decisions ahead of a determination on challenge proceedings. AJ Bell found that the challenge proceedings had been finally determined by the courts (that had jurisdiction). AJ Bell, therefore found, in his summary judgment jurisdiction on the Commissioner's debt recovery proceeding, that the due date for payment of the tax had passed and the tax remained unpaid.

Timing issues

Mallon J noted at [34] that there could be 'potential timing difficulty' because summary judgment had been heard in advance of the decisions of Toogood and Jagose JJ and any appeal from those decisions.

Despite this, Mallon J went on to state that the Court would have dismissed Dr Muir's appeal from the Associate Judge's decision on the basis that an Associate Judge can decide whether challenge proceedings have been finally determined by a hearing authority.

Mallon J further stated at [36] that it was 'ultimately a matter of judgment' for the Associate Judge on whether to grant an adjournment of the summary judgment application and Associate Judge Bell was entitled to make an assessment of the prospects of the outstanding proceedings in the High Court when deciding to refuse an adjournment.

> "He was not required to grant an adjournment if his assessment was that a final determination had been made and further proceedings were not permitted."

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