Vol 31 No 4 May 2019

TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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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**

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

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

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

Ref	Draft type	Title	Comment deadline
ED0207	Operational statement	Square metre rate for the dual use of premises	10 May 2019
PUB00317	Interpretation statement	Income tax – exempt income of non-resident entertainers	10 May 2019
ED0213	Standard practice statement	Income equalisation deposits and refunds	10 May 2019

Correction – ***Tax Information Bulletin*** **Vol 31 No 3 April 2019 – Hybrid mismatches**

The table published in the *Hybrid mismatches* item on page 42 (titled "Table 1: New Zealand's implementation of the OECD recommendations") is incorrect.

The second part of that table ("Specific rule recommendations") should have contained the following information:

Section	Rec.	Hybrid mismatch	Hybrid arrangement	Corresponding branch arrangement	Counteraction	Scope
CW 9	2	D/NI	Hybrid financial instruments – specific rules**		2.1 Payee country should turn off any exemption 2.2 Restrict foreign tax credits to hybrid arrangement	No limit
Subpart EX	5	D/NI	Reverse hybrids – specific rules***	Disregarded branch structure and diverted branch payments	5.1 Improve CFC and other offshore rules 5.2 Turn off transparency/non-taxation 5.3 Improved disclosure	Specific to NZ's domestic law

IN SUMMARY

New legislation

Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 3

The new Act sets the annual rates for income tax for the 2018–19 tax year and simplifies and modernises the administration of individuals' income tax and aspects of the Tax Administration Act 1994. It also contains a large number of technical changes to ensure the tax rules work as intended.

Orders in council

The Income Tax (Minimum Family Tax Credit) Order 2018 148

Questions we've been asked

QB 19/01: What are the requirements for claiming tax deductions for payments to family members for services? 149

This Question We've Been Asked (QWBA) deals with the requirements for claiming income tax deductions for payments to spouses, partners, or other family members for services they provide to businesses or other income earning activities. It reminds taxpayers that to claim deductions the family member must provide services to the business; the amount paid must not be excessive; and if the family member is a spouse or partner, the Commissioner's prior approval for a deduction is required unless the business is run though a company (s DC 5 of the Income Tax Act 2007). The QWBA sets out the kinds of evidence that may be relevant to show the family member provided services to the business.

QB 19/02: Depreciation - change of use event 153

This item considers whether depreciation recovery income may arise for a business that becomes a charity and begins deriving exempt income. It concludes that a business that becomes a charity will have a change of use of its depreciable property, as that property is no longer available for use in deriving assessable income but will be used for deriving exempt income. As depreciation deductions will be disallowed, ss EE 47(2) and EE 47(2B) apply. The issue was raised following an amendment to the timing of this income (now contained in s EE 47(2B)) which means that any depreciation recovery income will arise immediately before the income exemption applies.

Standard practice statements

SPS 19/02: Voluntary disclosures 157

This statement sets out the factors that the Commissioner will consider when forming an opinion as to whether a taxpayer has made a full voluntary disclosure of all the details of a tax shortfall. It replaces *SPS 09/02: Voluntary disclosures* with application from 27 March 2019.

Operational statements

OS 19/02: Persons who are permitted to confirm an income statement of a deceased person or provide information to the Commissioner to finalise the tax account of a deceased person 173

This operational statement lists the persons who are able to confirm an income statement of a deceased person under s RZ 15 of the Income Tax Act 2007 and who can provide information to the Commissioner to finalise a deceased person's tax account under s 22F of the Tax Administration Act 1994 where the deceased does not have a will and no executor or administrator has been appointed.

IN SUMMARY (continued)

Legal decisions - case notes

Commissioner wins liquidation rehearing 176

This was a liquidation rehearing. The Court found that the Commissioner had established the grounds for making an order of liquidation and accordingly placed Chesterfields Preschools Limited into liquidation.

Commissioner wins tax avoidance case against Cullen Group Limited in the amount of $51.5m plus interest and penalties 177

This matter concerned Cullen Group Limited's ("CGL") challenge to the Commissioner of Inland Revenue's ("the Commissioner") assessment that CGL avoided $59.5 million of non-resident withholding tax ("NRWT"). CGL had paid $8 million in approved issuer levy ("AIL"), leaving a shortfall of $51.5 million. CGL argued that the arrangement involved the restructuring of Mr Eric Watson's affairs in order to achieve certainty about his change of tax residency from New Zealand to the United Kingdom and to plan for application of the United Kingdom's laws governing remittance of foreign-sourced income. In finding for the Commissioner, the Court did not consider the arrangement was within the contemplation and purpose of Parliament in enacting the AIL regime. It had a more than merely incidental purpose or effect of altering the incidence of tax and was a tax avoidance arrangement which was void against the Commissioner.

Supreme Court dismisses application for leave to appeal 180

This was an application for leave to appeal to the Supreme Court on the basis the Court of Appeal did not apply the principles set out in *Commissioner of Inland Revenue v Diamond* [2015] NZCA 613 ("*Diamond*") to Mr van Uden's case. In addition, Mr van Uden challenged decisions about taxation of his employer's superannuation fund; whether the reassessment was properly made given the position of the officer who made it; and, as to the penalties imposed.

High Court clarifies when Commissioner's Notice of Response is due following s 89K decision 181

The Commissioner of Inland Revenue's ("the Commissioner") Notice of Response ("NOR") was filed within two months of the decision by the Taxation Review Authority ("the TRA") that the Commissioner should have accepted the Doug Vesey Trust's ("the Trust") Notice of Proposed Adjustment ("NOPA") out of time pursuant to s 89K of the Tax Administration Act 1994 ("the TAA"). In her judgment, Peters J upheld the finding of the TAA that the Commissioner's NOR was filed in time and there was no deemed acceptance of the Trust's NOPA.

Taxation Review Authority clarifies the meaning of "stop" in s EC20 182

The Tax Review Authority concluded that the use of the phrase "stops deriving income from the sale of specified livestock" in s EC 20 of Income Tax Act 2007 is to be read as requiring a permanent stop. A "stop" for one income year is not sufficient to be able to use the livestock valuation provisions in s EC 20.

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 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019

The Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill was introduced into Parliament on 28 June 2018. It received its first reading on 3 July 2018, its second reading on 19 February 2019 and its third reading on 12 March 2019. The new Act received Royal assent on 18 March 2019.

The new Act sets the annual rates of income tax for the 2018–19 tax year and simplifies and modernises the administration of individuals' income tax and modernises aspects of the Tax Administration Act 1994, such as the information collection and disclosure provisions. The new Act also implements several other policy changes, such as enhancing the KiwiSaver rules, and contains a large number of technical changes to ensure the tax rules work as intended.

The Bill contained four Supplementary Order Papers.

Supplementary Order Paper No. 074 released on 14 August 2018 clarifies the GST treatment on non-profit bodies for non-income earning assets, extends the depreciation roll-over relief provisions for businesses affected by the Canterbury earthquakes to the end of the 2023–24 income year and corrects a technical flaw to ensure recently enacted legislation to neutralise base erosion and profit shifting meets its original policy intent.

Supplementary Order Paper No. 135 released on 16 October 2018 makes changes to the tax treatment of bloodstock.

Supplementary Order Paper No. 188 released on 19 February 2019 exempts directly funded disability support payments from income tax, ensures that the company demerger rules are effective in providing tax relief for certain New Zealanders. It also adds income tax, Working for Families tax credits and donation tax credits to the definition of START tax type, broadens the grandparenting protection for certain cross border debt issued by registered banks and contains a number of minor remedial adjustments and corrections.

Supplementary Order Paper No. 189 released on 19 February 2019 grants the New Zealand Memorial Trust – Le Quesnoy temporary donee status for three years.

The new Act amends the Income Tax Act 2007, Tax Administration Act 1994, Goods and Services Tax Act 1985, KiwiSaver Act 2006, Child Support Act 1991, Student Loan Scheme Act 2011, Taxation (Annual Rates for 2017–18, Employment and Investment Income and Remedial Matters) Act 2018, Families Package (Income Tax and Benefits) Act 2017, Income Tax Act 2004, Accident Compensation Act 2001, Intelligence and Security Act 2017, Financial Advisers Act 2008, Financial Service Providers (Registration and Dispute Resolution) Act 2008, Income Tax Act 1994, Taxation Review Authorities Act 1994, Taxation Review Authorities Regulations 1998 and the Tax Administration (Binding Rulings) Regulations 1999.

Simplifying tax administration – Individuals income tax

The Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 has introduced changes that will simplify individuals' year-end income tax filing obligations and will help people to use more appropriate rates of withholding during the year.

The following items are covered in this TIB item:

- The year-end income tax obligations of individuals.
- Refunds and tax to pay.
- Pro-active actions.
- Tailored (special) tax codes.
- The administration of donations tax credits.

OVERVIEW

Subpart 3B, sections 24B, 24D, 24DB, 25A, 33,41, 41A, 89C, 89D 92, 106, 108, 108B, 110, 111, ,120C, 141JA, 143, 173L, 184A, 227G and schedule 8 of the Tax Administration Act 1994

Sections LB 7, RM 2, RM 4, RM 5, RZ 15, RZ 16 of the Income Tax Act 2007

New rules have been introduced to simplify individuals' year-end income tax filing obligations and to help people use more appropriate rates of withholding during the year.

The key changes:

- enable Inland Revenue to proactively help individuals to use the most appropriate tax rates or codes;
- enable the use of tailored tax codes to improve the way that secondary sources of income and irregular patterns of income earning are taxed;
- simplify the year-end income tax obligations of individuals;
- enable the automation of refunds of tax and amounts of tax to pay; and
- improve the administration of donations tax credits.

Other miscellaneous amendments have also been made to ensure the individuals' income tax changes are integrated smoothly into the tax system. These include changes to the refund provisions and the time bar.

Application date

The changes apply from 1 April 2019 and the end of year processes apply to the tax year ended 31 March 2019 and later income years.

THE YEAR-END INCOME TAX OBLIGATIONS OF INDIVIDUALS

Subpart 3B, sections 33, 37, 41, 89C, 89D, 92, 106, 108, 108B, 110, 111, 143, 173L, 184A, 227G and schedule 8 of the Tax Administration Act 1994.

A number of amendments have been made that will simplify the end of year income tax obligations of individuals and some of the processes that Inland Revenue performs.

All section references are to the Tax Administration Act 1994 unless otherwise stated.

Background

In previous tax years, the year-end processes for individuals required Inland Revenue to determine whether or not individuals who earn PAYE income should be issued with a personal tax summary (PTS) containing their PAYE income information or whether they ought to be filing a tax return. If an individual was not sent a PTS by Inland Revenue, they could request one. If an individual did not get a PTS or did not file a tax return, their tax position would not be squared up. This meant that any refund available or amount of tax payable would not be calculated, and the amount of tax the individual had to pay for the tax year would simply be based on what had already been withheld. When a PTS was issued, if the refund amount was less than $600, it was treated as confirmed after two months and the refund would be paid out. If the refund was greater than $600, the taxpayer was required to confirm the PTS as correct before the refund would be paid.

As the PTS only includes salary and wage information, individuals were required to add in income from other sources, such as interest income or dividend income. Sometimes an individual would need to gather this information from several payers even though these payers may have also provided this information to Inland Revenue directly. An IR3 tax return was required where the individual had other types of income such as business income or foreign sourced income, or if they wished to claim deductions or tax credits.

As a result, a large number of individuals would choose to interact with Inland Revenue through PTS intermediaries, perhaps because of a lack of awareness of how to directly claim any available refund directly from Inland Revenue. PTS intermediaries assist taxpayers with refund claims and typically charge a percentage of the refund or a fixed fee for the service they offer. If an individual instead applied directly to Inland Revenue, they would receive the full amount of their refund.

It was also possible for an individual to work out whether they were due a refund or had tax to pay by requesting a summary of earnings before they requested a PTS. Generally, taxpayers who had requested a summary of earnings were not then required to request a PTS, with the result that a PTS was typically only requested when refunds were due.

Key features

The end of year income tax process changes will mean that more individuals will have an end of year square up, with more refunds or bills of tax to pay being issued as applicable. Under the new rules, Inland Revenue will do most of the work by pre-populating as much information about an individual's income and tax credits as possible into the individual's pre-populated account. This account will contain income information for all the types of income that are subject to regular reporting to Inland Revenue, such as PAYE income, which is referred to as "reportable income".

This pre-populated account forms the basis for the calculation of the individual's tax position (refund or tax to pay). If the Commissioner is satisfied that an individual's income information as set out in their pre-populated account is correct and complete, Inland Revenue may finalise the individual's account for the tax year.

Some individuals will be required to provide additional information on their "other income" (income other than their reportable income) which may not be contained in the pre-populated account and will be able to provide information on deductions and tax credits when relevant. This additional information will be added to the individual's pre-populated account and will form part of the individual's self-assessment.

This means that, generally, individuals who only earn reportable income will not have to do anything, and Inland Revenue will automatically issue them with a refund or tax bill once the account is finalised. Only individuals who earn other income or have deductions that Inland Revenue does not already know about will have to provide further information to Inland Revenue and file tax returns.

New error correction provisions and processes provide simpler ways for individuals and Inland Revenue to adjust the information if they become aware that an account is incorrect. This can be done before an assessment has occurred or after subject to the time-bar rules.

The key changes are as follows:

- Inland Revenue will make pre-populated accounts available to individuals containing the relevant income information for the tax year.
- If the Commissioner is satisfied that the information set out in the pre-populated account correctly and completely records the individual's income for the year, Inland Revenue will calculate the refund or tax to pay without the individual needing to provide any additional information.
- Inland Revenue will pay out refunds without the individual having to confirm the tax position that Inland Revenue has calculated.
- Individuals who earn other income will be required to provide income information other than reportable income to Inland Revenue subject to *de minimis* rules before an assessment can be completed.
- Individuals will be able to provide other relevant information such as deductible expenses and relevant tax credit information to Inland Revenue.
- Individuals will be required to provide or correct reportable income if they know, or might reasonably be expected to have known, that the reportable income amount should properly be included in their final account.
- An individual's tax assessment will arise once they have confirmed the tax information is complete, when the Commissioner is satisfied that the information is correct and complete, or if the Commissioner is not satisfied that the information is correct and complete and issues a default assessment.

- Individuals and Inland Revenue will be able to make corrections to the information held if they become aware that it is incorrect or incomplete and there will be error correction processes for adjustments made before and after an assessment has occurred.
- Qualifying individuals, being those who only earn reportable income, will be able to amend their assessment at any time up until their terminal tax date without being exposed to penalties or interest.
- The end of year income tax process will replace the current PTS process and will replace the IR3 tax return immediately for online filers and over time for any paper filers as the paper IR3 is phased out.

Application date

The amendments apply from 1 April 2019 for the 2018-19 tax year.

Detailed analysis

Key terms – Section 22D

Inland Revenue will make a pre-populated account available for an individual for the tax year which will include the relevant income information that Inland Revenue holds about the individual. The individual's tax assessment will crystallise once this pre-populated account becomes a "final account" in accordance with these new rules. Individuals will be grouped based on the type of income they earn. Whether an individual is a "qualifying individual" or not influences the way in which the individual's tax position is finalised, their obligations and the concessions they may be eligible for.

The key terms below are defined in section 22D.

Individual

The new individuals' income tax changes apply to "individuals" as defined only. New section 22D(1) defines an individual as a natural person. This definition includes a natural person who is non-resident, unless their only income is non-residents' foreign-sourced income. This is necessary to exclude individuals who are not New Zealand taxpayers under existing law. Deceased natural persons are also excluded from the date of their death. Legal persons, such as companies, are not subject to the new provisions and must fulfil their tax obligations under existing law.

Income definitions

The income earnt by individuals is categorised as either "reportable income" or "other income".

Reportable income

Reportable income is defined in new section 22D(3). Reportable income is income that Inland Revenue receives regular information about, typically from third party payers such as employers, during the income year or by 31 May following the end of the relevant tax year. This includes PAYE income payments, along with resident and non-resident passive income.

Importantly, new section 22D(3)(b) states that income will not be "reportable income" if the payer of the income, for example an employer or bank, does not have the individual's tax file number. Where recipients of reportable income do not ensure that their payers have their tax file number, they will be obliged to provide Inland Revenue with the relevant income information.

Example 1 - Roger

Roger gets his first job at the local library in his town. His new employer tells him he needs to obtain an IRD number. Roger applies for and receives an IRD number but forgets to give it to his employer. The payroll staff at the library do not follow up with Roger about his IRD number and pay him his wages and account for the PAYE to Inland Revenue.

Roger decides he does not like working at the library and resigns from his job after a month. He then starts work at a local café and provides his new employer with his IRD number.

At the end of the tax year, Inland Revenue will prepare a pre-populated account for Roger but cannot include his wages from the library. That income, although paid to Roger and reported to Inland Revenue, may not be able to be allocated to him without an IRD number. The account therefore only contains his wages from the café.

In this case, although Roger only earns PAYE income, which is generally a type of "reportable income", the wages he earned from the library are treated as "other income as the requirement to provide the employer with his IRD number was not met. This means Roger is obliged to contact Inland Revenue to provide this information.

An exception to this rule exists for income which is earned jointly, such as interest income of holders of joint bank accounts, if the Commissioner is able to allocate the amounts as between the individuals. This could be the case where two individuals own a bank deposit investment in equal shares, and the Commissioner is made aware that the interest earned from the deposit is to be allocated on that basis.

Other income

Per section 22D(4), "other income" is an individual's income other than their reportable income. Schedule 8, Part A, table 1 lists the types of "other income" that must be reported to Inland Revenue. These include:

- income from a New Zealand estate or trust;
- income with a foreign source;
- income from a partnership;
- income from a look-through company;
- income from rents;
- income from self-employment;
- employee share scheme income that is not reportable income; and
- other income, including income from a disposal of property that is not otherwise included in reportable income.

In accordance with new section 22K(1) an individual has no obligation to provide information for a tax year if they derive $200 or less of other income in the corresponding income year.

Qualifying individual

The distinction between the types of income an individual earns is important because it determines obligations under the new individuals' income tax process. Section 22D(2) introduces the term "qualifying individual" which means an individual who only earns reportable income for an income year and has no other income information that must be provided to Inland Revenue. Qualifying individuals have different obligations from other individuals and are eligible for certain concessions. These concepts will be explained in greater detail later in this TIB item.

Pre-populated account

New section 22D(5) defines a pre-populated account as one provided by Inland Revenue to an individual for a tax year containing the reportable information held by the Commissioner, including any income information provided by the individual; and quantifying the amount of reportable income and other income derived by the individual for the income year.

New section 22E(1) requires Inland Revenue to include in the individual's pre-populated account for the tax year the information that Inland Revenue holds with respect to reportable income and other income that the Commissioner considers has been derived by the individual for the tax year. This requirement is limited to the extent that the information is both available and relevant to the individual's assessment for the tax year (section 22E(2)).

Section 22E(3) provides that an individual who has no reportable income for a tax year may ask the Commissioner to make a pre-populated account with a zero balance available so that they can provide their income information for the tax year. In practice, an individual can go into their income summary online via myIR and add their income type (for example, self-employment income) and select a start date. Once the individual has updated their income sources the account will be created for them to complete.

Section 22M requires Inland Revenue to establish an electronic form and means of communication as well as a non-electronic form or mode of delivery to allow an individual to provide other income information to Inland Revenue. This will enable taxpayers to submit information either electronically or by post which will be populated into the taxpayer's account for the tax year.

Final account

Section 22D(6) defines a final account as a pre-populated account that has been finalised under section 22HB. Section 22I(1) provides that a final account is treated as a return of income and an income tax assessment. In accordance with 22I(2), the assessment is treated as being made on the date on which the individual's pre-populated account is finalised for the tax year.

The way in which a pre-populated account is "finalised" will be discussed in greater detail later on in this TIB item.

An individual's income tax assessment (sections 22F, 22H and 22I)

The purpose of this section is to explain how an individual's income tax assessment arises, and to explain the obligations an individual may have in relation to this assessment. This section will consider:

- an individual's obligations to provide information (section 22F); and
- finalising accounts and the assessment process (sections 22H and 22I).

Information requirements – Section 22F

Before an individual's tax position can be finalised, it is important to ensure that the individual's pre-populated account accurately records the individual's income for the tax year. Section 22F outlines the circumstances in which an individual must provide income information to Inland Revenue. This explains to individuals what their obligations are and when they do not have to do anything.

Qualifying individual

A "qualifying individual" is generally not required to provide any income information to Inland Revenue and in most cases their tax position will be squared up automatically without them having to do anything.

Example 2 - John

John earns a salary of $70,000 per annum. His employer deducts PAYE correctly and remits this to Inland Revenue. John does not earn any other income.

Per section 22E, the Commissioner includes this income information in John's pre-populated account for the tax year. As Inland Revenue has no information that suggests John might be earning other income or reason to suspect the reportable income is incorrect, the Commissioner is satisfied that the information set out in John's pre-populated account correctly and completely records his income for the tax year and, at the end of the tax year, finalises his account in accordance with section 22H(1).

John is not required to do anything and will receive an email notification informing him that his notice of assessment is available via myIR. The notice of assessment informs John that Inland Revenue has calculated his assessment and that, in his case, he has no further tax to pay and is not due a tax refund as the correct tax was withheld by his employer.

Although in most cases a qualifying individual will not be required to provide income information to Inland Revenue, section 22F(2) provides an exception for an individual who knows or might reasonably be expected to have known that an amount of income should properly be included in their final account for the tax year, but it is not. In that case the individual will be obligated to provide that information to Inland Revenue.

Example 3 - Adam

Adam works part-time at the local supermarket, and as he really loves cars and is a keen mechanic, in his spare time he fixes cars for his friend Brad's auto garage. Adam gave Brad his IRD number and tax code when he first started at the garage, but he is not sure whether Brad accounts properly for any PAYE on his earnings as Brad is not an accountant and he's never seen a pay slip. But since he gets such a good wage and Brad is a mate, he just never asks Brad about it.

In July Adam mentions his recent tax refund to Brad, as he was so impressed it was sorted for him by IR, and Brad tells him that he doesn't account for any PAYE on what he pays Adam for his work at the garage.

When he gets home that day Adam is worried that not enough tax is being paid, so he logs in to his myIR account to check his earnings for the previous tax year. Sure enough he can see his supermarket earnings are correctly recorded, but the account does not show any of his income from the garage.

In this case the income he has earned as a mechanic is untaxed reportable income, and Adam knows that there is income missing (the earnings from the garage) section s22F(2) applies. This puts an obligation on Adam to tell IR about his missing income. If he does not tell IR Adam would be breach of s22F(2) as he knows, or might reasonably be expected to have known, that an amount of income should properly be included in his final account for the tax year but is not.

In this situation, Adam should inform Inland Revenue of the income information that is missing from his account. It is an absolute liability offence under section 143(1)(b) to not provide the Commissioner with information when required by law. Accordingly, Adam will be subject to penalties and interest on this undisclosed income if he does not inform Inland Revenue and Inland Revenue later finds out about the income.

If the Commissioner considers an individual's account is incorrect or incomplete despite containing all the relevant reportable income information, for example because the Commissioner believes the individual has other income which needs to be included, she would not finalise the account. Instead, the individual's assessment will be "suspended" for a period of time and the Commissioner will contact the individual to ask them to provide this further information. This will be discussed in greater detail later in this TIB item.

"Other income" earner

If an individual earns "other income", section 22F(1) requires that individual, subject to the $200 *de minimis* threshold in section 22K(1), to provide to the Commissioner their "other income" information for the tax year. This applies irrespective of whether the individual also has "reportable income" or not. This information is then included in the individual's pre-populated account for the tax year.

Income that a person receives under an employee share scheme which their employer has correctly recorded in their relevant employment income information is not treated as other income.

Example 4 - Ian

Ian works part-time as a mechanic. To supplement his income, Ian starts his own lawn mowing business on 1 March 2019. For the first month, Ian only earns $188 in income from this venture. This means that, for the tax year ending 31 March 2019, Ian has less than $200 of "other income" and is therefore not required to provide this information to Inland Revenue.

If Ian's lawn mowing business grew in the following tax year, and he earned $8,000. The entire amount would need to be reported to Inland Revenue in his account for the year.

Finalising accounts and the assessment process (section 22H and 22I)

As previously mentioned, new section 22I(1) provides that a final account is treated as a return of income and an income tax assessment. In accordance with 22I(2), the assessment is treated as being made on the date on which the individual's pre-populated account is finalised for the tax year. The finalising of accounts is governed by the process set out below. When an account is finalised, section 22I(4) requires the Commissioner to notify an individual that their assessment is treated as having been made.

Assessments for qualifying individuals (section 22H(1) and 22H(3))

For qualifying individuals, section 22H(1) provides that the Commissioner may finalise the individual's pre-populated account for the tax year when the Commissioner is satisfied that the income information set out in the pre-populated account correctly and completely records their income for the corresponding income year. If the Commissioner requests information from a qualifying individual, the individual may when providing that information also correct any errors in their reportable income before finalising the account by confirming the correctness of their pre-populated account (22H(3)).

From an operational standpoint, the Commissioner intends to finalise the assessments of qualifying individuals in batches, starting from early May and running through June. When an individual's income tax assessment is finalised, Inland Revenue will notify the individual accordingly.

Example 5 - Lauren

Lauren earns a salary as an accountant. This is the only "reportable" income information that Inland Revenue has received for Lauren. Inland Revenue considers Lauren's activity for previous tax years and notes that she has never filed an IR3 return and has never earned "other income". There is no other information that Inland Revenue holds that suggests Lauren has any other earnings or that the reportable income received is incorrect or incomplete.

On this basis, Inland Revenue is satisfied that the income information set out in Lauren's pre-populated account correctly and completely records her income for the corresponding income year.

Inland Revenue therefore finalises Lauren's pre-populated account on 15 May 2019 for the tax year ending 31 March 2019. Lauren is not required to do anything and will receive an email notification informing her that her notice of assessment is available via myIR. The notice of assessment informs Lauren that Inland Revenue have calculated her assessment and that, in her case, she has no further tax to pay and is not due a refund as her employer withheld the correct amount of tax on her behalf.

Assessments for other individuals (section 22H(2))

Section 22H(2) provides that an individual other than a qualifying individual, may adjust their pre-populated account to provide other income information and correct errors at any time prior to 7 July following the end of the tax year, or later if they have an extension of time to file their return. The individual may also then finalise their account by confirming that the income information in the account correctly and completely records their income for the corresponding tax year.

Example 6 - Roman

Roman studies at a university in Wellington and works part time at a local supermarket earning wages. When university is over for the year, Roman goes back home to Christchurch. For the last few years, Roman has operated a car washing business over the holiday period which nets him about $1,800 in additional income. Roman has filed an IR3 return for the previous tax years to account for this additional income.

On 1 April 2019, Roman's pre-populated account only includes his supermarket wages which have been reported to Inland Revenue. Based on Roman's past returns, he has been an earner of "other income" in past tax years so Inland Revenue does not automatically finalise Roman's account and instead prompts Roman to provide the additional information about his business earnings for the year.

On 15 June 2019 Roman logs into myIR and updates his pre-populated account to include his business income. Roman then confirms that his pre-populated account is complete and correct. Roman's account is finalised and his tax assessment crystallises, he is sent a notice of assessment which sets out the amount of tax he has left to pay.

Assessments when Inland Revenue is not satisfied that the information is correct and complete

If an individual does not provide the required information relating to their "other income", the Commissioner can make an assessment of the amount of income that the Commissioner considers ought to be subject to tax by issuing a default assessment under section 106(1). This is because an individual who failed to provide the required information is treated as having failed to file their return.

Similarly, if the Commissioner is satisfied that the income information provided in a final account for a tax year is not likely to be correct, the Commissioner may raise a default assessment per section 106(1A).

Section 106(1B) provides that tax assessed under section 106(1A) is payable by the individual unless the individual disputes the assessment under section 89D. Section 89D(2B) requires an individual to first amend their final account before disputing the assessment as described in 22I(3).

Default assessments will be discussed in greater detail under the 'Disputes resolution and error correction' section for both qualifying and other individuals.

Proportionate extension of time for taxpayers due to system issues (amended section 37)

Section 37 has been amended to provide an additional extension of time to a date advised by the Commissioner if a systems issue arises for an Inland Revenue digital platform that results in a taxpayer being prevented from, or being otherwise hindered or disadvantaged in, providing the required return or income information.

This proportionate extension of time applies to "a person or class of persons" and therefore extends outside the scope of the individuals' rules (that is it applies to entities such as companies as well). If such a systems issue arises, the Commissioner will make the extension available, as appropriate.

Assessments for non-resident individuals

Non-resident individuals with New Zealand sourced income have an obligation to pay tax in New Zealand on that income, under existing laws. The new individuals' end-of-year process does not alter these obligations.

For non-resident individuals who have New Zealand reportable income, Inland Revenue will follow the standard pre-population process and will generate an account containing income information for the New Zealand sourced amounts.

An example is employment income with a source in New Zealand, which is subject to PAYE irrespective of the residence of the individual.

Non-residents, who earn other income and would ordinarily have been required to file an IR3NR, will continue to have an obligation to provide this information to Inland Revenue and to complete the required assessment to account for tax due on New Zealand sourced "other income".

Disputes resolution and error correction

This section sets out how an individual can correct errors in their income information at different stages throughout the process and how the dispute resolution rules apply within the context of the new individuals' income tax rules.

The main way in which the approach to disputes is different under the new individuals' income tax rules is that there are now mechanisms in the law that allow for an assessment, and for errors in general, to be amended more easily and without going through the formal disputes process. The following section will set out the new error correction rules and outline how they are integrated within the disputes resolution process.

Qualifying individuals

A qualifying individual can amend their assessment, or have their assessment amended by the Commissioner, under the new error correction provisions and the existing dispute resolution process. This section will cover the following in relation to qualifying individuals:

1. Correction of pre-assessment errors by the individual;
2. Correction of pre-assessment errors by the Commissioner;
3. Correction of post-assessment errors by the individual;
4. Correction of post-assessment errors by the Commissioner;
5. Default assessments;
6. Formal disputes process commencing with a notice of proposed adjustment (NOPA) issued by the taxpayer;
7. Later requests for changes by individuals.

New section 22G sets out the process for correcting errors in respect of a taxpayer's account for a tax year when information is either missing or incorrect.

1. Correction of pre-assessment errors by individuals (section 22G)

Section 22G(2) provides that an individual can amend income information in their pre-populated account at any time before it is finalised under section 22H. This provision applies to both "reportable" and "other income" earners. It is noted that the mechanism through which an account becomes finalised differs between "reportable" and "other income" earners and therefore the timeframes for pre-assessment error correction may differ from taxpayer to taxpayer.

Individuals will be able to view their income information, which will be used to pre-populate their account after year end, at any point during the year by logging into the their MyIR. Any errors in this income information can be corrected by contacting Inland Revenue.

Section 22H(2) provides that an individual other than a qualifying individual may adjust their pre-populated account to provide other income information and correct errors any time prior to 7 July following the end of the tax year, or longer if they have an extension of time (being the due date by which they should file their return).

Example 7 - Alyssa and Zane

Alyssa and Zane are both reportable income earners. Alyssa works in marketing and Zane works in journalism. Alyssa's assessment for the 2018–19 tax year is finalised on 15 May 2019 and Zane's on 1 June 2019. This means that Zane has an additional two weeks to correct any errors in his pre-populated account under 22G(2) than Alyssa. Due to the post-assessment error correction provisions for qualifying individuals, all qualifying individuals may amend their assessment up until their terminal tax date without being exposed to penalties or interest. If Alyssa didn't have a chance to make an amendment to her pre-populated account before it is finalised, she will have time to do so afterwards with the same effect.

As neither Alyssa or Zane are obliged to check their pre-populated accounts unless they know, or might reasonably have known, that the account will be incorrect or will omit information, the difference in timing is not likely to affect the correctness of their assessments.

2. Correction of pre-assessment errors by the Commissioner (Section 22G)

Section 22G(5) provides that the Commissioner may amend information in an individual's pre-populated account to correct errors. The Commissioner must notify the individual of any amendment. This provision applies to both reportable and other income earners.

NEW LEGISLATION

During the year, the Commissioner will update income information contained in the pre-populated account as it is received. Changes that the Commissioner makes to income information before the end of the tax year (and before an assessment arises) will be available to view online during the year and will be included in the pre-populated account prepared at the end of the year. Inland Revenue is unlikely to issue additional paper notifications to non-digital customers each time additional income information is received during the year, as that would result in undue administrative and compliance costs.

Post year-end changes will need to be separately communicated to individuals, particularly for other income earners who must provide additional income information to Inland Revenue. That is because any changes to the reportable income information contained in the pre-populated account would need to be checked by the individual as the assessment can only arise, per section 22H(2), if the individual considers the account to correctly and completely record their income for the year. For this reason, changes made after the end of the tax year, for example to reflect updated information in employment income information will be notified more directly.

3. *Correction of post-assessment errors by qualifying individuals (Section 22G)*

Section 22G(3) provides that a qualifying individual or an individual who is treated as a qualifying individual may amend the income information in their final account at any time before their terminal tax date for the tax year. The amended information forms a new assessment and any earlier assessment for the tax year is regarded as not having been made.

This means that when a taxpayer, who is a qualifying individual or is mistakenly treated as such, amends their assessment under section 22G(3) prior to their terminal tax date, they will not be subject to penalties or interest (unless they are subject to the provisional tax regime). The changes are treated as the initial assessment rather than an amendment to the original assessment which the Commissioner finalised. Changes made to section 120C, which governs the day that interest starts for the purposes of the Use of Money Interest (UOMI) rules, ensure that interest does not start until the day after the payment of tax is due.

The due date for terminal tax is generally 7 February following the end of the tax year for taxpayers with a standard balance date (tax year 1 April – 31 March). If a taxpayer with a standard balance date is linked to a tax agent, the terminal tax date will be 7 April of the following year. This applies even if the initial Commissioner finalised assessment results in a refund being paid to a taxpayer and the subsequent assessment results in tax to pay. Any disbursed refund that has to be repaid will be treated as due on the taxpayer's terminal tax date.

Notwithstanding a taxpayer's ability to correct their income information under section 22G(3), section 22G(4) clarifies that if the Commissioner has reason to believe the amended information is incorrect, the Commissioner can decide not to accept the taxpayer's amendment and issue a default assessment under section 106. This process protects the integrity of the tax system by ensuring that the Commissioner's assessment is not immediately displaced with an incorrect assessment. Instead disputed amendments of this nature are processed under the existing rules, discussed further below.

Example 8a - Lauren

Lauren, as mentioned in a previous example, is an accountant earning a salary. The only income information Inland Revenue has received in relation to Lauren for the tax year is her salary income, and her earnings in previous tax years have always been consistent with this position. As such, Inland Revenue has no reason not to be satisfied that the information in Lauren's pre-populated account is correct and complete and her account is therefore finalised on 15 May 2019 in accordance with section 22H.

What Inland Revenue does not know is that Lauren earnt $2,000 during the 2018–19 tax year regularly babysitting for a friend. On 1 November 2019 Lauren logs into her myIR to add this "other income" information.

Although by virtue of adding this "other income" information into her final account Lauren is no longer a "qualifying individual", she was treated by Inland Revenue as a qualifying individual and therefore still falls within section 22G(3) for the correction of post-assessment errors by qualifying individuals. This means that when Lauren logs in on 1 November 2019 to add additional income information, this is not treated as an amended assessment but rather as a new assessment. The assessment that resulted when Inland Revenue finalised her account on 15 May 2019 is regarded as not having been made. Lauren will now have until her terminal tax date to pay any resultant tax bill and will not be subject to any penalties or interest provided that the amount due is paid on time.

In the following year she is likely to be prompted to provide additional income information so that Inland Revenue can confirm whether she has continued to earn other income from babysitting.

Example 8b - Olivia

Lauren's sister, Olivia, works at the same accounting firm and earns a salary. Olivia purchased a rental property in 2015 which Inland Revenue are aware of due to Olivia's IR3 returns for the preceding tax years showing a return of rental income. As such, Inland Revenue categorises Olivia as an "other income" earner who is required to provide more information to Inland Revenue. This means that Olivia will not be subject to the automatic process that applies to reportable income earners.

New section 22H(2) requires an "other income" earner to adjust their pre-populated account to provide other income information and correct any errors by no later than 7 July following the end of the tax year. This means that, for the tax year ending 31 March 2019, a taxpayer with a standard balance date who earns "other income" has to provide this information by no later than 7 July 2019. In the event that the information is not provided by this date, Inland Revenue can issue a default assessment in accordance with section 106.

What Inland Revenue does not know is that Olivia sold the rental property in March 2018, prior to the commencement of the 2018–19 tax year. Olivia's only income for the 2018–19 tax year is her salary as an accountant, which means she is actually a reportable income earner for the 2018–19 tax year.

Based on the above, Olivia does not provide "other income" information and finalise her account by 7 July 2019 as expected by Inland Revenue. Inland Revenue does not issue Olivia with a default assessment immediately, although it has the scope to do so under section 106, and instead contacts Olivia to request further information. What happens next depends on what Olivia decides to do:

(i) Olivia contacts Inland Revenue and finalises the assessment

If Olivia responds to Inland Revenue and provides the required information, telling Inland Revenue that she has sold the property and has no rental income this year, she can finalise the account. The finalisation is late and, as such, Olivia may be charged a late filing penalty per section 139A, for failing to complete her final account (provide her return) on time.

As Olivia has sold the property, she will no longer be an "other income" earner, so for the following tax year she is likely to have her assessment finalised by Inland Revenue as a qualifying individual.

(ii) Olivia does not respond: default assessment issued by Inland Revenue

If Inland Revenue decides to issue Olivia with a default assessment prior to her terminal tax date 7 February 2020, the assessment can include an amount of rental income that the Commissioner considers, based on available information, that Olivia has earned in the tax year. Tax on this amount will be payable per section 106(1B), as noted above.

As the Commissioner is unaware of the sale Olivia can contact Inland Revenue and ask for an amendment to her assessment by providing the required information to correct the account. In this case she can demonstrate that she had no rental income as she sold the property. The Commissioner would therefore amend the assessment per section 113.

If there was disagreement between the Commissioner and Olivia as to whether any rental income ought to be included in Olivia's assessment, Olivia would need to raise a dispute to change the assessment. Section 89D(2B) requires an individual to first amend the assessment by making an adjustment to their final account for the tax year before they are able to commence a dispute by issuing a NOPA. This is consistent with the previous rules which required an individual who had been issued a default assessment because they failed to file their tax return on time, to first file the missing return before being able to commence a dispute.

Olivia must make the adjustment to her final account by no later than the time of filing the NOPA and both of these actions must be completed within the response period (four months from the issue of the default assessment).

Usually a taxpayer will discuss the correctness of the default assessment with the Commissioner before making an adjustment to their final account or engaging in the disputes process. However, a taxpayer is required to adjust their final account and issue a NOPA if the Commissioner does not accept the taxpayer's proposed changes to their assessment within the response period. As noted above, in this case the Commissioner is unlikely to decline Olivia's request to amend her assessment, as it is clear she has sold the property and has no rental income, therefore a dispute is unnecessary.

Example 8c - Ruairi

When Olivia sold her rental property in March 2018, she sold it to her brother, Ruairi. The sale and purchase was settled on 2 March 2018. Ruairi, unsurprisingly, is also an accountant who works at the same firm as his sisters.

The only income information that Inland Revenue has received in relation to Ruairi for the 2018–19 tax year is his salary income. – His earnings in previous tax years have always been consistent with this position. As such, Inland Revenue has no reason to consider that the information in Ruairi's pre-populated account is incorrect so finalises his account on 20 May 2019 in accordance with section 22H.

What Inland Revenue does not know however, is that by virtue of his rental property purchase on 2 March 2018, Ruairi has a month of rental income that he needs to return. Ruairi is therefore an "other income" earner for the 2018–19 tax year. Ruairi does not have an extension of time and his return filing due date is therefore 7 July 2019 for the 2018–19 tax year.

Section 22G(3) provides that a qualifying individual or an individual who is treated as a qualifying individual may amend the income information in their final account at any time before their terminal tax date for the tax year. Ruairi has been treated as a qualifying individual by Inland Revenue and therefore can rely on section 22G(3). Ruairi can amend his return and provide what he considers to be his correct and complete income for the 2018–19 income year at any point before 7 February 2020. This will be treated as a new assessment, and he has until 7 February to pay the additional taxes due.

Although in most cases a qualifying individual or an individual who is treated as a qualifying individual, may amend the income information in their final account before the terminal tax date, there are limited circumstances in which a provisional taxpayer will be subject to UOMI.

Example 9 - Jeff

Lauren, Olivia and Ruairi have a brother called Jeff who also works at the accounting firm and earns salary and wages. On 1 April 2018, Jeff also commences a start-up technology venture, which he operates in his own capacity. Although Jeff is only working on his venture part time, it is successful and he earns an additional $200,000 for the 2018-19 tax year.

Inland Revenue reviews Jeff's income information at the end of the 2018–19 tax year and based on the information held for Jeff, the Commissioner is satisfied that the information contained in his pre-populated account correctly and completely records Jeff's income for that tax year. Inland Revenue therefore finalises Jeff's pre-populated account and it becomes an assessment on 15 May 2019.

New section 22G(3) provides that a qualifying individual, or an individual who is treated as a qualifying individual, may amend the income information in their final account at any time before their terminal tax date for the tax year. Although Jeff clearly has "other income" that he needs to provide, he has been treated as a qualifying individual and therefore has until his terminal tax date (7 February 2020) to provide any additional information and amend his tax position for the year.

Jeff logs into myIR on 1 February 2020 and updates his tax position to include an additional $200,000 in income and finalises his account for the tax year. Although this is treated as a new assessment for the purposes of section 22G(3), Jeff is liable to pay provisional tax as he derived untaxed income during the tax year which caused him to have residual income tax (RIT) of more than $2,500 at year-end. Due to his level of untaxed income, Jeff's RIT exceeds $60,000 and therefore he does not qualify for the provisional tax safe harbour in section 120KE. This means that provisional tax instalments were due for one third of his RIT on each of the missed instalment dates (being 28 August 2018, 15 January 2019 and 7 May 2019 for Jeff (as he has a standard 31 March balance date). As Jeff did not pay these instalments when they were due, he is subject to UOMI.

For the sake of completeness, for the 2019–20 income tax year, because Jeff has filed his 2018–19 tax return after the first two provisional tax instalment dates for that year, he can pay provisional tax equalling his 2020 RIT on the third instalment date, being 7 May 2020 and not have to pay UOMI in that year.

4. Correction of post-assessment errors by the Commissioner for qualifying individuals

Section 22G(6) provides that the Commissioner may amend information in a qualifying individual's final account for the tax year to correct errors in the information at any time before the end of the time bar period per section 108(1), notifying the individual of the amendment.

The time bar prevents the Commissioner from amending an assessment to increase the tax payable if four years have passed from the end of the tax year in which the taxpayer provides the return. This does not apply if a return is fraudulent or misleading.

Section 22G(6) allows the Commissioner to correct finalised assessments in cases when the reportable income information provided to Inland Revenue is corrected after the end of the tax year, resulting in incorrect individual assessments.

The Commissioner can correct the final accounts without first having to issue a NOPA due to amended section 89C(1) which references amendments made per section 22G(6).

This section is limited to qualifying individuals because it reflects the way in which qualifying individuals' assessments are finalised by the Commissioner.

This means that if the Commissioner sought to amend information contained in the account of an individual with other income who finalises their own assessment per section 22H(2), the usual NOPA process would need to be followed.

Example 10 - Rachel

Rachel is a qualifying individual earning salary and wages. Her tax position is automatically calculated by Inland Revenue for the 2018–19 tax year and it is determined that she has tax payable of $100. Rachel pays this amount prior to her terminal tax date of 7 February 2020.

On 1 March 2020 Inland Revenue realises that a mistake has been made in calculating Rachel's tax position for the 2018–19 tax year because her employer contacts Inland Revenue to correct several periods of employment income information. Instead of having $100 tax payable, Rachel actually had $300 of tax payable, because her employment income information has been incorrectly reported.

Section 22G(6) means that Inland Revenue can amend Rachel's return and issues her with a tax bill for the additional $200. Rachel is given an additional 30 days, commencing on 2 March 2020, to pay this additional $200 (see section 142AB).

5. *Default assessment*

A qualifying individual's income tax assessment is typically automated. In most cases, the Commissioner will satisfy herself that the information in an individual's pre-populated account, which will have been provided to her by way of third-party reporting during the year, is correct and complete.

Where the Commissioner is not satisfied that the information is correct and complete, she can request that the individual provides more information under section 22H(3). The individual can then simply finalise the account by confirming that the income information is correct and complete or correct any errors in their reportable income and finalise the account by confirming that the corrected income information is correct and complete. Section 22G(4) provides that where the Commissioner has reason to believe that the amended information is incorrect, she can decline to accept the information and issue a default assessment under section 106. Amended section 89D(2B) provides that an individual can only dispute a default assessment by making an adjustment to their final account for the tax year.

It is therefore expected that default assessments will only occur for qualifying individuals in limited circumstances. These include where an individual has been miscategorised as an "other income" earner, or where Inland Revenue is unsure about some of the individual's information and has requested further clarifying information but the individual has failed to provide an adequate response.

Example 11 - Pamela

Pamela is a salary earner who works in a large corporate office as an accountant. Inland Revenue knows that in previous tax years, Pamela has claimed a deduction of $1,000 for income protection insurance. Inland Revenue therefore has reason to believe that Pamela may intend to claim this deduction for the current (2018–19) tax year as well. Instead of immediately finalising Pamela's income tax assessment, since she is a qualifying individual, Inland Revenue sends Pamela a letter noting that she has previously claimed income protection insurance and gives her a period of time to respond and provide the deduction information if it is again relevant to this tax year.

When Pamela responds confirming that she has this information, her assessment will be finalised based on the information she provides and confirmed as her complete and correct position for the tax year as set out in section 22H(3).

If she does not respond in the given time period, Inland Revenue can progress the assessment on the basis that Pamela must not have any income protection insurance to claim for the 2018–19 tax year, otherwise she would have responded to the letter as she has done in the past.

For the 2018–19 income year, Pamela does not make a deduction claim for the usual $1,000 for income protection insurance, but instead, when prompted by Inland Revenue, claims a deduction for $100,000. She then confirms this as her correct and complete tax position for the tax year.

As the $100,000 claim is far more than Pamela has claimed previously, Inland Revenue may ask Pamela whether this is a mistake. Pamela is on holiday and does not receive the correspondence from Inland Revenue.

Inland Revenue has reason to believe that the amended information is incorrect. This is because in previous years Pamela has only claimed $1,000 in income protection insurance and her salary has remained roughly the same.

Because Inland Revenue cannot get a hold of Pamela, the Commissioner issues a default assessment correcting the deduction claimed to $1,000 and issues a NOPA detailing the change.

When Pamela returns from her holiday she sees the correspondence, realises that she made a mistake and agrees to the proposed adjustment.

6. Formal disputes process commencing with a notice of proposed adjustment issued by the taxpayer or Commissioner

As a starting point, it is noted that the Commissioner is unlikely to issue a NOPA in respect of a qualifying individual. As previously discussed, the Commissioner is not required to issue a NOPA to amend a qualifying individual's tax position post-assessment. Under section 22G(6) the Commissioner can amend a qualifying individual's final account for a tax year to correct errors in the reportable income information at any time before the end of the time bar period, notifying the individual of the amendment.

Although a qualifying individual is able to commence the formal disputes process by issuing a notice of proposed adjustment, it is expected that this will happen rarely due to the qualifying individuals having up to their terminal tax date under the new error correction provisions to amend their assessments. Section 22G(3) allows a qualifying individual until their terminal tax date to correct any information in their final account, treating any earlier assessment as not having been made. This provides the taxpayer with a longer period of time to ensure they get their assessment right and allows them to amend their assessment in a much more flexible way than was provided for previously.

In the event that a qualifying individual wishes to commence the formal dispute process, the taxpayer can issue a NOPA under section 89DA of the TAA. The taxpayer must issue the NOPA within the applicable "response period" as defined in section 89AB. Generally, this will be within the four-month period that starts on the date that the Commissioner finalised the taxpayer's account for the tax year. However, this four-month period can change due to the application of section 22G(3), which allows a qualifying individual to amend their assessment at any time up until their terminal tax date, treating any earlier assessment as not having been made.

Example 12 – Rangi & Siobhan

Example 1: Rangi's pre-populated account was finalised on 15 May 2019 (assessment date) for the 2018–19 tax year. Rangi did not make any amendments to his assessment under section 22G(3) prior to his terminal tax date of 7 February 2020. This means that, if Rangi realised some of his income information was incorrect on 8 February 2020, Rangi would be unable to commence a formal dispute by issuing a NOPA. This is because section 89AB requires the NOPA to be issued within the four-month period starting on the date of assessment, which in Rangi's case ended on 15 September 2019.

It is noted that Rangi is not precluded from requesting an amendment to his assessment under section 22G(8) and section 113. Section 22G(8) provides that, after their terminal tax date, an individual may ask the Commissioner to amend information contained in their final account for the tax year under section 113. This will be discussed on the following pages under the heading "later requests for changes by individuals".

Example 2: Siobhan's pre-populated account was also finalised on 15 May 2019 (assessment date) for the 2018–19 tax year. Siobhan noticed an error in her income information and therefore made an amendment to her assessment under section 22G(3) on 1 February 2020, which is prior to her terminal tax date of 7 February 2020. This is treated as a new assessment . This means that, if Siobhan realised that further income information was incorrect on 8 February 2020, she would be able to commence a formal dispute by issuing a NOPA. Because her assessment was deemed to occur on 1 February 2020, the applicable response period for issuing a NOPA under section 89D(1) would not expire until 1 June 2020.

However, due to the complexity of the formal disputes process, it would be easier for Siobhan to simply ask the Commissioner to amend her assessment using sections 22G(8) and 113.

The application of the error correction provisions means that it is unlikely that a qualifying individual will need to use the formal disputes process and issue a NOPA. Should a qualifying individual issue a NOPA, then the disputes process that follows is left unchanged by the transition from the previous rules to the new individuals' income tax rules.

Section 89F governs the information required to be included in a taxpayer's NOPA. The remaining stages of the disputes resolution process remain unchanged. If the Commissioner disagrees with the taxpayer's proposed adjustment, then the Commissioner must advise the taxpayer as such and issue a notice of response (section 89G(1)). The process then continues as under existing law, and the stages of the disputes resolution process include an administrative phase, disclosure, a potential adjudication and then, potentially, an amended assessment. For a more in depth look at the dispute resolution process see *SPS 16/06 Disputes resolution process commenced by a taxpayer, SPS 16/05, Disputes resolution process commenced by the Commissioner of Inland Revenue and SPS 16/01 Requests to amend assessments.*

7. Later requests for changes by individuals

When an individual wishes to amend the information in their final account after their terminal tax date, section 22G(8) provides that the individual may ask the Commissioner to amend their final account under section 113.

Section 113 provides the Commissioner with a discretionary power. The Commissioner will, subject to the time bar, generally agree to amend assessments that are requested when the result can be clearly shown to be correct. In determining whether to exercise the discretion, the Commissioner will evaluate an amendment request using the care and management principles in sections 6 and 6A. For more information see *SPS 16/01 Requests to amend assessments*.

As has already been noted, a taxpayer can amend the information in their final account prior to their terminal tax date by amending their assessment under new section 22G(3) where they are a qualifying individual. If a qualifying individual wishes to amend their assessment after that date, they must request the Commissioner make an amendment under section 113. Although a qualifying individual is not permitted to issue a NOPA after four months post-assessment, they are given a longer period of time, up until their terminal tax date, to amend any errors and the corrected information will constitute a fresh assessment. This provision provides more flexibility to the taxpayer by avoiding the highly structured disputes process.

Other individuals

An individual will fall into the category of "other income" earner where they earn "other income" above the $200 *de minimis* threshold. This means they will be required to provide income information to Inland Revenue. This section will cover the following in relation to individuals who earn "other" income:

1. Correction of pre-assessment errors by the individual
2. Correction of pre-assessment errors by the Commissioner
3. Correction of post-assessment errors by the individual (formal disputes process)
4. Correction of post-assessment errors by the Commissioner (formal disputes process)
5. Default assessments
6. Later requests for changes by individuals

1. Correction of pre-assessment errors by individuals (Section 22G)

Individuals who earn other income can amend income information in their pre-populated account at any time before it is finalised (22G(2)). An individual who earns other income is required to finalise their account by 7 July of the following tax year, or longer if they have an extension of time.

2. Correction of pre-assessment errors by the Commissioner (Section 22G)

Section 22G(5) provides that pre-assessment the Commissioner may amend information in an individual's pre-populated account to correct errors. The Commissioner must notify the individual of any amendment and this will typically be done by providing them with the updated information online and in their pre-populated account at the end of the year.

3. Correction of post-assessment errors by the individual

Section 22G(8) applies to an individual who is an "other income" earner and has finalised their account per section 22H(2), and wishes to amend their assessment after the account has been finalised. This means that they must either request an amendment from the Commissioner per section 113, or they may choose to issue a NOPA if they are still within the applicable response period.

Therefore, to change the assessment, the taxpayer can request that the Commissioner amend their assessment under section 113. Under section 113 the Commissioner has a discretionary power to amend assessments. When a requested amendment can be clearly shown to be correct, such as a simple arithmetic error, the Commissioner will generally agree to the amendment. For more information see *SPS 16/01 – Requests to amend assessments.*

Alternatively, the individual can issue a NOPA but must do so within the applicable response period as defined in section 89AB. Generally, this will be within the four-month period that starts on the date that their assessment was made (this occurs when they finalised their pre-populated account under section 22H(2)). The standard dispute resolution procedures then apply.

4. Correction of post-assessment errors by the Commissioner: other individuals (Section 22H)

When the Commissioner wishes to make an adjustment in relation to an individual other than a qualifying individual, section 22G(2) requires the Commissioner to issue a NOPA under section 89B (subject to the exceptions set out in section 89C, such as if the taxpayer provides a return with a simple mistake or obvious oversight). The new individuals' income tax rules therefore make no change to what would have applied under the old rules for the correction of post-assessment errors. For more in-depth guidance regarding the disputes resolution process as commenced by the Commissioner of Inland Revenue, see *Standard Practice Statement SPS 16/05*.

Example 13 - Ben

Ben is a lawyer earning a salary. Ben also owns a rental property and therefore earns rental income as well as his salary. Ben is classified as an "other income" earner for the purposes of the individuals rules. As Ben is not a qualifying individual, if Inland Revenue wished to amend his tax return to increase the amount of tax payable, in most cases a notice of proposed adjustment would need to be issued.

5. Default assessments

Section 22I(3) of the Income Tax Act 2007 provides that if an individual does not satisfy the Commissioner that the income information in their pre-populated account for the tax year correctly and completely records their income for the corresponding income year, the date on which the assessment is treated as being made is the date on which the Commissioner provides a default assessment under section 106 of the Tax Administration Act 1994.

Where a default assessment has been made, an "other income" earner can dispute this by:

- adjusting their final account under section 89D(2B); and
- issuing a NOPA to the Commissioner in respect of the default assessment within the applicable response period. Generally, this will be within the four-month period that starts on the date that the Commissioner issues the default assessment.

The standard disputes resolution process then applies. As advised previously, for a more in depth look at the dispute resolution process see *SPS 16/06 Disputes resolution process commenced by a taxpayer, SPS 16/05 Disputes resolution process commenced by the Commissioner of Inland Revenue* and *SPS 16/01 Requests to amend assessments.*

6. Later requests for changes by individuals

As is applicable to a reportable income earner, where an "other income" individual wishes to amend the information in their final account after their applicable response period has expired, section 22G(8) provides that the individual may ask the Commissioner to amend their final account under section 113.

Categorising individual income earners

This section sets out the various groupings that an individual taxpayer may fall into and then, using the above framework as a base, provides a walk-through of what an individual needs to do to meet their obligations in various fact scenarios, and what will happen for them automatically under these new processes.

Individuals will be put into one of three groupings which they may move between over time as their income profile changes. The groupings are:

- Group A (automated process) – the individual earns "reportable income" and IR determines whether the income information it holds for the person is correct. In these cases, the refund or tax to pay will automatically be calculated, assessed and progressed accordingly (that is – refund or tax bill issued).
- Group B – the individual earns reportable income, but IR considers, based on previous returns and other information, that the individual may have other income information that they may need to provide, deductions for example. In these circumstances, the individual will be asked to provide the additional information or confirm that the income information held is correct.
- Group C – while the individual may have reportable income, it is expected that these individuals will also have other income. Individual's that fall into this category will then be required to provide income information – similar to the current IR3 process where a return of income is required.

This TIB item will deal with each grouping in turn and provide a walk-through of how the new individual's income tax proposals will apply to a taxpayer in each respective grouping, drawing on examples to illustrate how the rules will apply. From the outset, it is important to note that where an individual has a tax agent, communication will be sent directly to the tax agent. If the individual wishes to receive communication from Inland Revenue directly, they must change their mail preferences from their agent to themselves either through MyIR or by contacting Inland Revenue.

The individuals' income tax changes for a "Group A" individual

This section explains how the new individuals' income tax changes will apply to a person who falls within "group A". A "group A" individual is a person who earns reportable income only, for whom Inland Revenue considers that the income information contained in their pre-populated account is correct and complete. This section will cover the following scenarios:

1. Assessment results in a net zero position at year-end
2. Assessments results in a small amount of tax payable that is written off resulting in a net zero position at year-end
3. Assessment results in a tax refund
4. Assessment results in tax to pay
5. Individual amends their pre-populated account pre- assessment
6. Commissioner amends individual's pre-populated account pre-assessment
7. Individual amends their final account post-assessment
8. Commissioner amends individual's account post-assessment
9. The individual requests to amend their assessment after terminal tax
10. Inland Revenue miscategorises which "group" the individual should be in.

Scenario 1: "Group A" taxpayer when tax has been withheld correctly and the year-end tax position is a net zero

Example 14 - Natalia

Natalia is on a salary of $70,000 per annum. Her employer deducts PAYE correctly and remits this to Inland Revenue. Natalia does not earn any other income.

Under new section 22E the Commissioner is obliged to include this income information in Natalia's pre-populated account for the tax year. Based on the information Inland Revenue holds, the Commissioner is satisfied that this is all of Natalia's income and finalises Natalia's tax position in accordance with section 22H(1) at the end of the tax year.

Natalia is not required to do anything and is notified of her assessment automatically. The notice of assessment informs Natalia that Inland Revenue has finalised her assessment and that, in her case, she has no further tax to pay and is not due a tax refund.

The above example is the most simple under the new individual income tax rules and is the ideal outcome for a taxpayer that solely earns reportable income. The taxpayer has paid the correct amount of tax throughout the year and has not been left with a tax bill or a refund due at year-end. The tax position has been completed for the individual by the Commissioner and a notice of assessment issued accordingly, without the taxpayer having to interact with Inland Revenue to make this happen.

When will a "Group A" individual's assessment be finalised?

For most taxpayers with a standard 31 March tax year end, assessments are likely to be finalised between May and June. A notice of assessment will be sent out to the taxpayer when their assessment is calculated, whether electronically or by post.

Scenario 2: Assessment for a "Group A" taxpayer results in a small amount of tax payable that is written off resulting in a net zero position at year-end

A taxpayer can also reach a net zero position at year-end where they have a small amount of tax payable that is written off under the new write off rules. This will occur automatically without the taxpayer having to do anything. The write off rules will be discussed in greater detail under the "refunds and tax to pay section" of this TIB item.

Example 15 - Kaylor

Kaylor is a butcher who earns a salary. Kaylor is paid weekly and his employer deducts PAYE each pay day.

Last year, Kaylor's annual salary was $78,000. Each week Kaylor earned $1,500 from which Kaylor's employer withheld $320 PAYE (excluding ACC earners' levy) each pay-day. Because of the day on which his salary is paid, last tax year Kaylor received 53 weekly salary pays in the tax year (a standard tax year has 52 pay-days).

Because the PAYE system is based on 52 weekly pay days occurring in a tax year, Kaylor has a tax shortfall of $175. (He received $79,500 salary income in the tax year, but his weekly PAYE was based on $78,000).

Although Kaylor has a tax shortfall of $175, this will be written off under the write off rules (discussed later). Therefore, just like Natalia in scenario 1, Kaylor is also not required to do anything and will receive a notice of assessment automatically. The notice of assessment will inform Kaylor that Inland Revenue has calculated his assessment and that, in his case, he has no further tax to pay and is not due a refund.

Scenario 3: "Group A" taxpayer due a refund at year-end

As scenario 1 demonstrates, a qualifying individual's income tax assessment will be completed without them having to do anything.

Example 16 - Sophie

Sophie earns $35,000 from her main job and $18,000 from her second job ($53,000 total) on which she will pay $10,545 in tax. The $10,545 that Sophie pays in tax is comprised of $1,470 tax paid on the first $14,000 at 10.5%, $3,675 from $14,001–$35,000 taxed at 17.5% and then, because a secondary tax code is applied at her marginal rate, the $18,000 from her second job will be taxed at 30%, resulting in $5,400. The total tax payable on $53,000 of income is actually $8,920 meaning that Sophie is due a refund of $1,625.

Because Inland Revenue has Sophie's current bank account details, once Sophie's tax position is finalised at year-end, her refund will be direct credited to her account and her notice of assessment will inform her of the refund that has been paid out to her automatically.

If Inland Revenue did not have bank account details for Sophie, the refund would be unable to be direct credited. For this reason, it is important that taxpayers keep their bank account details up to date with Inland Revenue to enable any refund due to be paid out automatically.

For the sake of completeness, it is noted that under the new individuals' income tax rules Inland Revenue could proactively recommend that Sophie adopt a tailored tax code to help fix the over taxation caused by the secondary tax code. Had Sophie accepted this and her pattern of earnings remained the same throughout the year, then she would not have been owed a refund at year-end. This is because the tailored tax code would have ensured that the correct amount of tax was withheld during the year, enabling Sophie to have more money throughout the year. Both "pro-active actions" and "tailored tax codes" have their own sections later in this TIB item.

It is also noted that under the previous personal tax summary rules, a tax payer was required to confirm the correctness of their income statement (PTS) under section RM 5 of the Income Tax Act 2007 before a refund exceeding $600 could be issued to the taxpayer. Under the new rules there is no refund confirmation threshold and refunds of any amount will be paid out automatically. This means that the $1,625.00 owing to Sophie in the above scenario will be paid out to her without her having to do anything specific to request it (providing that she has updated her bank account details with Inland Revenue).

Scenario 4: "Group A" taxpayer with tax to pay at year-end

Example 17 - Robert

Robert is an employee earning wages. His tax position is finalised by Inland Revenue for the 2018–19 tax year and it is determined that he has tax payable of $200 that has arisen due to being on an incorrect tax code for a portion of the tax year.

Inland Revenue sends Robert a notice of assessment and also informs him that he has $200 of tax to pay. Robert will have until the terminal tax date of 7 February 2020 to pay this additional amount of tax without incurring any penalties or interest. If Robert has not paid this amount by the terminal tax date, he will be sent a statement of account which will include a late payment penalty and interest owing on the outstanding tax.

The above four examples deal with the most common situations that reportable income earners can expect to experience. Although they outline the experience that the majority of "Group A" individuals will have, there are some situations where these individuals will have further interactions with Inland Revenue in order to ensure the correctness of their income tax assessment.

Scenario 5: Individual amends their pre-populated account pre-assessment

There are times when, due to an error, an individual's pre-populated account may not accurately reflect their income position for a tax year. Individuals are therefore encouraged to log into their myIR account during the year to take a look at the information that has been included and make any corrections when necessary. To enable that the new individuals' income tax rules allow an individual to amend their pre-populated account at any time before it is finalised.

Example 18 - Charles

Charles logs into his pre-populated account for the 2018–19 tax year and notices that there is some income for a job he does not recognise. What has likely occurred is that an employer has input a wrong IRD number when calculating their payroll, resulting in the income incorrectly being attributed to Charles.

Under new section 22G(2) Charles is able to amend his pre-populated account at any time before it is finalised, so he contacts Inland Revenue and proposes a correction to the information in his pre-populated account to delete this unknown income source.

Scenario 6: Commissioner amends an individual's pre-populated account pre-assessment

Although a Group A individual is encouraged to log in to myIR during and after the tax year to review their information, the Commissioner is also able to correct any errors to ensure the correctness of the individual's income information. New section 22G(5) provides that the Commissioner may amend information in an individual's pre-populated account for a tax year to correct errors. The Commissioner is required to notify the individual of any amendment made.

Example 19 - Charles

Using the example of Charles above, let's assume that Charles did not log into his pre-populated account and notice the incorrect income information, and instead Inland Revenue became aware of the error.

In these circumstances, Inland Revenue would amend Charles's pre-populated account to correct the error and then send Charles a letter to notify him of the amendment.

Scenario 7: Individual amends their account post-assessment

A qualifying individual's pre-populated account will become a final account for a tax year once it is finalised by the Commissioner. New section 22H(1) provides that the Commissioner may finalise the individual's pre-populated account for the tax year once the Commissioner is satisfied that the income information set out in the pre-populated account correctly and completely records their income for the corresponding income year.

As previously discussed, when a "Group A" individual amends their final account prior to their terminal tax date, any earlier assessment for the tax year is regarded as not having been made. The individual will have until terminal tax to pay any resultant tax bill without being subject to penalties or interest.

Example 20 - Charles

Again, carrying on with the example of Charles, let's assume that neither Charles nor Inland Revenue noticed that some income information had been incorrectly attributed to Charles and his assessment is finalised for the tax year.

Charles logs into myIR to view his income information for the 2018–19 in July 2019, which is after his income tax assessment for the year has been finalised. Charles notices that some income has been attributed to him for a job that he has never worked for. In accordance with new section 22G(3), Charles is able to amend his assessment at any time prior to his terminal tax date. This amendment will be treated as a new assessment and he will have until his terminal tax date to pay any tax outstanding without being subject to penalties or interest.

Charles amends his assessment to remove the income information. Inland Revenue contacts the employer in question to seek out the correct IRD number for the employee whose income was mistakenly added to Charles' account.

It turns out the extra income should have been paid to Amelia, one of Charles's colleagues. She has also had her account finalised by the Commissioner in June. Using new section 22G(6), the Commissioner amends Amelia's final account to correctly include the missing employment income and withheld PAYE and notifies Amelia of the change made which results in a small refund to Amelia.

Scenario 8: The Commissioner amends the individual's account post-assessment

Under new section 22G(6), the Commissioner may amend information in a qualifying individual's final account for a tax year to correct errors at any time before the end of the time bar period in section 108(1). An amendment made to section 89C(1) ensures that the Commissioner can amend information in the individual's final account without first having to issue a NOPA. As the time bar period extends for 4 years from the end of the tax year in which the return is furnished, the Commissioner can rely on this provision to amend the taxpayer's assessment after their terminal tax date.

Example 21

On 1 March 2021 Inland Revenue discovers, following an audit, that a large employer had been incorrectly accounting for PAYE since the introduction of pay-day filing rules in April 2019. The mistakes resulted from an error in the coding of the payroll software that the employer uses.

Inland Revenue works with the employer over the next few months to identify the extent of the error and finds that, in total, approximately $7.5 million was mistakenly misreported during the period April 2019–March 2021.

The company employs 325 staff across New Zealand and Inland Revenue sets about checking the assessments for the affected employees.

Upon reviewing the assessments, Inland Revenue discovers that the vast majority of the company's employees are qualifying individuals for whom assessments for the year ended March 2020 had been finalised.

To correct the errors made in each of the finalised accounts for these employees, Inland Revenue recalculates the corrected tax positions and amends the final accounts as per section 22G(6). Some employees receive additional refunds which are immediately direct credited, and others small tax bills for which the employees are given additional time to pay as per section 142AB.

For the remaining minority of affected employees who have "other income" and therefore filed returns for the March 2020 year-end, the Commissioner relies on section 22G(8) instead. To amend the assessments, the Commissioner contacts each employee and provides proposed adjustments.

Finally, because the March 2021 assessments have not yet been finalised the Commissioner, uses section 22G(5) to correct the pre-populated accounts of all of the employees and to reverse the mistake in the reported employment income information.

Scenario 9: The individual requests an amendment to their assessment after the terminal tax date

There are some circumstances where a qualifying individual can utilise the formal disputes process to request an amendment to their assessment after their terminal tax date. As previously discussed, this could occur where a taxpayer has amended their assessment under section 22G(3) at some point prior to their terminal tax date and, by virtue of this action resulting in a fresh assessment, the taxpayer may still be within the relevant response period to issue a NOPA.

The above will only occur in rare cases. Usually where an individual wishes to amend the information in their final account after their terminal tax date, they can do so under section 22G(8). Section 22G(8) allows the individual to ask the Commissioner to amend their final account under section 113. The Commissioner will accept the amendment where she is satisfied that the suggested amendment is clearly correct.

There are instances where the Commissioner would refuse to exercise her discretion to amend an assessment under section 113. This could include where the proposed adjustment is merely arguable or involves disputed facts or statutory interpretation or where a taxpayer is attempting to circumvent the disputes process. For further information please consult *SPS 16/01: Requests to amend assessments*.

Example 22 - Caleb

Caleb works as a mechanic and earns wages. For the last pay period of the 2018–19 tax year, Caleb received an end of year bonus of $800. This bonus is treated as a lump sum payment and is taxed in accordance with the extra pay rules. Although the payment was only $800, an error occurs which results in the payment being remitted to Inland Revenue as a $900 payment. This means that, as far as Inland Revenue is concerned, Caleb has been undertaxed. His employer withheld tax based on an $800 payment when, according to the information remitted to Inland Revenue, Caleb was paid $900.

Caleb is not aware of this error. When his tax position is finalised on 1 June 2019, Caleb has a small amount of tax payable. This amount is under $50 and therefore written off under section 22J.

Caleb becomes aware of the error on 15 March 2020, which is after his terminal tax date of 7 February 2020. Although the error has not had any material effect on the amount of tax Caleb had to pay for the tax year, Caleb wants his tax position to be accurate.

Under section 113 Caleb requests that the Commissioner makes an adjustment to Caleb's tax return for the 2018–19 tax year. The Commissioner uses her discretion under section 113 to correct this error.

Scenario 10: A taxpayer with "other income" is miscategorised as a "Group A"

Inland Revenue uses the information it knows about a taxpayer to determine which grouping that taxpayer is put into. It is acknowledged that in some situations Inland Revenue may not get this completely right.

Example 23 - Keith

Keith earns a salary of $70,000 per annum. This is the only type of income he has earnt for several years. On 1 March 2019 he buys a rental property but does not tell Inland Revenue. Sometime in May 2019, Inland Revenue automatically finalises Keith's tax position. This is because Inland Revenue is satisfied, based on the information held for Keith, that he is solely a reportable income earner.

The income Keith earns from the rental property is "other income" and will need to be included in Keith's end of year income tax assessment. Keith has been treated as a qualifying individual by Inland Revenue. This means that under new section 22G(3) Keith has until his terminal tax date (generally 7 February of the following year) to amend his assessment without being subject to penalties or interest.

When Keith receives notification from Inland Revenue in May that his end of year tax position has been finalised, he promptly logs into his myIR and amends his assessment to include the rental income information and confirms this as his final tax position for the year. Under section 22G(3) this is treated as a new assessment and Keith has until terminal tax to pay any outstanding tax.

Example B

Drawing on the example above, if we assume that Keith informed Inland Revenue about his rental property prior to Inland Revenue finalising his assessment, then Keith would be recategorised as a "Group C" person for the purposes of the individual's income tax rules.

In accordance with section 22H(2), this means that Keith would have until 7 July 2019 to provide other income information, correct any errors and finalise his account as correct and complete. If Keith has not finalised his account by this date, then he will be subject to a late filing penalty and Inland Revenue may eventually issue a default assessment under section 106.

Walkthrough of the individual's income tax changes for a "Group B" individual

This section sets out some common scenarios that a "Group B" individual may find themselves in and explains how the new law applies.

A "Group B" taxpayer is a qualifying individual who earns reportable income and who may have provided additional information in prior years' assessments, such as claiming an allowable deduction. For Group B individual, Inland Revenue considers, based on previous returns and the other information it holds about the individual, that they may have other income information to provide.

In these circumstances, the taxpayer's assessment will not be immediately finalised by the Commissioner but will be "suspended" for a period of time to give the individual an opportunity to provide this further information if applicable.

Scenario 1: When a pre-populated account may be temporarily suspended to give the individual an opportunity to provide additional information

The types of information that would result in an individual being subject to a suspended process are set out in section 22F(3) and the relevant table in schedule 8. As per that section, an individual may provide information for a tax year on amounts set out in schedule 8, part A, table 2. Table 2 provides that an individual may provide additional information on the following:

1. A deduction.
2. A tax credit carried forward under section LE 3 of the Income Tax Act 2007.
3. A tax loss balance, or tax loss component, other than a tax loss component under section LE 2 of the Income Tax Act 2007.
4. A donations tax credit.
5. An amount of income protection insurance.

Inland Revenue will contact an individual if it appears that the individual may have some additional information to provide. This will be informed by whether the taxpayer may have had or claimed expenses, credits or losses in prior tax years and any other relevant information that Inland Revenue holds in respect of the taxpayer.

This means that if an individual wishes to claim expenses but has not done so in the past, the onus will be on the individual to contact Inland Revenue or update their pre-populated account before it is finalised to include this information. If they fail to do this prior to their assessment being finalised by the Commissioner, they would have to apply the relevant error correction processes in order to include the additional information.

When an individual provides a valid expense claim or deduction, this will lower the individual's liability for the tax year. Therefore, there is an incentive for the individual to respond to the Commissioner's query about additional information. Although there are limited deductions available to individuals earning reportable income, Inland Revenue intends to provide an opportunity for taxpayers who it considers likely to have such deductions an opportunity to claim them before their account is finalised for them. Inland Revenue will therefore utilise what it knows about an individual to make it easier for the individual to provide the relevant expense information, when applicable, rather than having to use post-assessment correction provisions to add this in after the account is finalised.

Example 24 - Rohit

Rohit is a salary earner who works as a scientist. Inland Revenue knows that in previous tax years, Rohit has claimed a deduction for income protection insurance. Inland Revenue therefore has reason to believe that Rohit may intend to claim this deduction for the current tax year as well. Instead of automatically calculating Rohit's income tax assessment, Inland Revenue notifies Rohit via myIR that he has previously claimed income protection insurance and may wish to do so again this year. Inland Revenue give him a period of time to respond.

If Inland Revenue has not heard from Rohit at the conclusion of the given period, Inland Revenue will progress on the basis that Rohit does not have any income protection insurance to claim for this tax year and will finalise his assessment based on the information in his pre-populated account. If Rohit responds confirming that he has this information, his assessment will be calculated using the information he provides and confirms as his complete and correct position for the tax year.

Certain types of other income, such as ACC attendant care payments and expense information in relation to schedular payments, will also be subject to this suspended auto calculation process. For example, where an ACC beneficiary is receiving personal service rehabilitation payments and on paying that to their personal carer (known as an ACC attendant care payment), Inland Revenue would require the ACC beneficiary to provide information regarding how much was passed on to the caregiver.

Individuals may also have to provide additional income information to Inland Revenue on an interim basis until the changes in the recently enacted Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 take full effect. These changes introduced in that Act will require investment income payers to provide detailed information to Inland Revenue about the income paid to individuals from these sources ("reportable income").

During the transitional period, if Inland Revenue records indicate that qualifying individuals have in the past returned dividends or Maori authority distributions, then these individuals may also initially be prompted to provide this additional information in order to complete their assessments.

Walkthrough of the individuals' income tax changes for a "Group C" individual

This section explains how the new individual's income tax changes will apply to a person who falls within "group C". A "group C" individual is a person who, although they may have some reportable income, is expected to have other income. Individuals that fall into this category will not be required to provide income information to Inland Revenue. This section will cover the following scenarios:

1. A standard assessment for a group C individual
2. Individual amends their pre-populated account pre-assessment
3. Commissioner amends individual's pre-populated account pre-assessment
4. Individual wishes to amend their final account post-assessment
5. Commissioner amends individual's final account post-assessment
6. The individual requests to amend their assessment after terminal tax
7. Inland Revenue miscategorises which "group" the income earner should be in.

Scenario 1: A standard assessment for a group C individual

Example 25 - Mike

Mike is a doctor on a salary of $200,000 per annum. His employer deducts PAYE correctly and remits this to Inland Revenue. Mike also owns a portfolio of rental properties which provides him with additional rental income of $100,000 per annum. This represents all of the income Mike earns for the 2018–19 tax year.

As rental income comes under the definition of other income in section 22D(4) and Schedule 8 Part A table 1, Mike is categorised as an "other income" earner. This means that, under section 22H(2) Mike must, as an "other income" earner, provide his other income information to Inland Revenue. Mike is then required to review the information in his pre-populated account and finalise his account for the tax year by confirming it as correct and complete by the due date in section 22H(4) (usually 7 July unless Mike is entitled to an extension of time).

Mike logs into myIR on 15 May 2019, provides his other income information, and then finalises his account as correct and complete. By finalising his account, Mike has filed his tax return for the 2018–19 tax year. Mike would have until the terminal tax date to pay any applicable tax due, or if in a refund position would receive his refund shortly after his account is finalised.

The above example sets out the assessment process for an "other income" earner. All of the "reportable income" that an individual earns will be provided to Inland Revenue by way of third-party reporting and will be included in the individual's pre-populated account for the tax year. If an individual earns income that falls under the definition of "other income" in section 22D(4) and Schedule 8 Part A table 1, they are required to provide this information and finalise their tax position themselves.

An individual who earns both "reportable" and "other income" must ensure that the information included in their pre-populated account is correct and complete before they confirm their end of year assessment. If the individual wishes to file their return shortly after the end of the tax year, and before Inland Revenue will have received all reportable income information from the relevant third parties, they must ensure that they include this information in their tax return. It follows then that it may be easier for an "other income" earner who also earns "reportable income" to wait until Inland Revenue has complete "reportable income" information before filing their return. "Reportable income" information will likely be completed by shortly after 15 May following the end of the tax year.

Example 26 - Mike

Let's assume that instead of logging into myIR on 15 May 2019 to provide his other income information and finalise his tax position for the tax year, Mike logs into myIR on 1 April 2019 to provide his "other income" information and finalise his tax position. In this situation, it is unlikely that the last few pay periods from Mike's salary as a doctor will have been pre-populated. This means that, if Mike wishes to finalise his tax position for the 2018–19 tax year on 1 April 2019, Mike will need to provide this information himself.

Mike provides his other income information and then commences a review of all of the information that is included in his pre-populated account for the tax year. As expected, Mike realises that the last few pay periods of salary and wage income are missing. Mike logs out of myIR and sets a reminder in his Calendar to log back in on 15 May 2019 to review and confirm his income information for the tax year.

Scenario 2: How an individual amends their pre-populated account pre-assessment

An individual who earns other income can amend their income information in their pre-populated account at any time before it is finalised (section 22G(2)). As above, an individual who earns other income is required to finalise their account by 7 July of the following tax year, or later if they have an extension of time.

Example 27 - Mike

Let's assume a further variation of example 25 above which deals with Mike as a salary earner who also has rental income. Under this variation, Mike does the following:

15 May: Mike logs into myIR and provides his rental income for the tax year. Mike does not finalise his account at this point as he had some repairs done on his property during March 2019. Mike is waiting for the invoice for this work so that he can claim a deduction against this income.

20 May: Mike receives an invoice from the builder who performed the repair work on his property for $8,000. Mike logs into myIR and claims this as an expense against his income. Mike then finalises his return accordingly by confirming his income information as correct and complete under section 2H.

Scenario 3: Commissioner amends individual's pre-populated account pre-assessment

As is applicable to individuals who earn reportable income, section 22G(5) also allows the Commissioner to amend information in an "other income" earner's pre-populated account for the tax year to correct errors. This must be done prior to the account being finalised and the Commissioner is required to notify the individual of any amendment made.

Example 28 - Sally

Sally is 17 years old and still at school. She is passionate about animals so works part time at a local charity that rehomes stray dogs. Sally earns a salary of $10,000 per annum. Sally is so passionate about animals that she decides to donate $12,000 to her local charity. She makes this donation on 15 March 2019. Sally logs into myIR on 1 May 2019 to add a donation tax credit claim of $12,000. Sally also runs a lemonade stand at her local netballing club and updates her pre-populated account to include the additional $2,000 income that she earnt from that during the tax year. Sally does not yet confirm her income information as complete, as she wants her dad, who is an accountant, to check that she has inputted the information correctly. Sally's dad is on holiday in India so is unable to check over the information until he returns on 1 June 2019.

In the meantime, Inland Revenue notices that Sally has claimed donation tax credit for $21,000, despite the receipt provided stating that a $12,000 donation was made. In these circumstances, Sally has clearly made a typing error. The amount claimed is incorrect. Inland Revenue make a provisional amendment to Sally's donation tax credit claim to ensure that the claim is $12,000 and matches the receipts provided. Inland Revenue notify Sally of the update via myIR.

When Sally's dad returns from India he checks over her pre-populated account for the tax year and confirms that the information is correct. Sally finalises her account accordingly.

Scenario 4: Individual amends their final account post-assessment

When an "other income" earner wishes to amend their final account post-assessment, they must request that the Commissioner makes an amendment as per section 113, as discussed above.

Alternatively, they may be able to issue a NOPA if the applicable timeframes have not lapsed. The taxpayer's NOPA must be issued within the applicable response period as defined in section 89AB. Generally, this will be within the four-month period that starts on the date that the Commissioner receives the taxpayer's assessment unless the Commissioner allows a late NOPA under section 89K(1).

Example 29 - Mohammed

Mike's cousin, Mohammed, runs an online business selling vintage clothes. He sells items through his personal website and also through a Trade Me account. When Mohammed finalised his account for the 2018–19 tax year, he included $5,000 worth of sales on his Trade Me account that were his own personal items, a second-hand TV and a leather lounge suite. Mohammed's Trade Me account lists thousands of items for sale per year and when filing his return Mohammed had forgotten he had used his business account to sell these personal items which led to the items being included in his return by mistake.

Mohammed finalised his account for the 2018–19 tax year on 1 June 2019. Mohammed realised he had made a mistake on 15 September 2019. This is still within the valid response period as set out in section 89AB. Mohammed wishes to make an adjustment to his tax return. He completes a NOPA requesting that $5,000 be excluded from his taxable income as assessed for the 2018–19 tax year and sends it to Inland Revenue.

Scenario 5: Commissioner amends individual's final account post-assessment

Section 22G(7) requires the Commissioner to issue a NOPA under section 89B (subject to the exceptions set out in section 89C, such as when the taxpayer provides a return with a simple mistake or obvious oversight) before amending an assessment for an "other income" earner. This is consistent with the settings in place prior to the new rules being introduced.

Example 30 - Ben

Ben is a salary earner who owns a large amount of rental property. Ben also claimed some expenses against his income for the 2018–19 tax year for repairs carried out on one of his rental properties. Ben finalised his tax position for the 2018–19 tax year on 1 June 2019. On 8 August 2019, Inland Revenue does an audit on one of Ben's accounts and discovers that he has incorrectly categorised the installation of insulation in one of his properties as a repair and has claimed that amount as an expense. As the property was previously uninsulated, the amount should have been treated as an improvement and capitalised.

In accordance with the requirements in section 22G(7), the Commissioner issues Ben with a NOPA under section 89B.

Scenario 6: The individual requests an amendment to their assessment after the terminal tax date

If an individual wishes to amend the information in their final account after their terminal tax date, section 22G(8) provides that the individual may ask the Commissioner to amend their final account under section 113. The Commissioner will progress the amendment if she is satisfied that the suggested amendment is clearly correct. The purpose of this provision is to clearly signpost to the taxpayer what mechanisms will exist under the law for an individual earner to amend their assessment after the terminal tax date. Section 22G(8) does not limit the use of section 113 more generally. The Commissioner may consider a request under section 113 at any time (such as after the expiration of the time period for issuing a NOPA but prior to a taxpayer's terminal tax date, for example).

Example 31 - Mike

Mike got a builder in to do repair work on one of his properties and the builder sent Mike a bill for $8,000 in May 2019 for the work he had quoted for and completed in March 2019. Mike had accrued this cost but had accidentally keyed in $5,000 instead of $8,000. He didn't notice this when he was providing his tax information for the year so he only claimed a $5,000 expense, but he paid the builder the $8,000 in May.

Mike discovered his earlier error when he was reconciling his accounts for the 2019–20 year. As this was an expense that related to the 2018–19 income year, Mike asks the Commissioner to amend his assessment in accordance with section 22H(4).

As the amendment is clearly correct, the Commissioner agrees to use her discretion to make the change.

Scenario 7: Inland Revenue miscategorises which "group" the income earner should be in

There are two ways in which Inland Revenue can miscategorise which "group" an individual income earner should be in. The first is where the Commissioner treats the taxpayer as a qualifying individual in circumstances where the individual actually earns "other income". The second is where the Commissioner treats an individual as a person who earns "other income" when they are actually a "qualifying individual".

An individual who is actually a qualifying individual will always be able to take advantage of the rules that apply to qualifying individuals. However, section 22G(3) also provides that an individual who is treated as a qualifying individual may amend the income information in their final account at any time before their terminal tax date for the tax year. Any earlier assessment for the tax year is regarded as not having been made. Extending this to miscategorised "other income" earners ensures that they are not disadvantaged by any miscategorisation.

Example 32 - Ousmane

Ousmane works for a florist earning wages. The only income information Inland Revenue has received in relation to Ousmane for the 2018–19 income tax year is this wage income, and his earnings in previous tax years have always been consistent with this position. As such, Inland Revenue is satisfied that the information in Ousmane's pre-populated account is correct and complete. His account is therefore finalised on 1 June 2019 in accordance with section 22H.

What Inland Revenue do not know is that in February 2019 Ousmane started his own business creating and selling gift baskets. For the 2018–19 tax year, Ousmane earnt an additional $3,000 income from this side business. This is classified as "other income".

As an "other income" earner with a standard balance date, Ousmane is required to finalise his account by confirming that the income information in his pre-populated account is correct and complete by 7 July of the following tax year (section 22H(4)). However, by virtue of being treated by Inland Revenue as a qualifying individual, Ousmane can, under section 22G(3), provide this information by as late as his terminal tax date of 7 February.

As previously advised, Inland Revenue auto calculated Ousmane's tax position on 1 June 2019. As long as Ousmane logs into his myIR to provide his "other income" information and finalise his account before 7 February 2020, this will be treated as a fresh assessment for the purposes of the individuals' rules. The assessment that resulted when Inland Revenue finalised Ousmane's account on 1 June 2019 will be regarded as not having been made. Ousmane will have until his terminal tax date to pay any resultant tax bill and will not be subject to any penalties or interest (this means that if he finalises his account right before terminal tax, the payment date will be almost immediate).

REFUNDS OF TAX AND AMOUNTS OF TAX TO PAY

Sections 22F, 22J, 22IB and Schedule 8 of the Tax Administration Act 1994. Sections RM 2, RM 4, RM 5, RZ 15 and RZ 16 of the Income Tax Act 2007. Sections MD 1, MD 1B and MD 1C of the Income Tax Act 2004. Sections MD 1, MD 1B and MD 1C of the Income Tax Act 1994.

Several amendments have been introduced to improve the process for issuing refunds and advising individuals that they have tax to pay or are due a refund. New write-off rules have also been introduced to reduce compliance costs and improve the fairness and integrity of the tax system. Together, these changes will simplify the rules so that more individuals can understand their obligations and meet those with minimal effort.

Changes have also been made to the refund provisions for back years. As the law previously limited Inland Revenue's ability to refund some credits, these amendments will allow for these amounts to be managed and refunded.

Background

Under the previous law, individuals were responsible for determining whether they were required to file a return, or whether they needed to take any action to finalise their tax position.[1] Taxpayers who were not required to file returns did not have their tax positions squared up automatically. If these taxpayers wanted to determine whether they had tax to pay or were due a refund, they were required to interact with Inland Revenue (by requesting a personal tax summary, for example). Non-filing taxpayers could be selective and, based on their summary of earnings, request a personal tax summary only in years in which a refund was due. This approach did not accord with the Government's objective of making tax simpler for individuals, and there was an integrity concern with taxpayers being able to choose to obtain refunds but not be obligated to crystallise amounts of tax to pay.

Under the new rules, if an individual who is not required to provide additional information is due a refund or has tax to pay, then Inland Revenue will complete this process for them. Refunds will be paid out without an individual having to interact with Inland Revenue to request them and Inland Revenue will contact individuals and inform them of any amounts of tax to pay. To improve the integrity and fairness of the system, new write-off rules have also been introduced. The objective behind these write off rules is to reduce compliance costs and ensure that individuals who have done everything they reasonably could to meet their obligations are not surprised by a tax bill at year-end.

[1] A person was not required to file a return if they, in addition to satisfying a number of other criteria, derived $200 or less of certain types of income from which tax had not been withheld or had been withheld incorrectly (see section 33AA(1) of the Tax Administration Act 1994).

Key features

The changes are as follows:

New individuals' income tax changes

- Inland Revenue will determine whether individuals who are not expected to be required to provide information to Inland Revenue are entitled to a refund or have tax to pay.
- Refunds will be paid out without individuals having to request them.
- Inland Revenue will issue income tax refunds by direct credit (provided customer bank account information is up to date), but not if that would result in undue hardship or is not practicable.
- Write-off rules have been introduced that will be reversible if the taxpayer no longer meets the requirements to receive the write-off. These rules provide that when an individual has only earnt reportable income:
  - Amounts of tax payable that do not exceed $50 will not have to be paid.
  - Amounts of tax payable that arise due to an extra pay period where that income has been taxed at the correct rate will not have to be paid (subject to exclusions).
  - Amounts of tax payable that arise at year-end when an individual's income is derived solely from an income tested benefit, education grant or payment of NZ superannuation/veterans' pension will not have to be paid.
- An amendment has also been made to allow a list of prescribed persons to supply income and expense information on behalf of a deceased taxpayer if no executor or administrator is appointed.

Changes to allow refunds to be made for back years

- The refund provisions have been amended for back years to ensure that they are clear and unambiguous, that there is consistency across time periods and to allow previously time barred refunds to be paid out.
- An amendment has been made to ensure that there are mechanisms in the law to allow for credits owed to deceased taxpayers under the previous law, to be refunded.
- Inland Revenue will allow certain prescribed persons to provide "other income" information on behalf of a deceased taxpayer from 1 April 2019 to ensure assessments can be completed on behalf of deceased taxpayers in the year of their death.

Application date(s)

The individuals' income tax proposals apply from 1 April 2019, with the exception of the write-off rule for income derived from an extra pay period which applies from 1 April 2020.

The amendment to the refund provisions to ensure consistency for back years applies retrospectively for the period 1 October 2004 until 31 March 2013.

The amendment to allow a list of prescribed persons to confirm an income statement on behalf of a deceased taxpayer applies retrospectively for the period that the law on income statements was in force, being 1 April 2000 until 1 April 2019.

Detailed analysis

No obligations to provide information: de minimis and certain other amounts

New section 22K sets out the circumstances in which an individual will not have to provide income information to Inland Revenue. 22K(1) provides that an individual will not have to provide information for a tax year if the individual derives other income below a $200 de minimis threshold.

Example 1 - Max

Max works in an office as an analyst, earning $70,000 per annum. Max's first anniversary with his girlfriend is coming up, and Max really wants to buy her a necklace. Unfortunately for Max, their anniversary falls shortly after they have been away on holiday and Max has spent all of his money.

Max visits the beach on the weekend and sees a bunch of people riding about and having fun on Feijoa scooters. Max enquires further and finds out that he can make some additional money as a Feijoa scooter recharger. The task involves collecting Feijoa scooters that are running low on battery, recharging them at home and taking them back to a designated area.

Max loves the beach and lives just across the road from a Feijoa "drop off" point. Max eagerly signs up as a recharger, hoping to make enough money for the necklace and have some fun in the sun at the same time.

After a weekend of recharging Feijoa scooters, Max checks his Feijoa app and finds that he has earned $188 for his weekend of work. Max goes out and buys the necklace and lets Feijoa know that he will no longer be recharging for them anymore.

As the amount of other income Max has earned is under $200, and this is the only additional income Max has earned during the tax year that has not been subject to withholding, Max does not have to return this income in accordance with new section 22K.

Example 2 - Jamie

Jamie works as a ranger at the local wild life park, earning $50,000 per annum. His best friend, Bateson, is going away for three months and pays Jamie $250 to keep his lawns and garden in shape while he is away.

As this amount is above $200, Jamie will need to provide this income information to Inland Revenue and pay tax on this income.

Threshold for refunds or tax payable

It was initially proposed that the $5 refund threshold in section 174AA(b) would be removed. This threshold meant that refunds lower than $5 did not have to be paid out and removing the threshold would require all refunds to be paid out regardless of amount. This change was not enacted and the existing $5 threshold in section 174AA(b) will remain. While the intention is to move to issuing tax refunds by direct credit, there will still be a need to issue cheques in the short term. Although the $5 threshold will be retained legislatively, Inland Revenue are currently expecting to refund amounts lower than $5 but will not yet refund very small amounts.

Write-off rules for individuals

In accordance with new section 22J and new schedule 8, an individual who only earned **reportable income** will be able to qualify for a write off in certain prescribed circumstances.

These are:

- if the amount of tax payable is no more than $50;
- if the amount of tax payable is derived solely from certain income tested benefits; or
- if the amount of tax payable is derived solely from an extra pay period.

Example 3 – Max and Jamie

Drawing on our two examples above:

Max: Although Max's Feijoa scooter earnings fall under the definition of "other income", the amount is less than $200. Because this is below the de minimis threshold, Max is deemed to be an individual who only earns "reportable income" and therefore will qualify for a write off where he meets the criteria.

Jamie: Jamie has $250 of "other income". This means that Jamie is no longer an individual who only earns "reportable income" and is therefore discounted from the write off rules.

New section 22J(2) also provides that these write-offs will be reversible where a taxpayer no longer meets the requirements to receive the original write off, whether that be through a subsequent reassessment or otherwise.

Example 4 - Dan

Dan is a prison warden and earns $50,000 per annum. When his father died, he was left an inheritance of $20,000. Dan has this in a low risk term deposit with his local bank and earns 5% interest per year. When Dan set the term deposit up he used the most appropriate RWT rate for his expected income, which was 30%.

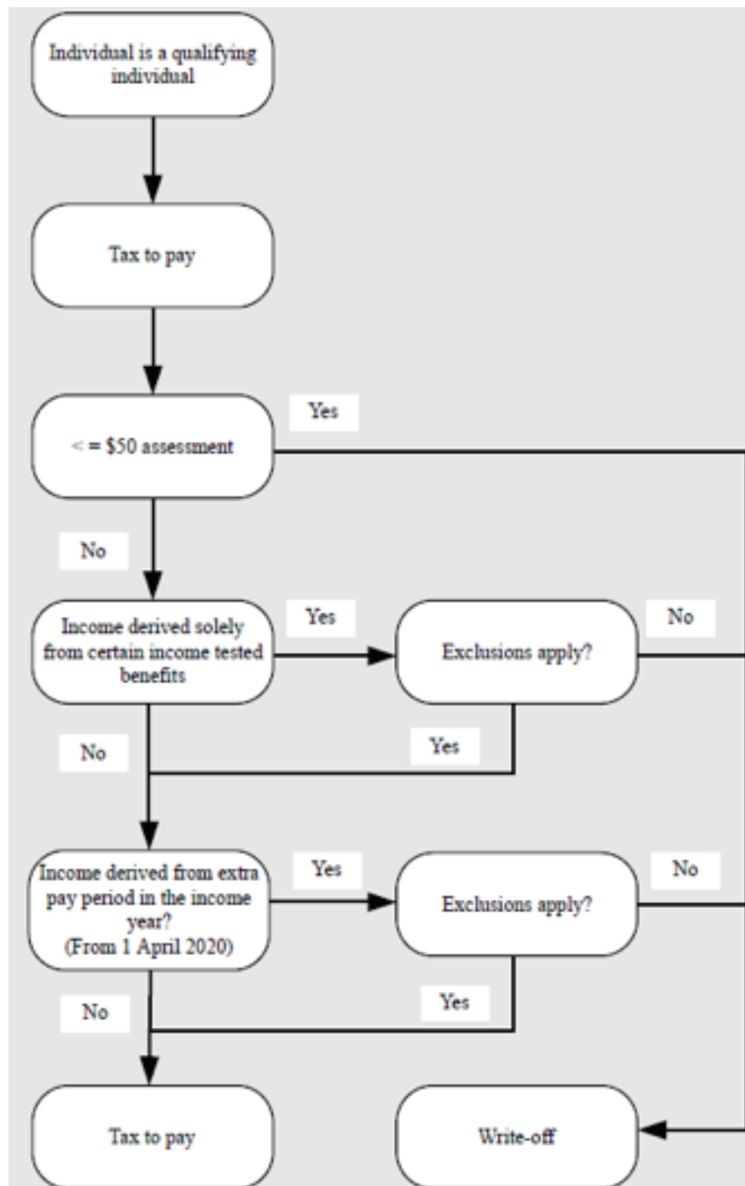
On 1 April 2018, Dan is promoted at work to senior warden, and now earns $70,000 per annum. This means that Dan's marginal tax rate is now 33% and therefore, 33% is the appropriate RWT rate for Dan to be on to ensure that his interest income is taxed correctly.

Dan remains on the 30% RWT rate for the entire 2018–19 tax year. It follows that the $1,000 in interest that he earns from his term deposit would have been under withheld by $30, leaving him with tax to pay of $30.

When the new individuals' income tax changes kick in on 1 April 2019, Dan, as a reportable income earner who has never had any other income, has his assessment finalised by the Commissioner. This leaves Dan with a $30 tax bill, but this is written off automatically as it is under $50.

After Dan's tax position has been squared up, Dan realises that he fixed his neighbour's car in March and was paid $1000 for his handy work. Dan logs onto myIR and makes an amendment to submit the $1,000 of other income. Dan's tax position is recalculated, and he has a tax bill of $360.00. This is comprised of 33% tax on $1000 at Dan's marginal rate (or $330) and, because Dan is now no longer an individual who solely earns reportable income, Dan no longer meets the requirements for the $30.00 write off he received. The write off is therefore reversed as per new section 22J(2).

The following flowchart provides a brief overview of how the write off rules operate. The write off rules, and the number of exceptions that apply to them, will be discussed in greater detail over the following pages.



NEW LEGISLATION

(a) Where an individual only earns reportable income and tax payable is not more than $50 (Schedule 8, Part B, clause 1(a)).

Part B clause 1(a) in new schedule 8 provides that when an individual who only earns reportable income has tax payable at year-end that is no more than $50, that amount of tax will not be required to be paid. If the amount of tax payable is greater than this amount, the entire amount payable must be paid unless another one of these rules applies.

The purpose of this rule is to ensure that individuals who have had about the right amount of tax deducted will not have a tax bill at year-end. As interest income will now be included in a taxpayer's income and tax calculation, the addition of the $50 write off essentially maintains the position where undertaxed interest income was not required to be reported provided it was less than $200.

Example 5 - Sarah

Sarah works part time at a local café for 20 hours per week while she is at school. Sarah finishes school in December and carries on working part time over the summer. When summer ends, Sarah asks to increase her hours to full time. As the café is unable to offer Sarah full time hours, Sarah obtains another job at a local childcare centre, also for 20 hours per week. Both jobs pay her $25.00 per hour.

Sarah commences her job at the childcare centre on 22 March and elects an "M" tax code. This now means that both Sarah's job at the café and her job at the childcare centre are on the M tax code, instead of adopting a secondary code. When an M tax code is used for concurrent sources of income, there will be multiple claims to the lowest (or lower) tax rates and therefore tax to pay at year-end due to this overuse of the lower tax brackets. This is an incorrect tax code for Sarah to be on.

In Sarah's case, as both jobs are on the M tax code she is paying $68.65 in tax from each job (excluding ACC earner's levy) per week. This amounts to $137.30 and less than the $165.76 that she should be paying if she were taxed at the right rate. As Sarah is being taxed at the incorrect rates for only one week, being the last week of the tax year, she will have tax to pay at year-end of $28.46.

As this not more than $50, the tax will not be required to be paid as per schedule 8 clause b part 1(a).

For the sake of completeness, it is also worth pointing out that, as Inland Revenue receives information by way of pay day reporting, Sarah's use of incorrect tax codes will be picked up early in the following income year. As the income she receives from her two jobs crosses an income tax threshold, a tailored tax code would be more appropriate for her as opposed to a secondary tax code. Inland Revenue would therefore contact Sarah and recommend she selects a tailored tax code. If Sarah did not consent to this, Inland Revenue would instruct her second employer to adopt a secondary code – as using two M codes is an incorrect use of tax codes. In Sarah's case she would be better off accepting a tailored tax code as this will ensure about the right amount of tax is deducted during the year.

(b) All income from income-tested benefits

When an individual receives all of their income from an income tested benefit, education grant or a payment of NZ superannuation/veterans' pension (or a combination of these), and an amount of tax payable arises at year-end, then this amount will not have to be paid by the individual.

The purpose of this rule is to deal with an apparent under-withholding of PAYE in the situation where a person may receive a payment for a back-year entitlement.

Example 6 - Cameron

Cameron is a 64-year-old beneficiary and is in receipt of a benefit for part of the 2018–19 tax year. Cameron turns 65 on 1 November 2018 and begins receiving NZ Superannuation from that date.

It transpires that Cameron is owed a back-paid benefit entitlement due to being underpaid in a previous tax year. In the event that the calculation of the tax payable on this back payment led to a tax bill at year-end, that tax would not need to be paid by Cameron.

This is because, for the purposes of schedule 8, part B, clause 1(b) of the TAA, this constitutes an amount of tax that relates to reportable income derived solely from income sources in clause 1(b). For the purposes of this rule, it does not matter that Cameron derived income from a combination of the sources listed in clause 1(b) (in his case a benefit and NZ superannuation).

(c) Extra pay period in the corresponding income year

If an individual who only earns reportable income which has been taxed at the correct rate has tax payable at year-end that has arisen **solely** because of an extra pay period, then that amount of tax owing will not need to be paid.

Example 7 - Sam

Sam is an employee earning salary income which is paid weekly and from which his employer deducts PAYE each pay day.

Last year Sam's annual salary was $78,000. Each week Sam earned $1,500 from which Sam's employer withheld $320 PAYE (excluding ACC earners' levy) each pay-day. Because of the day on which his salary is paid, last tax year Sam received 53 weekly salary pays in the tax year (a standard tax year has 52 pay-days).

Because the PAYE system is based on 52 weekly pay days occurring in a tax year, Sam has a tax shortfall of $175. (He received $79,500 salary income in the tax year, but his weekly PAYE was based on $78,000).

Sam would not be required to provide any income information to Inland Revenue. Inland Revenue would consider what it knows about Sam. There would be no reason to suggest that Sam needs to provide any information to Inland Revenue, as Sam only earns reportable income which has been taxed at the correct rate, he will not have to pay the extra tax that has arisen due to the extra pay period.

Exclusions (Schedule 8, part B, clause 2)

As mentioned above, there are three categories under which a reportable income earner may be eligible for a write off. These are:

- if the amount of tax payable does not exceed $50;
- if the income is derived solely from certain income tested benefits; or
- an amount of tax to pay on income derived from extra pay period in the income year.

The purpose of schedule 8, part B, clause 2 is to set out the exclusions that apply to these write off rules.

If the amount of tax payable does not exceed $50

As per Schedule 8 Part B clause 1(a), tax payable that does not exceed $50 will be written off. This applies irrespective of whether the taxpayer has complied with any other obligations. The purpose of this rule is to ensure administrative efficiency and to ensure consistency with the *de minimis* threshold for the provision of other income information (currently set at $200). There are **no exceptions** to this rule.

If the income is derived solely from certain income tested benefits

In order to qualify for a write-off under this rule, a taxpayer's income must be derived **solely** from an income tested benefit, education grant or a payment of NZ superannuation/veterans' pension.

It is acknowledged that there may be instances when an individual who qualifies under this rule may earn a small amount of additional income which should not necessarily disqualify them from a write-off. Schedule 8 Part B clause 3 provides that, despite the rule, the Commissioner may write off an amount of tax if the amount is not substantial and represents an underpayment of tax that is attributable to a function or operation of the tax collection rules.

Example 8 - Cameron

As mentioned in example 6, Cameron is a beneficiary and receives $250 per week (gross), or $13,000 pa. Cameron received a call from MSD informing him that they had miscalculated his entitlement for the 13–14 tax year and that he was owed $3,000. As Cameron's income was derived solely from an income-tested benefit, it was concluded that Cameron's $210 tax bill would be written off.

Consider a modification to that scenario whereby, instead of solely deriving his income from an income tested benefit, Cameron also had a small amount of money in an interest-bearing bank account. In that situation, although Cameron's income is no longer solely derived from an income-tested benefit, Schedule 8 Part B Clause 3 would kick in to ensure that Cameron still received the write off.

The threshold set under Schedule 8 Part B Clause 3 will be set administratively.

The other exception that applies to the write off rule for income derived solely from certain benefits, is the Working for Families Tax Credit (WfFTC) exception under Schedule 8 Part B Clause 2(1). This means that, if the taxpayer receives WfFTC, they will be unable to receive a write off under this rule.

If the income is derived from an extra pay period in the income year

As with the two above rules, if a taxpayer receives WfFTC, the taxpayer will not be eligible for a write-off of income derived from an extra pay period (see Schedule 8 Part B Clause 2(1). The application date for this extra pay rule is deferred until 1 April 2020.

Example 9 - Sophia

Sophia works at a meat processing plant and earns $38,000 per annum. She has 5 kids and her husband stays at home to look after them. Sophia is also a recipient of WfFTC.

Because of the day on which she is paid, Sophia receives 53 weekly pays in the tax year (a standard tax year has 52 pay-days for weekly earners). Because the PAYE system is based on 52 weekly pay days in a tax year, Sophia has a tax shortfall of $28.88 from her PAYE income at year-end. (She received $38,731 salary income in the tax year, but her weekly PAYE was based on $38,000).

Schedule 8 Part B Clause 1(c) provides that an amount of tax that arises solely because an individual has an extra pay period will be written off. However, the exclusion in clause 2(1) of this Part provides that a taxpayer will not qualify for an extra pay write off where the taxpayer has been assessed as receiving an entitlement and tax credit under the family scheme (receives working for families).

This means that Sophia would ordinarily have to pay the $28.88 shortfall that arose as a result of the extra pay. However, in this case, because the amount is still under $50.00, it will be written off as per Schedule 8 Part B clause 1(a).

A taxpayer will also not qualify for a write off under this rule if, for the types of income referred to in Schedule 8, Part B, clause 2(3):

- the Commissioner has recommended, and the individual has consented to a change to a higher tax code or rate; or
- the individual has used a tailored tax code.

The types of income listed in Schedule 8, Part B, clause 2(3) are:

- any income where the obligations of the individual under the PAYE rules are not met;
- investment income where RWT is withheld at a rate lower than the correct rate;
- schedular income, income from employment that is an extra pay or secondary employment where tax has been withheld at a rate lower than the correct rate;
- an amount of income derived from a Maori authority distribution or derived using the EDW or CAE code where the individual's gross annual income is more than $48,000; and
- employee share scheme income where the employer has not elected to withhold tax.

Example 10a - Thomas

Thomas works as an accounting intern and earns $40,000 per annum. Thomas also has a $100,000 inheritance which he has invested in a term deposit with his local bank yielding him 4% interest pa. At the time Thomas deposited the money, 17.5% was the most suitable RWT rate for his interest income.

Thomas leaves his intern position and takes up a position at another accounting firm as an analyst, starting 1 April 2019. Thomas's new salary is $78,000 per annum. Although Thomas's marginal tax rate for the 2018–19 income year will be 33% due to his new job, Thomas forgets to update his RWT rate with the bank.

Inland Revenue notices that Thomas's salary has increased and that 33% is a more appropriate RWT rate for him to be on for his interest income. Inland Revenue picks this up by way of a proactive action and on 20 April suggests that Thomas consents to an increased RWT rate. Thomas consents to the change.

Because of the day on which Thomas gets paid for his new job, he receives 53 weekly pays in the tax year (a standard tax year has 52 pay-days for weekly earners). Because the PAYE system is based on 52 weekly pay days in a tax year, Thomas has a tax shortfall of $175 from his PAYE income at year-end (he received $79,500 salary income in the tax year, but his weekly PAYE was based on $78,000).

Schedule 8 Part B Clause 1(c) provides that an amount of tax that arises **solely** because an individual has an extra pay period will be written off. However, the exclusion in clause 2(2) of this Part provides that a taxpayer will not qualify for an extra pay write off when the Commissioner has recommended, and the individual has consented to, a change in tax code or rate to a type of income in clause 2(3). The Commissioner recommended a change to Thomas's RWT rate and Thomas accepted this change. RWT on investment income that is withheld at a rate lower than the correct rate is listed in clause 2(3).

This means that Thomas will have to pay the $175 shortfall that arose as a result of the extra pay. He will also have some tax payable on his interest income to account for the period of time where he commenced his higher paying job but was still on the unsuitable RWT rate of 17.5% for his interest income.

For the sake of completeness, it is also noted that if Thomas had rejected the proactive action and had remained on the 17.5% interest rate for his investment income he would still have the same amount of tax payable at year- end. This is because Schedule 8 Part B Clause 1(c) requires the amount of tax payable to arise **solely** from the extra pay period in order for it to be eligible for a write off. In Thomas's case, there is also an amount of tax payable that has arisen due to the use of an unsuitable RWT rate at a time where his taxable income has increased (by virtue of the new job). Thomas is therefore not eligible for any form of write off.

Example 10b - Paul

Paul works two days per week as an engineering consultant for a small technology start up and is paid $35,000 per year. Paul starts another job for two days per week, on 1 April, as a project manager on a large building site and earns $25,000 per year. Because Paul's secondary income crosses an income tax threshold, Paul should ideally be on a tailored tax code for his project manager salary to ensure that about the right amount of tax is withheld during the year.

Paul initially elects an "M" tax code when he starts his job as a project manager. If an M tax code is used for concurrent sources of income, there will be multiple claims to the lowest (or lower) tax rates resulting in tax to pay at year-end due to this overuse of the lower tax brackets. This is an incorrect tax code for Paul to be on. Inland Revenue notice that Paul is on an incorrect tax code, and by way of a proactive action, suggest that he adopt a tailored tax code for his second job. Paul adopts the tailored tax code after 4 weeks.

Because of the day on which Paul is paid by the technology start up, Paul will have 53 pay periods in the year. Paul will therefore receive some income that has not been subject to the correct withholding and will have a tax shortfall at year-end. Paul will also have a small amount of tax payable to account for the period of time during which his second job (project manager) was also using the lowest tax rate.

Schedule 8 Part B Clause 1(c) requires the amount of tax payable to arise **solely** from the extra pay period in order for it to be eligible for a write off. Although Paul has some tax to pay that has arisen due to his extra pay, he also has a small amount of tax to pay due to being on an "M" tax code for part of the year for his project manager salary. Paul is therefore denied the write off.

Example 10c - Paul (variation)

If we consider a variation of the above example with Paul, but instead of Paul selecting an "M" tax code when he starts his second job as a project manager, Paul sets up a tailored tax code from the outset. This means that a more appropriate amount of tax will be withheld from his project manager salary throughout the year.

Although Paul will receive an extra pay from the technology start-up which will not be subject to withholding, he will be eligible for a write-off of this amount. This is because the amount of tax payable has arisen **solely** due to the extra pay period. Moreover, although Paul has used a tailored tax code, the tailored tax code was not applied to secondary employment earnings from which tax was withheld at a rate lower than the correct rate. In this case, the tailored tax code was applied to the secondary employment earnings from the beginning of the tax year and was therefore always withheld at the correct rate.

Schedule 8 Part B clause 3 provides that, despite the exceptions, the Commissioner may write off an amount of tax if the amount is not substantial and represents an underpayment of tax that is attributable to a function or operation of the tax collection rules.

Order in Council amending schedule 8 – 22J(3)

New section 22J(3) provides that amounts of tax may be added to or removed from schedule 8 part B, clause 1 and 2 by Order in Council. Schedule 8 Part B clause 1 sets out the types of tax payable that must be written off under the individual's write off rules. Clause 2 sets out when an amount of tax does not qualify for a write off under clause 1.

In accordance with section 22J(4), appropriate consultation must be undertaken on the proposed amendments before a Minister recommends a change by Order in Council.

The purpose of this rule is to ensure that there is flexibility in the law to deal with any unforeseen or changing circumstances in a timely manner without having to go through the full legislative process to make a change. As consultation is a requirement under 22J(4), this will ensure that differing views are considered adequately on any given proposal.

Changes to the refund provisions for back years

This section of this TIB item outlines changes made to the refund provisions for back years. Although these changes are not part of the substantive proposals under the new individuals' income regime, these changes are important to ease the transition between the previous law on income statements and the new rules for individuals.

Amendments to section RM 2 and its predecessors for refunds of overpaid tax

Section RM 2 of the Income Tax Act 2007 and its prior equivalents (MD 1 of the Income Tax Act 2004 and MD 1 of the Income Tax Act 1994) have been amended to simplify the section and to alleviate an ambiguity regarding the application of the time bar to various tax types (for example – income tax vs ancillary taxes and approved issuer levy). An amendment has also been made to section RM 4 of the Income Tax Act 2007, which deals with overpayments on amended assessments, to ensure that the time bar application is unambiguous in this section as well.

More significantly, the Act inserts section RZ 16 into the Income Tax Act 2007 and section MD 1C into the 2004 and 1994 Income Tax Acts. The purpose of these amendments is to ensure that RM 2 and its predecessors apply consistently for back years.

The way that section RM 2 currently applies limits a taxpayer's ability to claim a refund from an amended assessment to a four-year period, but the ability to claim a refund from the original return is unlimited. This is consistent with the policy intent. There is a period during which this section and its predecessors restricted a taxpayer's ability to claim from an original return to four years from the end of the tax year in which the taxpayer provides the return. The purpose of the amendments, which are retrospective in nature, is to ensure that the section applies consistently across all time periods and allow for previously time barred refunds to be paid out.

Example 11 - Adam

Adam is due a tax refund of $40 for the 2007–08 tax year. Inland Revenue does not have any contact details or a bank account for Adam and is unable to pay out the refund. Inland Revenue sends a letter to Adam's last known address advising him of the refund and asking him to contact Inland Revenue with bank account details.

Adam eventually receives the letter via a forwarding service six years later and calls Inland Revenue for the refund. The refund is time barred and is unable to be paid out to Adam. This is because the law that applied for the 2007–08 tax year restricted a taxpayer's ability to claim a refund to a four-year period.

It is noted that had the same situation occurred for the 2003–04 tax year, Adam would be able to claim the refund at any point in the future. This is because the restrictive application of the provision did not apply at this time.

The amendments made to these refund provisions ensures that refunds are treated consistently across all periods. This enables old refunds, such as the one in Adam's situation, to be paid out.

Repeal of section RM 5 and new provisions to govern the treatment of certain refunds made on income statements for back years

This Act repeals section RM 5 of the Income Tax Act 2007, along with all other law pertaining to income statements. Section RM 5 required a refund over a certain threshold to be confirmed as correct by the taxpayer before it could be paid out.

The application of section RM 5 meant that, when a taxpayer died, and no administrator or executor had been appointed, nobody could legally confirm the deceased's income statement as correct. This meant that the refund would sit in Inland Revenue's system indefinitely and could not be refunded.

New section RZ 15 has been added into the Income Tax Act 2007 and section MD 1B into the 2004 and 1994 Income Tax Acts to address this issue. These amendments allow for someone to act on behalf of a deceased person to confirm the refund when that person has died, no executor or administrator has been appointed and the refund amount is less than $15,000.

Example 12 - Juliet

Juliet is due a tax refund of $800 for the 2015–16 tax year. In accordance with the requirements in section RM 5 of the Income Tax Act 2007, Inland Revenue sends Juliet a letter requesting that she confirm the correctness of her income statement. This is necessary before the refund can be paid out. Juliet dies before receiving the letter.

Juliet dies intestate (without a will). Her estate is not worth much money, so there is not a sufficient incentive for her relatives to apply for letters of administration to deal with her estate (this can be costly and time consuming).

The law that applied prior to these amendments meant that nobody could legally confirm the correctness of Juliet's income statement. This meant that the refund could not legally be released. The amendments in this Act allow for relatives to confirm the correctness of an income statement to ensure that refunds owing to a deceased taxpayer are able to be paid out.

Provision of income information for deceased taxpayers

In order to ensure that the new individuals' income proposals work effectively, new subsections 22F(5) and (6) provide a mechanism through which certain prescribed persons can provide income information on behalf of a deceased taxpayer.

Similar to the situation set out above in the example with Juliet (which exists under the old law), under the new individuals' income tax rules it is important to ensure that income information is provided to Inland Revenue for a deceased taxpayer so that the taxpayer's tax position can be finalised. The inclusion of these new provisions makes it easier for Inland Revenue to finalise the account of a deceased person (further information is available in the operational statement OS 19/02 on the Inland Revenue website).

Example 13 - Adam

Adam works in an office and earns salary and wages. He also has three rental properties and has previously filed IR3 returns. Upon the introduction of the individuals' income tax changes for the 2018–19 tax year, Adam starts providing this "other income" to Inland Revenue so that his tax position can be can be finalised at year-end.

In 2022 Adam sadly passes away without a will. As there is no executor, no one can step into Adam's shoes and officially deal with his affairs. To ensure that his tax position can be resolved, new section 22F(5) and (6) allow the Commissioner to accept income information from a prescribed list of persons, such as relatives, to finalise Adam's tax position.

PROACTIVE ACTIONS

Sections 24DB and 25A of the Tax Administration Act 1994

Several amendments have been made to enable Inland Revenue to take proactive actions during the year to help people use appropriate tax rates or codes to minimise year-end debts and refunds.

Background

Previously, if an individual was using a tax code which they were not entitled to use, Inland Revenue would contact their employer and instruct that the code be changed. If an individual was using a code that was not wrong per se, but did not reflect their likely year-end tax liability, Inland Revenue lacked the relevant information to suggest corrective action. This would result in a debt or a refund at the end of the year when the individual squared up their tax position.

One of the key objectives of the changes to individuals' income tax is to ensure that individuals pay about the right amount of tax during the year, thereby minimising instances where there is a large debt or refund at year-end. To support this objective, Inland Revenue will utilise the more frequent employment and investment income information it receives to suggest corrective action where projections suggest that an individual is likely to end up with a material under or overpayment of tax because of the withholding rate they are using. This means that Inland Revenue will now contact an individual who is either on an incorrect or an unsuitable rate or code. The difference is that an individual can choose not to accept the change when their current code or rate is merely an unsuitable one.

Suggesting that individuals adopt more appropriate rates will improve how secondary and irregular sources of income are taxed and strengthens the overall perception that the tax system operates fairly throughout the year.

Key features

The changes are as follows:

- Inland Revenue will monitor changes in a person's earnings and identify when they may be using an incorrect or unsuitable tax code or rate.
- Inland Revenue will contact individuals who use an incorrect or unsuitable code or rate and recommend they change it.
- If the individual consents to the change in code or rate, Inland Revenue will notify the employer or payer to update the code or rate.

Application date

The amendments apply from 1 April 2019.

Detailed analysis

In order to understand what these amendments aim to achieve, it is important to appreciate the distinction between an "incorrect" tax code and an "unsuitable tax code". An individual's tax code will be deemed incorrect when they are using a tax code that they are not entitled to use (for example – if a taxpayer has a student loan but is on an "M" tax code instead of "M SL"). The current position under the law will remain unchanged for incorrect tax codes and Inland Revenue will continue to contact the individual's employer and instruct that the code be changed.

An "unsuitable" tax rate or code is used to describe situations where an individual is using a code they are eligible to use, but when projections suggest that the individual is likely to end up with an under or overpayment of tax.

Use of unsuitable tax codes – Section 24DB

Under this section, if an individual who receives PAYE income is on an unsuitable tax code, Inland Revenue may recommend a prospective change to the tax code and, with consent of the individual, notify the employer of the change.

Example 1 - Susanna

Susanna earns a salary of $42,000 per annum. Her current tax code is "M", which is a code that she is entitled to use. Given that Susanna earns below $44,000, she is entitled to the full independent earner tax credit of $520 per year. In order to obtain this tax credit Susanna would need to be on an "ME" tax code or, if she has a student loan "ME SL".

As a result of the changes, Inland Revenue would contact Susanna and let her know that an "ME" tax code would be a more appropriate code for her to be on. If Susanna consents to the change, Inland Revenue will instruct her employer to update her tax code to "ME".

The new tax code would apply to PAYE income earned after the employer has been instructed to change the tax code or rate.

Use of unsuitable RWT rates – Section 25A

Section 25A provides that Inland Revenue may contact an individual regarding their use of an unsuitable tax rate for their investment interest income and recommend a prospective change to a more suitable RWT rate.

If the taxpayer consents to the change, Inland Revenue will notify the investment income payer. Once notified of the rate change, the investment income payer must update this as soon as reasonably practicable. If the taxpayer subsequently notifies the income payer of a different rate, the payer must apply the rate notified by the taxpayer.

Example 2 - Thomas

Thomas set up an interest-bearing bank account ten years ago. He selected the 17.5% tax rate, which was right at the time.

Thomas earns more now than he did ten years ago, so in order to have tax deducted at the most appropriate tax rate he should have increased the tax rate, but he didn't think of this.

Thomas earned $1,000 of interest this year, from which his bank withheld $175 of tax. Because Thomas' marginal tax rate has increased to 33%, $330 would have been a more appropriate amount to withhold (33% tax rate). As his tax rate was not updated, Thomas will be required to pay $155 of outstanding tax ($330 - $175) at the end of the year because less tax was withheld from his interest income than is ultimately due on that interest income.

Due to the changes, Inland Revenue could contact Thomas and let him know that 33% is likely to be a more appropriate tax rate for his interest income. If Thomas consents to the change, Inland Revenue will instruct the bank to change the rate to 33%.

TAILORED (SPECIAL) TAX CODES

Sections 24D and 24DB of the Tax Administration Act 1994

Several amendments have been made to enable Inland Revenue to help individuals use tailored tax codes to ensure that the rate of withholding tax on their income, including secondary sources of income, is appropriate during the year.

Background

A special tax code, now referred to as a tailored tax code, applies a tailored rate of withholding to a taxpayer's income. When a person is working multiple jobs or working while receiving a benefit from the Ministry of Social Development, a tailored tax code can help ensure that the individual pays about the right amount of tax during the year and is not left with a large tax bill or refund at year-end.

Although secondary tax codes and special tax codes were available to individuals under previous law, there were several limitations with that system that are rectified by this Act.

Secondary tax codes

Secondary tax codes are intended to ensure that income from a subsequent job is taxed at the appropriate marginal rate.

Example 1 – George and Mary

George has one job with a salary of $53,000 on which he will pay $8,920 in tax each year. This is comprised of $1,470 of tax paid on the first $14,000 of income at 10.5%, $5,950 from $14,001-$48,000 taxed at 17.5% and $1,500 from $48,001–$53,000 taxed at 30%.

Mary earns $48,000 from her main job and $5,000 from her second job ($53,000 total) on which she will also pay $8,920 in tax each year. This is comprised of $1,470 tax paid on the first $14,000 at 10.5%, $5,950 from $14,001–$48,000 taxed at 17.5% and then, because a secondary tax code is applied at her marginal rate, the $5,000 from her second job will be taxed at 30%, resulting in $1,500.

The above example demonstrates that secondary tax codes will work as intended when an income tax threshold has not been crossed. However, as we have a progressive personal tax scale, secondary tax codes can result in more tax being withheld during the year than is necessary to satisfy the individual's tax liability. This occurs when income from a second job takes a person's total income over a tax threshold.

Example 2 - Sophie

Sophie earns $35,000 from her main job and $18,000 from her second job ($53,000 total) on which she will pay $10,545 in tax each year. This is comprised of $1,470 tax paid on the first $14,000 at 10.5%, $3,675 from $14,001–$35,000 taxed at 17.5% and then, because a secondary tax code is applied at her marginal rate, the $18,000 from her second job will be taxed at 30%, resulting in $5,400.

Sophie will be owed a refund of $1,625 at the end of the tax year.

Example 2 above results in an overpayment of tax because, by taxing the entire $18,000 that Sophie earns from her second job at her marginal tax rate of 30%, the secondary tax code operates to deny Sophie the full use of the middle tax band. In her case, only income from $14,000 – $35,000 was taxed at 17.5%, as opposed to income from $14,000 – $48,000. Secondary tax codes are set at a taxpayer's marginal rate to prevent multiple claims to the lowest (or lower) tax rates for people with multiple sources of PAYE income. If it weren't for secondary tax codes, taxpayers may receive an unexpected tax bill at the end of the year.

Consider example 3 below:

Example 3 - Sophie

If Sophie used an "M" tax code for both of her jobs, then the following would apply:

Job 1 (salary of $35,000): $1,470 tax paid on the first $14,000 at 10.5%, $3,675 from $14,001-$35,000 taxed at 17.5% = $5,145.

Job 2 (salary of $18,000): $1,470 paid on the first $14,000 at 10.5% and $700 tax paid on income from $14,000-$18,000 taxed at 17.5% = $2,170

Total tax paid = $7,315 (compared with $8,920 that should be paid by somebody earning $53,000).

Sophie will have tax to pay of $1,605 at the end of the tax year.

As example 3 demonstrates, Sophie would have a tax bill of $1,605 at year-end if she used the M tax code for both of her jobs. Secondary tax codes are a somewhat blunt instrument designed to prevent over and under deductions from arising as they can only apply at a taxpayer's marginal rate. This works where the secondary income doesn't cross a tax threshold but causes the taxpayer to overpay tax if it does cross a threshold. Secondary tax codes are still used as the default option as they work in the majority of cases and because a more blended or tailored rate cannot be applied by default without knowing a taxpayer's pattern of earnings.

In order to limit instances of incorrect withholding, individuals who work multiple jobs and are able to estimate their likely annual income could opt for a tailored tax code, which gives a withholding rate that is tailored to their personal circumstances.

Tailored (special) tax codes

Although the previous system allowed an individual to apply for a special tax code to help ensure that the correct amount of tax was withheld during the year, special tax codes were not easily accessible to all individuals. This was because:

- an individual first needed to know about special tax codes;
- they needed to realise that using one could benefit them; and
- they needed to be able to estimate their likely annual income.

The process for obtaining a special tax code was also administratively burdensome and required an individual to fill out an application and post it to Inland Revenue. Inland Revenue would then calculate the appropriate withholding rate and grant the individual a special tax code and a certificate that was only valid until the end of the tax year. The individual was then required to advise their employer that they wanted the special tax code applied to their income. As a consequence of all of this, only approximately 8,000 individuals used a special tax code for the 2016 year (approximately 570,000 people were using secondary tax codes and a larger proportion of these people could have benefitted from using a special tax code if their secondary income took them over a tax threshold).

Key features

The newly enacted provisions make tailored tax codes more accessible and customer centric. The changes are as follows:

- The process of applying for a tailored tax code has been simplified (including being able to apply online).
- Inland Revenue will monitor changes in a person's earnings and identify when a person may benefit from using a tailored tax code.
- Inland Revenue will proactively contact individuals who may benefit from using a tailored tax code and recommend that they consider changing their code.
- When an individual has consented to a change to a tailored tax code, Inland Revenue will notify an individual's employer of their updated tax code.

Application date

The amendments apply from 1 April 2019.

Detailed analysis

Tax codes provided by the Commissioner – Section 24D

Section 24D has been amended to allow the Commissioner to recommend a tailored tax code to an employee.

The amendment to this provision ensures that Inland Revenue can recommend tailored tax codes as part of the proactive actions it undertakes. That is, where the information Inland Revenue receives about an individual suggests that the individual may end up with an under or overpayment of tax because of the withholding rate they are using, the Commissioner can recommend a tailored tax code to help the taxpayer to pay the right amount of tax during the year.

Use of unsuitable tax codes – Section 24DB

As previously mentioned under "proactive actions", when a taxpayer who receives PAYE income is on an unsuitable tax code, section 24DB allows Inland Revenue to recommend a prospective change to that code, and with the consent of the individual, notify the employer of the change. A change to a more suitable code includes a change to a tailored tax code.

Example 4 - Sophie

The following example demonstrates how a proactive action could be used to assist Sophie in selecting a tailored tax code. As per the previous example, Sophie earns $35,000 per annum from her main job and $18,000 per annum from her second job. The secondary tax code that applies to her second job means that all income she earns from this source is taxed at her marginal tax rate of 30%.

Sophie's tax year commences 1 April 2019. Inland Revenue receives Sophie's salary and tax information by way of pay day reporting and, after a few weeks, notices that Sophie has a regular pattern of earnings that is currently being overtaxed. As set out in the initial example with Sophie, if the current rate of taxation continues, Sophie will be owed a refund of $1,625 at year-end. This is money that Sophie could be using during the year.

Inland Revenue writes to Sophie to advise her that she may benefit from a tailored tax code. The aim behind the tailored code is to ensure that, where possible, there is no refund due or tax to pay at year-end. This means that the tailored rate of tax required to be applied to Sophie's secondary income will vary slightly based on the point during the tax year at which it is adopted. This is because the tailored tax code should take into account any under or over withholding that occurs at any point during the tax year to try to reach a net zero position at year-end. Consider the following variations:

Example 4a

Inland Revenue writes to Sophie four weeks after the commencement of the tax year and Sophie immediately consents to a tailored tax code.

Assuming Sophie is paid weekly, in this situation Sophie would have only received four pays from her second job from which tax had been over withheld, representing an over withholding of $118. To ensure that Sophie has no tax to pay or refund due at year-end, the tailored tax code that would need to be applied to Sophie's second source of income going forward will be approximately 20%. As Sophie has consented to this rate, Inland Revenue will instruct the employer at her second job to update the rate.

Example 4b

Although Sophie receives Inland Revenue's letter suggesting she accept a tailored tax code four weeks into the tax year, Sophie does not get in contact with Inland Revenue to set up a tailored tax code for a further six weeks. This means that Sophie will have received 10 pays from her second job from which tax had been over withheld, representing an over withholding of $295. For Sophie to have no tax to pay or refund due at year-end, the tailored tax code that would need to be applied to Sophie's second source of income going forward will be approximately 19%.

Example 4 above demonstrates that, in order to ensure that a taxpayer pays about the right amount of tax during the year, a tailored tax code needs to not only consider pay periods going forward, but also needs to consider any under or over withholding that occurred earlier in the tax year.

It is noted that there are some situations where it may not be appropriate to use a tailored tax code to ensure a "net zero" position at year-end. For example, a tailored tax code that fully recovers the underpaid tax would be unsuitable if a taxpayer has had their tax under withheld and there are not enough pay periods left until the end of the year to correct the under withholding without putting the taxpayer into hardship.

Inland Revenue will take this into account when deciding whether it's appropriate to recommend a tailored tax code to a taxpayer. This should prevent any hardship caused by imposing a very high tailored rate for any remaining pay periods for the tax year.

THE ADMINISTRATION OF DONATIONS TAX CREDITS

Section 41A of the Tax Administration Act 1994

Several amendments have been introduced to simplify the process for claiming donation tax credits. Inland Revenue will now accept donation receipts which are submitted electronically via myIR and submitted during the year. There is the option to file a separate donation tax credit claim if the payer chooses to do so.

Background

Previously, credits for donations could be claimed at the end of the tax year by filling in a *Tax credit claim form (IR526)*, or during the year through Payroll Giving, where the credits would be received immediately. An IR526 is a paper-based form, and paper versions of receipts had to be saved and submitted with this form at the end of the year.

These changes simplify the process for claiming donation tax credits and make it more flexible. Under the changes, they have the option to submit receipts electronically when they receive them, which reduces the risk that they could be forgotten or lost before being able to be submitted. The tax credit claim process (the IR526) will be retained as an option for those who prefer to file their donation tax credit claim separately. At year-end, if a person has submitted donation receipts during the year and Inland Revenue considers the person is entitled to the donation tax credit, the refund will be issued without the need to submit a tax credit claim request.

Key features

The key changes are as follows:

- Donations receipts can be submitted during the year and can be submitted electronically.
- Donations tax credits can be claimed as part of the income tax year-end process.
- If an individual has already submitted receipts during the year, these will automatically be taken into account without the individual having to fill in a separate claim form.

Application date

These amendments apply from 1 April 2019.

Detailed analysis

Returns by persons with tax credits for charitable or other public benefit gifts (section 41A amended)

Section 41A(1) prescribes the ways in which a person may apply to have their tax credit refunded. In practice, a person may:

- upload donation receipts through myIR during the year;
- complete the relevant donation section when providing other income information through the pre-populated account;
- complete a separate return online through myIR (that is – if done after other income information is provided); or
- complete a paper form.

Example 1 - Olivia

Olivia is crazy about animals and always donates money each week to a local animal charity that campaigns outside her office building. Olivia is tax savvy and always ensures that she receives a receipt with each donation. Under the changes, Olivia does not have to wait until the end of the year to submit her receipts with the paper based IR526 form at the end of the year.

Each time she donates, Olivia uploads her receipts electronically on myIR. At year-end Olivia receives the refund automatically without having to do anything.

Section 41A(6B) ensures that donation tax credit claims are subject to the same time bar rules that apply to income tax returns. This means that the Commissioner cannot amend a tax credit claim (either adjust up or down) after 4 years have passed from the end of the tax year in which the taxpayer submits the donation tax credit claim.

MISCELLANEOUS CHANGES RELATING TO THE INDIVIDUALS' INCOME TAX CHANGES

Sections YA 1(21) of the Income Tax Act 2007

All references are to the Income Tax Act 2007 unless otherwise stated.

Background

Under previous law individuals who only derived income from the following sources were not required to file tax returns:

- Income derived by an individual as a non-resident seasonal worker.
- Income derived by an individual as a provider of standard-cost house-hold services who derives exempt income under section CW 61(1).
- Income derived by an individual from providing personal services from which personal service rehabilitation payments are made when the taxable income of the income is not more than $14,000 for the income year and tax is withheld at a rate of 10.5% from the personal services rehabilitation payment.
- Non-resident passive income described in section RF 2(3) derived by a non-resident individual.

Key features

Amendments have been made to clarify whether individuals who derive the above sources of income will have filing requirements under the new individuals' income tax regime.

Application date(s)

The amendments apply from 1 April 2019.

Detailed analysis

Non-resident seasonal workers and non-resident passive income derived by non-residents

Income derived by non-residential seasonal workers and non-resident passive income derived by a non-resident are now included in the definition of a non-filing taxpayer in section YA 1(21). Where a taxpayer earns these sorts of income, the intention is that they sit outside the individuals' income tax changes and are not required to file a return. This minimises the compliance and administration costs that would arise if these taxpayers were required to file a return.

Standard-cost house-hold services

Income derived by a provider of standard-cost house-hold services is exempt under section CW 61(1). The definition of 'other income' in section 22D(4) of the Tax Administration Act 1994 now reflects that individuals who earn exempt income will not be required to provide information on this to Inland Revenue.

Personal service rehabilitation payments

Section 33C of the Tax Administration Act 1994, which provided that income derived by a carer providing personal services (if the amount is not more than $14,000) did not have to file a return, has been repealed. Under the individuals' income tax changes, all individuals will have their tax positions squared up at the end of the tax year. Repealing section 33C ensures that this group of income earners have their tax positions squared up at year end.

Modernising tax administration – Core aspects of the Tax Administration Act

INFORMATION COLLECTION, USE AND DISCLOSURE

Sections 10, 100, 101, 106 and 111 (inserting new sections 16-18J, 143C-E, 227F and new schedule 7 in the Tax Administration Act 1994)

This suite of changes modernises the information collection, use and sharing rules set out in the Tax Administration Act. They include:

- a rewrite of the information collection rules to make them clearer and easier to navigate;
- a new regulation-making power for regular large dataset collection;
- clarification that information collected for one revenue purpose may be used for other revenue purposes;
- a refocusing of the confidentiality rules on information about taxpayers;
- enhancements to the information sharing rules; and
- a restructuring of the confidentiality exceptions to improve clarity and navigability.

Background

Information is critical to Inland Revenue's ability to deliver services. Much of that information is provided by taxpayers. This may be information about themselves (such as in an individual or business income tax return) or about other taxpayers (such as in an employment information schedule). Inland Revenue has significant powers to enforce the provision of information that is not received through regular channels, but the use of these powers is the exception rather than the rule.

Inland Revenue's information collection powers are long-established, and generally work well. There is an established standard that where the Commissioner is using compulsory powers, this is only for information considered "necessary or relevant" to the Commissioner's functions. This gives an assurance that Inland Revenue will only use its powers to obtain information that is needed.

For taxpayers to be comfortable providing their information, they need to feel the information requested is reasonable and is treated appropriately by Inland Revenue. This assurance has been given by what is often referred to as the "tax secrecy" rule, previously set out in section 81 of the Tax Administration Act 1994 – which essentially stated that information provided to Inland Revenue will only be used for revenue purposes. Rules about the confidentiality of tax (and taxpayer) information are common across revenue agencies internationally. For most public sector agencies the primary rules governing collection, use and disclosure of information are set out in the Privacy Act 1993 and the Official Information Act 1982. However, for Inland Revenue, the Tax Administration Act 1994 provides the primary rules.

The confidentiality of tax information is important for three key reasons:

- It is seen as a balance for Inland Revenue's information gathering powers which, as for other revenue agencies, are widely-framed to ensure that taxpayers are meeting their obligations.
- Confidentiality has traditionally been considered necessary to promote compliance in the sense that taxpayers will be more willing to provide information to Inland Revenue if they are assured it will go no further.
- The importance of taxpayer privacy has also more recently been referred to by the Courts – and the right of taxpayers to have their affairs kept confidential is also recognised in section 6 of the Tax Administration Act 1994 in defining the integrity of the tax system.

"Tax secrecy", as it relates to the confidentiality of a taxpayer's individual affairs, is seen as a critical component of the integrity of the tax system, as reflected in the definition of integrity in section 6 of the Tax Administration Act 1994. However, the previous rules could lead to tensions, particularly between:

- confidentiality and wider government objectives, including the more efficient operation of government and the provision of services that can be achieved through increased cross-government information sharing; and
- confidentiality and the Official Information Act 1982 principle of open access to information held by government. Inland Revenue does, however, already share considerable amounts of information with other agencies.

These amendments aim to modernise and clarify the rules, better provide for confidentiality and sharing in the future, and more clearly balance the trade-offs inherent in decisions about whether information should be shared.

Key features

The information collection provisions have been rewritten in order to make them clearer and more navigable. There are no changes of substance with two exceptions:

- The introduction of a regulation-making power to govern the repeat collection of third-party datasets (new section 17L). This will provide a more efficient and transparent process for this type of collection, as distinct from the current ad hoc collection of such information using existing powers.
- Clarifying explicitly in the legislation that information collected for one Inland Revenue purpose can be used for the department's other functions (new section 17M).

The key amendments relating to confidentiality comprise:

- narrowing the confidentiality rule from its current coverage of all matters relating to the Inland Revenue Acts, to more clearly target information about taxpayers (new section 18, replacing previous section 81);
- providing a clearer exceptions framework, grouping the exceptions into categories and improving the navigability of the legislation (new sections 18B-18F and schedule 7);
- introducing a more flexible regulatory framework for information sharing to assist with the provision of public services (new section 18F, building on previous section 81BA); and
- allowing Inland Revenue to enter into agreements for information-sharing without need for regulations where the sharing will be done with customer consent (new section 18E). Again, this is linked to information-sharing for public service provision.

Application date

The changes apply from 18 March 2019, the date of Royal assent.

Detailed analysis

Information collection

The amendments modernise the information collection provisions by updating the language and removing some repetition. Provisions governing the collection use and disclosure of information are brought together in a new subpart 3A and rewritten in a more modern, navigable style. These amendments do not represent a policy change with the exception of one aspect, detailed below. A transitional provision (new section 227F) is included to make it clear that there is no policy change intended by the rewrite of these provisions.

Overarching purpose and principle sections have also been added to improve navigability and clarity. These new purpose and principle sections (new sections 16 and 16B) do not represent any policy change, rather they draw together the purpose and principles contained in the previous provisions.

A number of key terms are set out in new section 16C. These distinguish between "revenue information" and "sensitive revenue information" for the purposes of the subpart, and linked to the new confidentiality rule. "Revenue officer" and "revenue law" are also both defined, being modernised drafting of concepts from the existing legislation.

One policy change is included – introducing a new regulation-making power for repeat collection of certain data (new section 17L). This builds on the pre-existing power to collect information on an ad hoc basis by providing for regulations to be made where bulk data is considered necessary or relevant on a regular basis, with the aim of improving clarity and transparency in these situations.

A table is included at the end of this item detailing the section reference changes as a result of the enactment of Part 3A.

New section 17L – repeat collection of datasets

New section 17L inserts a new regulation-making power into the Tax Administration Act. This enables regulations to be made by Order in Council, authorising the collection, on a regular basis, of bulk data, where that collection is necessary or relevant for revenue purposes. A regulation must specify:

- the type of information to be collected;
- the person, or class of persons from whom it would be collected;
- the frequency of collection; and
- the form and specifications for the collection of the information.

The provision has a number of safeguards built in. Before recommending regulations the Minister of Revenue must be satisfied that:

- the regulations are necessary for the administration or enforcement of any of the Inland Revenue Acts or any other function lawfully conferred on the Commissioner;
- the proposed use of the information is consistent with the Inland Revenue Acts;
- the information to be collected is no more than necessary for the administration or enforcement of any of the Inland Revenue Acts or any other function lawfully conferred on the Commissioner;
- the regulations do not unreasonably impinge on the privacy of individuals, and contain safeguards that adequately protect the privacy of individuals; and
- a consultation process has been undertaken with those the Commissioner considers it is reasonable to consult with, including consultation with the Privacy Commissioner. Consultation on draft regulations would include an explanation of why they are considered necessary and how the proposed use of the information is consistent with the Inland Revenue Acts.

The provision also contains a statutory review requirement. This requires the Commissioner of Inland Revenue to conduct a review of the operation of the proposed provision, in consultation with the Privacy Commissioner. This review must be carried out five years after the proposed provision comes into force (but before the expiry of six years after it comes into force).

New section 17L does not alter the Commissioner's existing ability to collect large datasets on a one-off or ad hoc basis using the long-standing information collection power (new section 17B, previously section 17). This new power is specifically for situations where the information is to be collected on a regular, recurring basis.

Information use

Inland Revenue has a very broad range of functions. In many cases interactions with a customer may be for a particular purpose, or in relation to a particular product type, for example personal income tax or Working for Families tax credits. However, the information obtained may also be relevant for other purposes, for example the customer's student loan or child support accounts. Customers, both personal and business, have a range of different interactions with Inland Revenue and therefore information can be relevant for a range of purposes linked to Inland Revenue's various functions.

The Tax Administration Act 1994 charges the Commissioner of Inland Revenue with the care and management of the taxes and with other conferred functions. The care and management responsibility encompasses the requirement that the Commissioner carry out her functions in a way that makes the most efficient use of her resources. This requirement, coupled with the overarching requirement to protect the integrity of the tax system, suggests that the Commissioner should be able to make the most efficient use of information at her disposal in order to fulfil her various functions and responsibilities.

New section 17M clarifies that information gathered for the purpose of one revenue function is also able to be used for any of Inland Revenue's other functions. A similar approach is taken in the equivalent United Kingdom legislation which expressly provides that "information acquired by the Revenue and Customs in connection with a function may be used by them in connection with any other function".[1]

The principle that information obtained under the Tax Administration Act or any other Inland Revenue Act can be used for any revenue purpose includes reuse of information and use of the information in permitted disclosures pursuant to Inland Revenue's various information sharing provisions.

Example

Melanie calls Inland Revenue to update her details for Working for Families. She has moved to a new address with a new partner and now has another child in the care of the family. Inland Revenue recalculate her Working for Families entitlements and also update her address details for her child support, student loan and income tax accounts.

Confidentiality

In order to administer the tax system and associated social policy products, Inland Revenue collects and holds information on virtually all New Zealanders, as well as most corporate and other entities, such as trusts and partnerships. This is information that taxpayers are compelled to provide to Inland Revenue, and therefore it must be treated with care.

While the Privacy Act 1993 provides a framework for the collection, use and disclosure of personal information, much of the information held by Inland Revenue is non-personal, and no equivalent legislative framework exists. Given the breadth of the information Inland Revenue holds, and the sensitivity of some of this information, specific rules about confidentiality for Inland Revenue are important and have been retained.

[1] Commissioners of Revenue and Customs Act 2005, section 17.

A key issue with the previous rules about tax information was the difference between Inland Revenue and other government agencies in relation to official information. The Official Information Act 1982, which defines "official information" as including any information held by a department, provides a presumption of availability of information – that official information will be available to requestors unless there is a good reason for it to be withheld.

In contrast, the starting point of the rule relating to tax information was that Inland Revenue officers must maintain the secrecy of "all matters relating" to the Inland Revenue Acts. While the precise limits of the rule were not clear, it was apparent that this rule was not limited to information about taxpayers.

The breadth of the previous rule meant that a wide range of information, including information relating to procurement, analysis and statistics, information technology, finance and planning, policy development and even publicly available information was subject to the tax secrecy rule, unless a subsequent exception applied. Much of this information would not be considered confidential in the hands of any other agency.

As set out in the introduction to the information section, there are generally three key reasons given for confidentiality of tax information. Each of these reasons has at their core the protection of information about the taxpayers or entities that provide information to Inland Revenue. Each of the concerns – the impact on voluntary compliance, balancing information collection powers and the protection of privacy – is focused on the harm that would result from the disclosure of taxpayer (or entity) information. There does not appear therefore, to be a clear reason for the breadth of the previous secrecy rule and the inconsistency this created for Inland Revenue as compared with other agencies. The broad approach was also inconsistent with that taken in other jurisdictions such as Australia, Canada, the United Kingdom and the United States.

New confidentiality rule

Section 18 contains the new confidentiality rule. Rather than "all matters relating to" the Inland Revenue Acts, the new rule covers "sensitive revenue information". Sensitive revenue information is defined in section 16C as information that relates to the affairs of a person or entity that:

- identifies or could identify a taxpayer, whether directly or indirectly;
- might reasonably be regarded as private, commercially sensitive or otherwise confidential; or
- the release of which could result in loss, harm or prejudice to a person to whom or which it relates.

The rule therefore protects information about taxpayers, including where it might be commercially or personally sensitive. It protects not only information that directly identifies the taxpayer, but also information that could indirectly identify a taxpayer. The test is whether the information is "reasonably" capable of being used to identify a taxpayer. Whether this is reasonably capable of occurring depends on the facts, including the resources that would be required to use the relevant information to identify a taxpayer. However, if it is reasonably foreseeable that someone could identify a taxpayer using the information, including in combination with other information it is foreseeable that they have or could acquire, then the information should be treated as sensitive revenue information.

Examples, of how this applies in practice, to some extent taken from the Australian context where a similar rule is in place, are set out below.

Example: The "haysnorkel industry"

The Australian Tax Office (ATO) collects information on the volume of production of haysnorkels in Australia. Because haysnorkel production is a very specialised industry, only three firms manufacture haysnorkels in Australia. One major producer meets the needs of most of the Australian market, and two much smaller boutique producers manufacture only a small number of haysnorkels each year. If the ATO were to disclose information on the aggregate production of haysnorkels in Australia, then it would be possible for anyone with a general knowledge of the haysnorkel market to deduce (with a fair degree of accuracy) how many haysnorkels were being manufactured by each producer.

In this case, the disclosure of aggregate production information would allow a particular haysnorkel producer to be identified, despite not explicitly doing so. Such aggregate information would therefore be protected information.[2]

[2] This example is taken from the Australian (Commonwealth) Tax Laws Amendment (Confidentiality of Taxpayer Information) Bill 2010: Explanatory Memorandum, example 2.11 at paragraph 2.20. The Australian rules regarding "protected information" are similar to the new "sensitive revenue information" rules.

Example: Minerals resource rent tax

Following the introduction of the minerals resource rent tax (MRRT) in Australia, information was sought from the ATO about the amount of MRRT revenue collected. The ATO refused the requests initially as information from only one quarter was available and there was considered to be a significant risk that particular taxpayers and the amounts they had paid would be identifiable without much difficulty.

Following the receipt of a second quarter of revenue the information was disclosed. The decision to release the information was based on a range of factors, including:

- that the second quarter income was substantially larger than the first;
- the total number of MRRT payers;
- the degree of uncertainty with which such information could be used to deduce what a particular payer had paid;
- advice from the Australian Government Solicitor.[3]

Example: Sharing non-identifying data

A New Zealand NGO wants access to de-identified social sector data (from several social sector agencies and Inland Revenue) to support their service delivery. This will enable the NGO to assess which of their services are most effective and therefore better target services in the future.

The NGO does not hold individual authorisations to access identified data. It is seeking access to quarterly data that covers their customers and a comparable set of non-customers. Exact data point needs are expected to change over time.

Provided the data is aggregated or depersonalised to the extent that individuals cannot be identified, this information is no longer subject to the confidentiality rule. Access to such data might be directly from Inland Revenue or via a centralised data platform such as the Integrated Data Infrastructure managed by Statistics New Zealand, which contains data from a range of agencies including Inland Revenue.

A protection is also retained (new subsection 18(3)) for information that, while not specifically about taxpayers, is still highly sensitive and could adversely affect the integrity of the tax system or prejudice the maintenance of the law if released. This would include information about matters such as audit or investigative techniques or strategies, compliance information, thresholds, analytical approaches and so on. The release of such information, if not protected, could affect the Crown's ability to collect revenue.

Section 18(3) should be read in combination with section 6 with regards to integrity of the tax system. Therefore, it is necessary to consider whether disclosing the information would adversely affect taxpayer perceptions of fairness and impartiality, that all taxpayers must comply with the law, and that Inland Revenue keeps individuals' tax affairs confidential. A key consideration is the potential impact of releasing the information on compliance behaviour – information that would enable defrauding or gaming of the tax rules should not be released.

The other ground for withholding – the maintenance of the law – is a concept also contained in the Privacy Act 1993 and the Official Information Act 1982. In the Privacy Act 1993 this is described as relating to "law enforcement action by a public sector agency, including the prevention, detection, investigation, prosecution and punishment of offences."

Confidentiality certificates and declarations

As with the previous tax secrecy rule, section 18 sets out confidentiality requirements for Inland Revenue officers and for others who have access to Inland Revenue information. Section 18B sets out a requirement that before accessing information, officers and others must certify (or in the case of officers, complete a declaration) that they will comply with their confidentiality obligations. Previous declarations and certificates are treated as continuing to be valid under the new rule.

Confidentiality exceptions framework

The amendments restructure the exceptions to confidentiality into a clearer framework. Under the new structure the overarching rules are contained in the main provisions (sections 18C–18J) and the detail of most exceptions set out in new schedule 7. Other than as identified in this item, the content of schedule 7 is unchanged from previous legislation. A comparison of old and new provisions is included in a table at the end of this item.

While there has long been a rule of confidentiality applied to tax information, that protection is not absolute. There are a considerable number of exceptions allowing disclosure of information. Over time the number of exceptions increased which led to a legislative framework that was seen to lack clarity and clear unifying principles.

[3] "Swan reveals mining tax revenue" SBS News (8 February 2013) **https://www.sbs.com.au/news/swan-reveals-mining-tax-revenue**.

The amendments collect the exceptions into a clearer, more cohesive framework. Broadly the exceptions can be grouped into four main categories:

- disclosures for purposes related to the tax system;
- disclosures to the taxpayer or their agent;
- disclosures relating to international agreements; and
- disclosures to other government agencies for non-tax-related purposes.

The amendments group the existing exceptions as set out above, providing a clearer outline of the categories where exceptions are provided and then setting out the detailed exceptions in new schedule 7.

Carrying into effect

The first category of exceptions, set out in section 18D, relates to disclosures made in carrying tax laws into effect. Further details of each exception are set out in schedule 7, Part A. Section 18D encompasses the previous exceptions in sections 81(1) (carrying into effect), 81(1B) (disclosures relating to a duty of the Commissioner), 81(1BB) (disclosures in a co-located environment), and 81(3) (disclosures for court proceedings). The exceptions specified in clauses 3 to 13 of schedule 7 comprise previous exceptions that are also for purposes related to carrying into effect revenue laws.

Information sharing

Sections 18E and 18F relate to information sharing for public service provision. These provisions provide for such sharing in three ways:

- Under an Approved Information Sharing Agreement pursuant to Part 9A of the Privacy Act 1993 (previously section 81A).
- Under an agreement between agencies where information is to be shared with the consent of the taxpayer to whom it relates (new provision).
- Under regulations made under proposed new section 81F – this is a modified version of the regulation-making power previously contained in section 81BA.

Further detail about each of these information-sharing methods is contained in the next part of this item (*Information sharing*).

Disclosures to persons or their representatives

Section 18G authorises disclosures to the taxpayer themselves or their representative(s). Further detail is contained in schedule 7, Part B. The relevant clauses in the schedule replicate previous exceptions in section 81(4), specifically 81(4)(l) (disclosure to the taxpayer or their representative), 81(4)(lb) (tax pooling intermediaries) and 81(4)(ld) (software packages). Clause 16 brings together and broadens the existing exceptions in 81(4)(lb) and 81(4)(lc) (information regarding tax agents) to include the wider class of representatives covered by the proposed intermediary changes also included in this legislation (see the item on *Third party providers and intermediaries*).

This category also contains a new exception for disclosures to digital services providers. Clause 18, schedule 7 enables customers to use digital services to communicate with Inland Revenue, where the digital service is one that the Commissioner has listed as an accepted provider. This new provision is similar to the existing software clients provision (clause 17, schedule 7, previously section 81(4)(ld)) in that it permits disclosure to the provider of the service (in that case an accepted software package) as a consequence of a customer using that package or service to communicate with Inland Revenue.

Disclosures to other agencies

Section 18H and schedule 7, Part C set out specific legislative exceptions involving disclosures to other agencies. The exceptions set out in the schedule mirror those previously contained in Part 4 of the Tax Administration Act 1994 with no changes other than:

- minor changes for flow to combine provisions where an exception was contained in both section 81(4) and a subsequent section in Part 4;
- minor amendments to the sharing provision with Statistics New Zealand (schedule 7, clause 20). This exception has been updated to modernise the language, as unlike for most other agencies, it is considered appropriate to retain this sharing arrangement in legislation, rather than moving to a regulatory model. Retaining this as a legislative exception reflects the quantity and breadth of information shared, the nature of the sharing (for statistical and research, rather than operational purposes) and the statutory independence of both the Government Statistician and the Commissioner of Inland Revenue; and

- two proposed new authorisations arising from previously legislated rules. In both cases Parliament has already legislated for the information sharing in other statutes and the proposed amendments insert a parallel authorisation into the Tax Administration Act 1994:
  - Schedule 7, clause 23 enables the Commissioner to disclose information to a government agency or an Anti-Money Laundering and Countering Financing of Terrorism supervisor for the purpose of ensuring compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (see section 140(1) and 140(2)(k), (l) and (v) of that Act).
  - Schedule 7, clause 24 enables the Commissioner to disclose information to the New Zealand Customs Service in relation to a transfer price arrangement for the purpose of assessing the suitability of any such arrangement in relation to the use of provisional values under the Customs and Excise Act 2018 (see section 102(8) of that Act).

Disclosures for international purposes

Section 18I and schedule 7, Part D set out exceptions (previously sections 81(4)(k) and 88) for international disclosures. The exceptions set out in the schedule relate to double taxation agreements and reciprocal arrangements and are unchanged from the previous legislation.

Disclosures for risk of harm purposes

Section 18J contains an exception not previously expressly set out in the Tax Administration Act 1994. The section replicates the disclosure exception in the Privacy Act 1993 for situations where there is a serious threat to health and safety. The exception applies to allow disclosure where it is necessary to prevent or lessen a serious threat to public health or public safety, or to the life or health of a person. In determining the seriousness of the threat, matters taken into account are the event's likelihood, severity and immanency.

Any disclosure under this exception must only to be made to the person, body or agency which is able to do something to prevent or lessen the threat.

Example

An Inland Revenue staff member is speaking with a customer on the phone. During the call the customer makes comments and threats leading the staff member to think that the customer may harm themselves or others. In this situation information could be disclosed to the Police so they can take appropriate steps to prevent the harm.

Information sharing

The amendments build on Inland Revenue's previous rules for information sharing authorised by regulation and agreement. They provide for information sharing to be authorised by regulation by way of either:

- an approved information sharing agreement under Part 9A of the Privacy Act 1993. This is an existing exception previously set out in section 81A of the Tax Administration Act 1994; or
- an Order in Council under section 18F. This section is an amended version of the previous section 81BA. The amendments introduce greater consistency with the Privacy Act framework by extending the provision to enable sharing for the provision of public services, rather than being limited to government agencies.

A new provision is also included, allowing the Commissioner to enter into agreements for information sharing, where the consent of the customer will be obtained. These agreements do not require authorisation by order in council. In a similar way to the regulation-making sharing provisions, this type of sharing is limited to situations where the purpose is to facilitate the provision of public services.

Each of the alternatives relates to information sharing for public service provision. This is defined in section 18E(4) and mirrors the definition in the Privacy Act 1993 with regards to information sharing under Part 9A of that Act. This improves consistency across the rules in the Tax Administration Act 1994 and the Privacy Act 1993, regardless of which mechanism is chosen. A "public service" is defined as a public function or duty that is conferred or imposed on an agency by or under law, or by a policy of the Government. An agency may include a private sector agency if they are delivering a public service as defined. This could include, for example, non-government organisations delivering public services under contract with a government department so that they have access to the information if appropriate.

Consent agreements

In many cases, information sharing is undertaken to improve the services offered by Government to New Zealanders, and the expectation is that those affected would consent to their information being shared. Under the Privacy Act 1993, individuals

may authorise their information being shared, as privacy is theirs to waive. In contrast, confidentiality of tax information is an obligation imposed on Inland Revenue officers and the consent of the person to whom the information relates is no defence to breaching the obligation of confidentiality.

It is important to note that the introduction of consent-based arrangements does not mean that all information sharing requires consent – non-consented sharing will continue to occur where alternative legislative or regulatory authority exists. It is important that this is clear for customers and suggests that consented arrangements should generally only be used where there is not also the possibility of non-consented sharing occurring under a different arrangement.

Consent agreements under section 18E(3) must set out the conditions for security and use of the information provided under the agreement. The agreement must also stipulate a process to ensure consent is properly obtained and recorded. Consultation with the Privacy Commissioner is required, and the Privacy Commissioner must agree that the disclosure is appropriate.

Example: Consent-based sharing for social service provision

A regional NGO assists people to find affordable housing and negotiate their housing-related government entitlements. The NGO has a service agreement with the Ministry of Social Development to provide these services. Customers can be referred by the Ministry or approach the NGO directly.

In order to provide the best service to customers the NGO needs access to up-to-date personalised information. This includes income and other information (for example relating to other social policy entitlements and obligations) held by Inland Revenue. The NGO obtains the informed consent of its customers to access this information.

Inland Revenue, the Ministry of Social Development and the NGO (and potentially other NGOs offering the same service elsewhere) would sign an agreement. Inland Revenue could then provide information to the Ministry and/or the NGO on the customer's income and any other agreed data points. The agreement would include provision for information security and proof that customers had properly given informed consent.

Regulations under 18F

Section 18F is an updated version of the regulation-making power previously contained in section 81BA. The new provision enables sharing when:

- the sharing is for public service provision, rather than the current limit to sharing with "government agencies" (new);
- the sharing is intended to improve the ability of the Government to deliver efficient or effective services or to enforce the law (new criterion);
- the information is more easily or more efficiently obtained from or verified by Inland Revenue (existing criterion);
- it is not unreasonable or impractical to require the Commissioner to deliver the information (existing criterion);
- the nature of the sharing is proportionate, taking into account the purpose for which the information is proposed to be shared (new criterion);
- the person, entity, or agency receiving the information has adequate protection for the information (modified existing criterion); and
- the sharing of the information will not unduly inhibit the future provision of information to the Commissioner (existing criterion).

Regulations under the new section 18F must prescribe the classes or types of information to be shared, and how it would be provided, accessed, stored, secured, disposed of, and used. They must also provide for monitoring by the Privacy Commissioner and specify whether any further disclosure of the information is permitted, and whether the agreement is subject to review requirements, including where any breaches occur.

Before recommending any regulations under this provision, the Minister of Revenue must be satisfied that:

- the regulations are necessary for their proposed purpose;
- the type and quantity of information to be shared are no more than necessary;
- the regulations do not unreasonably impinge on the privacy of individuals and contain safeguards that adequately protect the privacy of individuals;
- the mechanism used to share the information is the most appropriate, taking into account the type and quantity of information to be shared; and

- a consultation process has been undertaken. This process must include distribution of draft regulations and an explanation of the way in which the proposed information sharing is necessary to achieve its stated purpose. Consultation must be undertaken with the Privacy Commissioner and other persons or organisations with whom the Commissioner of Inland Revenue considers it reasonable to consult, and must run for a period of at least four weeks.

Before proposing any new information sharing arrangements under either section 18E or 18F the Commissioner must inquire into, and carry out an assessment of, the likely provenance of the data to be shared. This means considering the types of data proposed for sharing and where and how Inland Revenue is likely to have obtained this data. For example, in a number of current sharing arrangements the primary source of data is the employment income information provided by employers. The Commissioner must also consider whether particular conditions should be specified for the security and use of the information.

Penalties for misuse of information

Both Inland Revenue officers and persons other than Inland Revenue officers who have access to sensitive revenue information are required to keep that information confidential and only disclose it in accordance with the Tax Administration Act 1994. If a person knowingly breaches their confidentiality obligations they are subject to a penalty of either imprisonment for a maximum of six months or a fine of up to $15,000 or both. These obligations of confidentiality and the penalties are longstanding features of tax administration law.

Sections 143D, 143E and 143EB restate the existing penalties for persons other than revenue officers (for whom the penalty applies under section 143C). The provisions update the previous rules to ensure they continue to clearly apply to all persons given access to sensitive Inland Revenue information, and do not represent a policy change.

Comparison of Tax Administration Act 1994 information collection, use and disclosure provisions – Changes resulting from Taxation (Annual Rates, Modernising Tax Administration and Remedial Matters) Act 2019

Table 1: sorted by previous Act

Prior to 18 March 2019	Post 18 March 2019 (New Subpart 3A)
16(1)	17(1)
16(2)	17(3)
16(2A)	17(4)
16(3)	17(2)
16(4)	17D(2)
16(5) *previously repealed*	N/A
16(6)	17D(4)
16(6A)	17D(5)
16(7)	17D(6) "issuing officer"; 17(5)(b) "private dwelling"
16B(1)	17C(1)(c)
16B(2)	17C(2)
16B(3)	17C(6)
16B(4)	17C(5)
16C(1)	17C(1)(d); 17C(3)
16C(2)	17D(1); 17D(3)
16C(3) *previously repealed*	*N/A*
16C(4)	17D(4)
16C(5)	17C(5)
16C(6)	17D(3)
16C(7)	17C(6)
16C(8)	17D(5)
16C(9)	17D(6)
17(1)	17B(1); 17B(2); 17B(3)(c); 17B(4)
17(1B)	17E(1)
17(1C)	17E(1)
17(1CB)	17E(2)
17(1D)	17B(3)(b)
17(2) *previously repealed*	*N/A*

17(3)	17C(1)(d); 17C(3)
17(4)	17C(5)
17(5)	17B(3)(a)
17(6)	17C(4)
17A(1)	Purpose, no longer required - refer new s16
17A(2)	17H(1)
17A(3)	17H(1)
17A(4)	17H(2)
17A(5)	17H(3)
17A(6)	17H(4)
17A(7)	17H(5)
17A(8)	17H(6)
17A(9)	17H(7)
17A(10)	17H(9)
17A(11)	17H(9)
17A(12)	17H(10)
17A(13)	17C(1); 17C(4)
17A(14)	17H(8)
17A(15)	N/A Terms not used in rewrite
18(1)	17J(1); 17J(2)
18(2)	17J(3)
18(3)	17J(4)
18(4)	17J(5); 17J(6)
18(5)	17J(3)(b)
18(6)	17J(7)
18(7)	17K(2)
18(8)	17K(3)
18(9)	17K(4)
19(1)	17I(1); 17I(2)
19(2)	17I(3)
19(3)	17K(2)
19(4)	17K(3)
19(5)	17K(3)
19(6)	17K(4)
21(1)	17F(1); 17F(2)
21(2)	17F(3)
21(3)	17F(5)
21(4)	17F(4)
21(5)	17F(6)
21(6)	17F(6)
21(7)	17F(1)(b)
21(8)	17F(7) Note “Information requisition” no longer needed – “information demand” used throughout subpart
21BA(1)	17G(1)
21BA(2)	17G(2)
21BA(3)	17G(3)
21BA(4)	17G(4)
81(1)	18(1); 18D(1)
81(1B)	18D(2)
81(1BB)	18D(3)
81(1C)	16C(1)
81(1D)	18B(1)
81(1E)	18B(3)

81(1F)	18B(4)
81(2) *previously repealed*	*N/A*
81(3)	18D(4)
81(4)(a)	Sch 7, cl 4
81(4)(b)	Sch 7, cl 5
81(4)(c)	Sch 7, cl 7
81(4)(d)	Sch 7, cl 20 (wording update)
81(4)(e)	Sch 7, cl 21
81(4)(eb)	Sch 7, cl 34
81(4)(ec)	Sch 7, cl 26
81(4)(f)	Sch 7, cl 41, 43, 44
81(4)(fb)	Sch 7, cl 27
81(4)(fc)	Sch 7, cl 8
81(4)(g)	Sch 7, cl 9
81(4)(gb)	Sch 7, cl 9
81(4)(gba)	Sch 7, cl 9
81(4)(gbb)	Sch 7, cl 9
81(4)(gc)	Sch 7, cl 6
81(4)(h)	Sch 7, cl 10
81(4)(i)	Sch 7, cl 11
81(4)(j)	No longer required due to new sensitive revenue information definition in 16C
81(4)(k)	Sch 7, cl 48
81(4)(l)	Sch 7, cl 15
81(4)(lb)	Sch 7, cl 16
81(4)(lc)	Sch 7, cl 16
81(4)(ld)	Sch 7, cl 17
81(4)(m)	Sch 7, cl 13
81(4)(mb)	Sch 7, cl 13
81(4)(mc)	Sch 7, cl 13
81(4)(n)	Sch 7, cl 32
81(4)(nb)	Sch 7, cl 29
81(4)*(o) previously repealed*	*N/A*
81(4)(ob)	Sch 7, cl 12
81(4)(p)	Sch 7, cl 35
81(4)(q)	Sch 7, cl 46
81(4)(r)	Sch 7, cl 30
81(4)(s)	Sch 7, cl 44
81(4)(sa)	Sch 7, cl 22
81(4)(sb)	Sch 7, cl 36
81(4)(sc)	Sch 7, cl 33
81(4)(t)	Sch 7, cl 21
81(4)(u)	Sch 7, cl 37
81(4)(v)	Sch 7, cl 31
81(4)(w)	Sch 7, cl 38
81(4)(x)	Sch 7, cl 38
81(4)(y)	Sch 7, cl 25
81(4)(z)	Sch 7, cl 28
81(5)	16C(6)
81(6)	Sch 7, cl 15
81(7)	No longer required

81(8)	"Authorised officer" sch 7, cl 25 "Inland Revenue officer" – 16C(4) "Duty of CIR" no longer needed "workplace legislation" s3(1)
81A	18E(2)
81BA	Replaced by amended provision 18F
81B	Sch 7, cl 3
82	Sch 7, cl 41
82AA	Sch 7, cl 25
82A *previously repealed*	*N/A*
83 *previously repealed*	*N/A*
84 *previously repealed*	*N/A*
85 *previously repealed*	*N/A*
85A	Sch 7, cl 43
85B	Sch 7, cl 45
85C	Sch 7, cl 45
85D *previously repealed*	*N/A*
85E	Sch 7, cl 42
85F	Sch 7, cl 35
85G *previously repealed*	*N/A*
85GB *previously repealed*	*N/A*
85GC *previously repealed*	*N/A*
85H	85H(1)-(4) no longer required. 85H(5) now included in Sch 7, cl 46
85I	Sch 7, cl 46
85J	Sch 7, cl 39
85K	Sch 7, cl 44
85L	Sch 7, cl 44
85M	Sch 7, cl 36
85N	Sch 7, cl 33
86	18(2)
87	18(2)
88	Sch 7, cl 49
89	18K

Table 2: sorted by new Act

Post 18 March 2019 (new Subpart 3A)	***Prior to 18 March 2019***
16	New
16B	New
16C	"Revenue law" - s81(1C) "Revenue information" – new "Revenue officer "– 81(8)(a) "Sensitive revenue information" – new "Permitted disclosure" – new "New Zealand superannuation" – 81(5)
17(1)	16(1)
17(2)	16(3)
17(3)	16(2)
17(4)	16(2A)
17(5)	"Property or documents" – new definition (drawn from 16(1)) "Private dwelling" – 16(7)
17B(1)	17(1)
17B(2)	17(1)
17B(3)	17(1); 17(1D); 17(5)
17B(4)	17(1)

NEW LEGISLATION

17B(5)	New linking provision
17C(1)	16B(1); 16C(1); 17(3)
17C(2)	16B(2)
17C(3)	16C(1); 17(3); 17A(13)
17C(4)	17(6)
17C(5)	16B(4); 16C(5); 17(4)
17C(6)	16B(3)
17D(1)	16C(2)
17D(2)	16(4)
17D(3)	16C(2); 16C(6)
17D(4)	16(6); 16C(4)
17D(5)	16(6A); 16C(8)
17D(6)	16(7); 16C(9)
17E(1)	17(1B), 17(1C)
17E(2)	17(1CB)
17F(1)	21(1)
17F(2)	21(1)
17F(3)	21(2)
17F(4)	21(4)
17F(5)	21(3)
17F(6)	21(5); 21(6)
17F(7)	21(7)
17G(1)	21BA(1)
17G(2)	21BA(2)
17G(3)	21BA(3)
17G(4)	21BA(4)
17H(1)	17A(2), 17A(3)
17H(2)	17A(4)
17H(3)	17A(5)
17H(4)	17A(6)
17H(5)	17A(7)
17H(6)	17A(8)
17H(7)	17A(9)
17H(8)	17A(14)
17H(9)	17A(10), 17A(11)
17H(10)	17A(12)
17H(11)	New linking provision
17I(1)	19(1)
17I(2)	19(1)
17I(3)	19(3)
17I(4)	New linking provision
17J(1)	18(1)
17J(2)	18(1)
17J(3)	18(2)
17J(4)	18(3), 18(5)
17J(5)	18(4)
17J(6)	18(4)
17J(7)	18(6)
17J(8)	New linking provision
17K(1)	New
17K(2)	18(7), 19(3)
17K(3)	18(8), 19(4)
17K(4)	18(9), 19(6)

NEW LEGISLATION

17K(5)	New linking provision
17L	New
17M	New
18(1)	81(1) (policy change)
18(2)	86, 87
18(3)	New
18(4)	New linking provision
18B(1)	81(1D)
18B(2)	86, 87
18B(3)	81(1E)
18B(4)	81(1F)
18B(5)	New
18C	New
18D(1)	81(1)
18D(2)	81(1B)
18D(3)	81(1BB)
18D(4)	81(3)
18E(1)	New
18E(2)	81A
18E(3)	New
18E(3B)	New
18E(4)	New
18E(5)	New
18F	81BA with policy changes
18G	New link to Schedule 7
18H	New link to Schedule 7
18I	New link to Schedule 7
18J(1)	New
18J(2)	New
SCHEDULE 7	
1	New (overview of schedule)
2	New overview of clauses 3-13 and also links to old 81(1)
3	81B
4	81(4)(a)
5	81(4)(b)
6	81(4)(gc)
7	81(4)(c)
8	81(4)(fc)
9	81(4)(g), (gb), (gba), (gbb)
10	81(4)(h)
11	81(4)(i)
12	81(4)(ob)
13	81(4)(m), (mb), (mc)
14	New (overview of clauses 15-18)
15	81(4)(l); 81(6)
16	81(4)(lc), (lb); subclauses (c) to (e) new
17	81(4)(ld)
18	New
19	New (overview of clauses 20-39)
20	81(4)(d) (wording update)
21	81(4)(e), (t)
22	81(4)(sa)

23	New
24	New
25	81(4)(y), 82AA
26	81(4)(ec)
27	81(4)(fb)
28	81(4)(z)
29	81(4)(nb)
30	81(4)(r)
31	81(4)(v)
32	81(4)(n)
33	81(4)(sc), 85N
34	81(4)(eb)
35	81(4)(p), 85F
36	81(4)(sb), 85M
37	81(4)(u)
38	81(4)(w), (x)
39	85J
40	New (overview of clauses 41-46)
41	81(4)(f), 82
42	85E
43	81(4)(f), 85A
44	81(4)(f), (s), 85K, 85L
45	85B, 85C
46	81(4)(q), 85I
47	New (overview of clauses 48-49)
48	81(4)(k)
49	88

SHORT-PROCESS RULINGS

Sections 91EK – 91ET of the Tax Administration Act 1994

Clauses 2, 3 and 5 of the Tax Administration (Binding Rulings) Regulations 1999

Background

The binding rulings system is a fee-based service provided by Inland Revenue and governed by Part 5A of the Tax Administration Act 1994. It provides certainty to taxpayers by binding the Commissioner to the position taken in the ruling. There are different types of binding ruling, including private and product rulings.

Binding rulings are usually provided to taxpayers on commercial arrangements they have entered into or are seriously contemplating.

Although anyone can apply for a binding ruling, they have generally been used by larger taxpayers because of the advisor costs and the time-based fee charged by Inland Revenue. Changes have been made to the Tax Administration Act 1994 to introduce a new type of binding rulings service – short-process rulings. This service will make it cheaper and more straightforward for individuals and small-to-medium sized taxpayers to obtain binding rulings from the Commissioner.

Key features

The key features of the proposals are:

- a person with annual gross income below a prescribed level ($20,000,000) and a tax question involving tax below a prescribed level ($1,000,000) can apply for a ruling under a shortened process;
- there is no requirement for an application for a short-process ruling to state the taxation laws and the propositions of law for which the ruling is sought; and
- the fees for short-process rulings will be determined and published by the Commissioner, but will be lower than the fees for other binding rulings.

Application dates

The amendments that enable the Commissioner to issue short-process rulings come into force on 1 October 2019.

Detailed analysis

New section 91EK of the Tax Administration Act 1994 allows the Commissioner to issue a short-process ruling on how a tax law applies, or would apply, to a person in relation to their particular circumstances.

A person may apply in their own right, jointly, or on behalf of a person who is yet to come into legal existence (for example, a company that is yet to be incorporated), where:

- the person's annual gross income for the tax year before the application is made is $20,000,000 or less (the annual gross income threshold); and
- the ruling is on a matter concerning a tax (other than provisional tax), duty, or levy that is expected to amount to less than $1,000,000 (the tax at stake threshold).

Both the annual gross income and tax at stake thresholds can be changed by the Governor General by an Order in Council.

The Commissioner can decline to make a short-process ruling if she considers that the question asked, or the circumstances set out in the application, would be inappropriate for a response under the short-process rulings process. This could apply where the application:

- raises an issue involving an apparent gap or deficiency in policy settings;
- is directly in opposition to an existing policy of the Commissioner, or technical position taken by the Commissioner;
- raises an issue that has, or would have, significant implications or wide effect as a precedent;
- fails to provide sufficient information; or
- raises a question that is better answered by the Commissioner through another process.

New section 91EK(3) states that the same rules that allow the Commissioner to decline to issue a private ruling also apply for short-process rulings. This means, for example, the Commissioner may decline to issue a short-process ruling if the applicant has outstanding debts relating to earlier binding ruling applications.

Section 91EK(3) also provides that the Commissioner may decline to issue a short-process ruling where she would not be able to issue a private ruling. Among other reasons, this means the Commissioner may decline to issue a short-process ruling where:

- the application would require the Commissioner to determine a proscribed question, other than the matters for which she can issue a ruling under section 91CB(3) of the Tax Administration Act 1994 (see section *Extending the scope of binding rulings*);
- an assessment has already been made in relation to the circumstance to which the short-process ruling is to apply, unless the application has been received by the Commissioner before the date the assessment is made;
- the matter on which the ruling is sought concerns a tax (excluding provisional tax), duty, or levy that is due and payable, unless the application is received before the amount is due and payable; or
- the matter on which the ruling is sought is being dealt with, or in the Commissioner's opinions should be dealt with, by one or both competent authorities of the parties to a double tax agreement.

Determining whether the annual gross income threshold is met

For most people applying for a short-process ruling, establishing whether the annual gross income threshold will be met will be straightforward as it only involves checking the annual gross income from the previous tax year is below $20,000,000.

Example 1: Determining whether annual gross income threshold is met

Linda wants to apply for a short-process ruling for the 2020 tax year.

She knows her annual gross income for the 2019 tax year is well below the annual gross income threshold of $20,000,000 as she received a salary of $200,000 and beneficiary income from a trust of $50,000.

Linda meets the annual gross income criterion to apply for a short-process ruling.

There are, however, some special rules for the purposes of determining whether the $20,000,000 threshold is met.

Group of companies: If the applicant is the member of a group of companies, the group itself must have annual gross income of less than $20,000,000 for the tax year before the application.

Example 2: Applicant is a member of a group of companies

Z Co Ltd is a member of a group of companies that also includes A Co Ltd, B Co Ltd, C Co Ltd.

In determining whether it meets the annual gross income threshold, the combined annual gross income of A Co Ltd, B Co Ltd, C Co Ltd and Z Co Ltd needs to be established.

The combined annual gross income of each member in the group of companies is less than $20,000,000 for the last tax year.

This means that Z Co Ltd meets the annual gross income criterion to apply for a short-process ruling.

Joint applicants: If two or more persons apply for a short-process ruling, each person must have annual gross income of less than $20,000,000 for the tax year before the application.

Example 3: Joint applicants

Matthew and Caroline are moving from New Zealand to the United Kingdom.

Matthew and Caroline both own several rental properties in New Zealand but will have no other connections to New Zealand after they move.

They apply jointly to Inland Revenue for a short-process ruling to obtain confirmation that they will be considered non-residents for tax purposes in New Zealand.

For the previous tax year, Matthew's gross income was $220,000 and Caroline's was $250,000 from the United Kingdom and New Zealand.

As both Matthew and Caroline's annual gross income was below $20,000,000 for the previous tax year, they both meet the annual gross income criterion to apply for a short-process ruling.

Application on behalf of another person: If a person applies for a short-process ruling on behalf of another person (for example, an employer on behalf of an employee), it is the person to whom the ruling applies to that must have annual gross income of less than $20,000,000 for the tax year before the application.

Example 4: Application on behalf of another person

David's employer applies for a short-process ruling on his behalf. The matter relates to whether an amount David receives from his employer is a reimbursement or taxable allowance.

David's salary for the last tax year was $650,000. As David's income is below the annual gross income threshold, David meets the annual gross income criterion.

It is not the annual gross income of David's employer that is relevant for the purposes of determining whether a short-process ruling can be issued for David.

Person not yet in legal existence: If the application is for a person who is not yet in legal existence, the person must have a reasonable expectation of meeting the annual gross income requirement for the tax year to which the ruling relates.

Example 5: Application from a person not yet in legal existence

Jason is a sole trader but plans to conduct his business through a company which is yet to be incorporated.

Jason has asked several of his friends if they would like to be passive investors in the business. He wants to know whether the company he plans to set up would meet the criteria to be a look-through company under the Income Tax Act 2007.

As the company is not yet in legal existence it must have a reasonable expectation that the company will not have annual gross income of more than $20,000,000 for the tax year in which the short-process ruling is issued.

Jason has prepared budgeted accounts which project the business's earnings for the tax year for which he is seeking a short-process ruling. The expectation is that the business will have annual gross income of less than $250,000 for the year.

Information about the expected annual gross income is provided to the Commissioner as part of the application. The Commissioner is satisfied that the company meets the annual gross income criterion for a short-process ruling.

Determining whether the tax at stake threshold is met

In addition to meeting the annual gross income threshold, the person must be seeking a ruling on a matter concerning a tax (other than provisional tax), duty, or levy that is expected to amount to less than $1,000,000.

Example 6: Determining whether the tax at stake is less than $1,000,000

Claire earns a salary of $100,000 a year and wants to apply for a short-process ruling as to whether an amount of income she has derived from the sale of land is taxable under sections CB 6 or CB 7 of the Income Tax Act 2007.

The profit from the sale of the land was $750,000. The amount of tax at stake is $247,500 (that is, $750,000 × 33 percent).

As the amount of tax at stake is less than $1,000,000 Claire meets the tax at stake criterion for a short-process ruling.

In some circumstances the amount of tax at stake may not be relevant, or may be very difficult to determine, such as when a person applies for a short-process ruling on whether they are a resident for tax purposes in New Zealand.

In these circumstances, the application must state that the expected amount of tax at stake is not known. The Commissioner will then consider whether to issue a short-process ruling.

Application requirements

The application for a short-process ruling must:

- identify the person applying for the ruling;
- describe the circumstances which the ruling is sought;
- disclose all relevant facts and documents;
- state the general tax outcome in relation to which the ruling is sought. For example, that income is not taxable, expenditure is deductible, or the person is a non-resident for tax purposes; and
- state if the expected amount of tax at stake is not known.

These requirements are much simpler than those currently required in binding ruling applications as they do not require the applicant to set out the taxation laws and the propositions of law for which the ruling is sought, or provide a draft ruling themselves.

Short-process rulings will be based on the information provided to Inland Revenue in the application. This does not prevent Inland Revenue from being able to inquire into the correctness or existence of facts contained in the application before the ruling is issued.

Other aspects of the short-process ruling process largely mirror the rules for private binding rulings. These include:

- an exclusion from ruling on an issue that is the subject of a dispute under the tax disputes process;
- the ability for the Commissioner to state conditions on which the ruling is based;
- the content that the ruling must include;
- the ability for the Commissioner to request information from the person applying for the ruling at any time;
- a requirement that the Commissioner provide the applicant with a reasonable opportunity to be consulted if the content of the proposed ruling differs from that for which the application is made; and
- the ability for Inland Revenue not to apply a ruling in certain circumstances.

A person can withdraw an application for a short-process ruling at any time by notifying the Commissioner.

Effect of a short-process ruling

If the Commissioner has provided a person with a short-process ruling, she must apply the law in the manner specified in the ruling in relation to the person. This requirement does not apply when the person issues a notice of proposed adjustment to change the effect of the ruling that the person has previously applied for or obtained.

However, section 91EN(2) of the Act provides that a short-process ruling does not apply to a person in relation to the particular circumstances and the related tax type to the extent to which:

- the circumstances are materially different to the circumstances described in the ruling;
- a material omission or misrepresentation was made in connection with the application for the ruling;
- the ruling is based on an express understanding about a future event or other matter, and the understanding subsequently proves to be materially incorrect; or
- the Commissioner has stipulated a condition in the ruling which has not been met.

These rules mirror the existing rules for private binding rulings.

Contents of a short-process ruling

Section 91ES of the Act outlines the content and notification requirements of a short-process ruling.

The Commissioner is required to provide the person who applied for the ruling with a copy of the ruling. The ruling must state:

- that it is a short-process ruling made under section 91EK of the Tax Administration Act 1994;
- the identity of the person, the taxation law, and the particular set of circumstances to which the ruling applies;
- how the tax law applies to the person, the circumstances, and the related tax type;
- the period or tax year for which the ruling applies; and
- if applicable, any conditions stipulated by the Commissioner.

Fees for short-process rulings

The Tax Administration (Binding Rulings) Regulations 1999 have been amended to enable the Commissioner of Inland Revenue to publish the fees for short-process rulings.

The fees must be lower than those that apply for full binding rulings. The fees will be set before 1 October 2019. Once set, they will be published in a *Tax Information Bulletin* and will be communicated using Inland Revenue's regular channels for communicating such information such as Inland Revenue's website and newsletters.

Further guidance from Inland Revenue on short-process rulings

Detailed guidance in relation to short-process rulings is being prepared by Inland Revenue. This additional guidance will be available before 1 October 2019.

EXTENDING THE SCOPE OF BINDING RULINGS

Sections 91C, 91CB, 91CC, 91E, 91EA, 91EB, 91EF, 91EH, 91FC, 91FF, 91FH and 91GB of the Tax Administration Act 1994

Background

Consistent with the "right-from-the-start" framework, greater upfront certainty will be available for taxpayers through amendments that extend the scope of matters on which the Commissioner of Inland Revenue can issue binding rulings.

In addition to the introduction of short process rulings, several improvements have been made to the binding rulings regime. These changes have:

- removed the prohibition on ruling on a taxpayer's purpose under certain provisions of the Income Tax Act 2007 and the Goods and Services Tax Act 1985;
- enabled rulings to be issued in relation to a person's status, such as whether a person is a New Zealand tax resident;
- expanded the ability to rule on financial arrangements; and
- clarified the role of conditions and assumptions in the rulings processes.

Key features

The key features of the amendments are:

- allowing rulings to be made on a taxpayer's purpose in certain circumstances, such as whether the taxpayer has the purpose of selling a property when they acquire it;
- allowing rulings on a person's status, such as whether a person is a New Zealand resident or not, to be made;
- allowing the Commissioner to rule on a financial arrangements rules question for which she can currently only issue a determination; and
- replacing assumptions with conditions and clarifying when a ruling ceases to apply because a condition is breached.

Application date(s)

These amendments apply from 18 March 2019, the date of Royal assent.

Detailed analysis

Section 91C of the Tax Administration Act 1994 sets out a broad range of matters on which the Commissioner may issue any form of binding ruling (public, product, or private). Section 91C also contains a limited number of exclusions. A private ruling could previously only be made, however, for a taxpayer and an "arrangement" which precludes applications for rulings on matters that are about the taxpayer's status such as their residence status. The Commissioner was also unable to issue private rulings if the ruling would require her to determine the answer to a proscribed question, such as a taxpayer's intent when land is disposed of. New section 91CB will allow for these sorts of rulings (whether regular or short process) to be made in certain circumstances.

New section 91CB provides that the Commissioner is now able to issue binding rulings in relation to the status of a person, without the need for an arrangement. Examples of matters that the Commissioner can rule on (including by way of short process ruling) include:

- whether a person carries on a business through a permanent or fixed establishment;
- whether a person is a resident or a non-resident;
- whether two persons are associated under the associated persons rules;
- whether a person is a non-profit body for the purposes of the Goods and Services Tax Act 1985;
- whether a person is a unit trust; and
- whether a person is a portfolio investment entity.

In addition to the ability to issue binding rulings in relation to a person's status, the Commissioner can issue binding rulings in relation to whether an item of property is "trading stock" or "revenue account property" as defined in section YA 1 of the Income Tax Act 2007.

The amendments also enable the Commissioner to issue binding rulings in relation to a person's purpose under specific provisions:

- whether the amount a person derives from disposing of personal property is income of the person under section CB 4 of the Income Tax Act 2007; and
- whether the amount that a person derives from disposing of land is income of the person under sections CB 6 or CB 7 of the Income Tax Act 2007.

An "arrangement" is not required for a ruling to be made under any of these new provisions.

New section 91CC of the Tax Administration Act 1994 allows the Commissioner to make binding rulings on these matters relating to financial arrangements:

- whether an amount is solely attributable to an excepted financial arrangement;
- the use of certain spreading methods; and
- the value of certain property or services.

The following amendments have also been made:

- clarifying that the date a private ruling ceases to apply is the date the event (misrepresentation, material omission or incorrectness) that causes cessation occurs unless the ruling expressly providers otherwise; and
- the term "assumption" is in most places replaced with the term "condition" as this better reflects practice.

AMENDING ASSESSMENTS

Section 113A of the Tax Administration Act 1994

Background

There are several reasons why the tax system requires taxpayers to adjust the original assessment or return in which the error arose:

- The tax collected by the government includes the time value of money as well as core tax payments which is why use-of-money interest usually applies to underpayments of tax.
- It is fairer to taxpayers who get their returns right from the start.
- It more readily provides Inland Revenue with information about the types of errors being made by taxpayers.

However, for minor errors, the compliance costs can outweigh the benefits of requiring taxpayers to amend the original assessment.

The rules that enable taxpayers to correct errors relating to income tax, GST and fringe benefit tax ("FBT") in the next return due following discovery of the error have been expanded.

Key features

Amended section 113A will allow taxpayers to correct errors made in returns for income tax, GST and fringe benefit tax in the next return due following discovery of the error, provided the tax discrepancy caused by the error does not exceed certain thresholds set within the legislation.

Application date

New section 113A applies from 18 March 2019, the date of Royal assent.

Detailed analysis

The new rules allow errors relating to assessments for income tax, GST and fringe benefit tax to be corrected in the next return due following discovery of the error if the tax discrepancy caused by the errors are not more than $1,000.

The requirements for the error to be "minor", and caused by a "clear mistake, simple oversight, or mistaken understanding" of the taxpayer have both been removed.

Example: Automatic correction of errors of $1,000 or less

In a review of its accounts for the year ending 31 March 2019, Kelvin's Cookies and Cakes Ltd realises it made an error by not including an amount of income from one of its stores in its income tax return. The income tax return has already been provided to Inland Revenue.

The total amount of sales that was not included in the income tax return was $3,000. The tax discrepancy caused by not including the sales of $3,000 in the income tax return is $840 (that is, $3,000 × 28 percent).

Instead of asking Inland Revenue to amend the income tax return, Kelvin's Cookies and Cakes Ltd can include the $3,000 of sales in its income tax return for the following income year.

For errors that exceed the $1,000 threshold, new section 113A(2) allows taxpayers to correct errors in their assessments for income tax, GST or FBT in the next return due following discovery of the error provided the error is not material.

For the purposes of these rules, under section 113A(4) an errors are not material if the total discrepancy caused by the errors are equal to, or less than, the lower of $10,000 and 2 percent of the taxpayer's annual gross income (for income tax and FBT returns) and output tax (for GST returns).

Example: Correction of immaterial errors

Bary's Brownies and Liquorice Rolls Ltd sells confectionaries in its 35 stores throughout New Zealand. Its GST returns are filed on a 2-monthly basis.

Bary's Brownies and Liquorice Rolls Ltd realises that it made an error in its GST return for the period ending 30 September 2019 when one of the stores sends additional information about its sales to the head office in early November 2019. The amount of sales not recorded in the GST return was $8,000. This resulted in an understatement of the business's taxable supplies of $8,000 and a tax discrepancy in the assessment of $1,200 (that is, $8,000 × 15 percent).

Bary's Brownies and Liquorice Rolls Ltd cannot rely on section 113A(1) to correct the error in the GST return for the period ending 30 November 2019. This is because the tax discrepancy caused by the error is more than $1,000. To determine whether Bary's Brownies and Liquorice Rolls Ltd can correct the error in the next return due, it needs to determine whether the error is a material error for the purposes of section 113A.

The total taxable supplies in Bary's Brownies and Liquorice Rolls Ltd's GST return for the period ending 30 September 2019 was $450,000. The amount of the tax discrepancy in the assessment resulting from not including the $8,000 worth of supplies from one of its stores is $1,200.

The amount of the error is less than both $10,000 and 2 percent of Bary's Brownies and Liquorice Rolls Ltd's output tax payable for the period. This means Bary's Brownies and Liquorice Rolls Ltd can correct the error by including the missed sales in the following GST return for the period ending 30 November 2019. It does not need to notify Inland Revenue that the sales relate to an earlier period in the return.

If a subsequent error is later discovered that also meets the criteria of being less than both $10,000 and 2 percent of the output tax payable for the period, that error or errors can also be corrected in the next return due following discovery of that error or errors.

If the person's main reason for applying the materiality threshold is to delay the payment of tax, the error must be corrected in the original assessment and cannot be corrected in the next return due after discovery of the error or errors.

SUSPENDING THE DISPUTES PROCESS PENDING THE OUTCOME OF A TEST CASE

Section 89N of the Tax Administration Act 1994

Background

An amendment has been made to section 89N(1)(c)(ix) of the Tax Administration Act 1994 to clarify that the disputes process in Part 4A of the Act can be suspended pending the outcome of a test case.

Key features

Section 89N(1)(c)(ix) is intended to allow for the disputes process in Part 4A of the Tax Administration Act 1994 to be suspended, pending the outcome of a test case, provided the taxpayer and the Commissioner agree, and have recorded their agreement in a document. The amendment ensures the provision reflects the policy intent.

Application date(s)

This amendment applies from 18 March 2019, the date of Royal assent.

Detailed analysis

Section 89N(1)(c)(ix) before amendment allowed for the suspension of "proceedings" in a dispute pending the outcome of a test case. This arguably did not allow for the suspension of the disputes process in Part 4A of the Tax Administration Act 1994 because the definition of "proceedings" in section 3(1) of the Act refers only to an objection or challenge under Parts 8 and 8A of the Act, and not the disputes process in Part 4A of the Act.

The amendment to section 89N(1)(c)(ix) clarifies that the disputes process of Part 4A of the Act can be suspended pending the outcome of a test case. The requirement for there to be agreement between the Commissioner and the taxpayer of the suspension, and for that agreement to be recorded in a document, are both retained. This ensures the provision achieves the policy intent of allowing the disputes process to be suspended pending the outcome of a test case.

TIME BAR WAIVER

Section 108B of the Tax Administration Act 1994

Background

Section 108B of the Tax Administration Act 1994 has been amended to clarify the period of time for which a taxpayer and the Commissioner can agree to a time bar waiver.

Key features

Section 108B of the Tax Administration Act 1994 allows taxpayers to agree with the Commissioner to a time bar waiver. An amendment has been made to clarify that the period of a time bar waiver will be no shorter than 12 months. Taxpayers can still extend the initial 12 months by a further six months.

Application date(s)

The amendment applies from 18 March 2019, the date of Royal assent.

Detailed analysis

The time bar in section 108 of the Tax Administration Act 1994 prevents the Commissioner from increasing the amount of tax assessed (or decreasing the amount of a net loss) in an assessment made by a taxpayer if more than four years have passed since the end of the tax year in which the taxpayer provided their assessment to Inland Revenue, subject to certain exceptions.

Section 108B of the Tax Administration Act 1994 allows the application of a time bar to be delayed by a waiver for 12 months from the time that the time bar would otherwise apply if the taxpayer and the Commissioner agree, and that agreement is recorded in a document. The period can then be extended for an additional six months if the taxpayer provides notice of such extension before the end of the original 12-month extension.

Under the previous wording, it was arguable that taxpayers could provide an initial waiver for a period that was less than 12 months. This led to confusion as to whether a taxpayer could provide a waiver for an additional six months if the original waiver was not for 12 months. The intent of the rules was that an initial waiver could not be for fewer than 12 months. An amendment has been made to ensure this rule operates as intended.

Example

William is the only director of A Co Ltd. A Co Ltd is involved in a dispute with Inland Revenue over its income tax return for the year ending 31 March 2014, which was provided to Inland Revenue during the 2015 tax year.

The time bar applies from 31 March 2019, which is four years after the end of the tax year in which A Co Ltd's income tax return was provided to Inland Revenue.

William agrees with the Commissioner under section 108B to a waiver of the time bar for 12 months so that there is sufficient time to complete the dispute with Inland Revenue. This means the time bar will now apply from 31 March 2020, unless William gives notice before that date to extend the waiver for an additional six months.

THIRD PARTY PROVIDERS AND INTERMEDIARIES

Part 7B of the Tax Administration Act 1994

Background

Inland Revenue provides a range of services specifically for tax agents, including a dedicated phone service and the E-File software package which allows tax agents to file their clients' tax returns electronically.

As part of Inland Revenue's Business Transformation, it will extend its online services to tax agents and other third party providers of tax services. In doing so, a concern is protecting the revenue base and the integrity of the tax system against any potential risks arising from providers' use of these services.

New Part 7B of the Act contains the rules for third party providers and intermediaries. It also contains additional rules for nominated persons and a new type of third party provider referred to in the Act as "representatives". The existing rules for tax agents and other third party providers and intermediaries (for example, PAYE intermediaries and RWT proxies) are now also contained in new Part 7B.

The amendments to the Act allow Inland Revenue to withhold approval or disallow a person as a representative or a nominated person when the action is necessary to protect the integrity of the tax system. The amendments will assist Inland Revenue in managing the potential risks of extending its online services to additional types of third party providers of tax services.

Before these amendments, Inland Revenue used the statutory definition of a "tax agent" to determine who could access extended service offerings through Inland Revenue's online services. This meant that other tax service providers (such as those who only file employment income information and GST returns, and those who provide budget advice and assist with tax return preparation and claiming social policy entitlements) were not given access to these extended service offerings, despite it being desirable in many cases to do so.

Key features

New section 124D sets out that a person is eligible to be a representative if they:

- have signed authorities to act for 10 or more other persons in relation to their tax affairs, or in relation to their entitlements and obligations arising under social policy that is administered by Inland Revenue; and
- are in a business, occupation or employment in which they act on behalf of others in relation to their tax affairs or social policy entitlements and obligations; or
- are carrying on a professional public practice dealing in matters relating to tax and social policy assistance; or
- are in a business, occupation or employment in which they provide budget advisory services to other persons or claim entitlements to social policy assistance on behalf of other persons.

Examples of the activities that might be undertaken by a representative on behalf of their clients are filing and preparing tax returns, setting up instalment arrangements, and managing a person's correspondence with Inland Revenue.

Inland Revenue must approve the person as a representative if it considers that the person meets the above requirements and that approving the person as a representative would not adversely affect the integrity of the tax system.

New section 124G provides Inland Revenue with the ability to revoke approval if it considers that the person does not meet the relevant eligibility requirements, or that continuing to allow the person to act as a representative for others would adversely affect the integrity of the tax system. Similarly, Inland Revenue may disallow a person's status as another's nominated person if continuing to allow the person to be a nominated person would adversely affect the integrity of the tax system.

Application date(s)

These amendments apply from 18 March 2019, the date the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 received the Royal assent.

Detailed analysis

New Part 7B of the Tax Administration Act 1994 sets out the classes of persons who may:

- apply to the Commissioner of Inland Revenue to be listed or approved as a provider of services to other persons in relation to their tax affairs or their entitlements and obligations arising under social policy administered by Inland Revenue (tax agents, representatives, PAYE intermediaries, tax pooling intermediaries and approved AIM providers);
- be nominated by a person to act on their behalf in relation to their tax affairs or social policy entitlements and obligations (nominated persons); or
- notify the Commissioner of their intermediary status in relation to certain tax types (RWT proxies).

These classes do not exhaustively cover the types of persons who may provide tax advice or other tax compliance services. These classes instead focus on the categories of providers that:

- prepare and file tax returns on behalf of other persons;
- manage tax payments for other persons, such as tax pooling and PAYE intermediaries;
- are the approved providers of a particular tax compliance service which requires them to hold or have access to the information of taxpayers using their service;
- manage a person's correspondence with Inland Revenue in relation to their tax obligations, or their entitlements and obligations arising under social policy administered by Inland Revenue, such as Working for Families tax credits; and/or
- otherwise have access to Inland Revenue's online services on behalf of other persons.

The amendments are not intended to restrict a person's ability to appoint an agent to only the classes listed in section 124B of the Tax Administration Act 1994. For example, a tax advisor (who is not the tax agent, representative, or nominated person of the applicant) may prepare and submit a binding ruling application for a taxpayer. The tax advisor would not be required to become a tax agent, representative, or nominated person in order to be able to discuss the details of the binding ruling with Inland Revenue on behalf of the applicant.

Existing provisions for various third party providers

In addition to the new sections for representatives and nominated persons (sections 124D and 124F), several existing sections in the Tax Administration Act 1994 have been re-drafted or re-numbered so that they come within new Part 7B. The old provisions, what they related to, and the corresponding new provisions, are shown in the following table:

	Old section(s)	New section(s)
PAYE intermediaries and listed PAYE intermediaries	15C to 15M	124H to 124R
RWT proxies	15N	124ZF
Approved AIM providers	15O to 15T	124Y to 124ZE
Tax agents	34B	124C, 124E and 124G

Information requirements for tax agents and representatives if non-natural persons

New section 124E sets out that if a person who is applying to be a representative or a tax agent is not a natural person, they must provide Inland Revenue with the names of the following:

- For an entity that is a body corporate other than a closely-held company, each person who has the duties of tax manager, chief financial officer, chief executive officer, or director.
- For a closely-held company, each shareholder.
- For a partnership, each partner.
- For an unincorporated body, each member.

The information is also required if it has not previously been provided to Inland Revenue at the time of making the application, or, where the information was previously provided but is no longer accurate. Where there is a change, the updated information must be provided to Inland Revenue within 12 months after the date the change occurs.

Nominated persons

New section 124F sets out that a person may nominate another person to act for them in relation to their tax affairs or social policy entitlements by informing Inland Revenue of the nomination and providing the following information:

- Their name, contact address and IRD number.
- The name of the nominated person, and any other information that may lead the Commissioner to be satisfied about the identity of the nominated person. This could include, for example, the person's date of birth and address information.
- The relevant tax types or social policy entitlements and obligations in relation to which the nominated person intends to act for them, for example, Working for Families tax credits or income tax.
- The relevant start and end dates, as applicable, applying in relation to the tax types and social policy entitlements and obligations.

Where the person making the nomination is not a natural person, there is an additional information requirement for the name and position of a natural person who is associated with or related to the entity, such as a director for a company or a trustee of a trust.

Commissioner's ability to refuse or remove tax agents, representatives and nominated persons

New section 124G(1) requires the Commissioner to refuse to list a person as a tax agent if the Commissioner is satisfied that:

- the person does not meet the requirements to be a tax agent (listed in proposed section 124C(3)); and/or
- listing the person as a tax agent would adversely affect the integrity of the tax system.

These rules are the same as the previous equivalent section 34B(7) of the Tax Administration Act 1994.

NEW LEGISLATION

New section 124G(2) sets out the Commissioner's discretion to remove a person from the list of tax agents or to disallow a person's approval as a representative if she considers that the person does not meet the relevant eligibility requirements, or if continuing to allow the person to act on behalf of another person in relation to their tax or social policy affairs would adversely affect the integrity of the tax system.

Similarly, new section 124G(3) states that the Commissioner may disallow a person's status as a nominated person if she considers that:

- the person is acting in a fee-earning or other professional capacity (or if the person is acting for multiple persons whether in a fee-earning or other capacity); and
- continuing to allow the person to act on behalf of another person in relation to their tax or social policy affairs would adversely affect the integrity of the tax system[4].

The discretion to disallow a person's status as a nominated person is more limited than the Commissioner's discretion to remove a person from the list of tax agents, as well as the discretion to disallow a representative for adversely affecting the integrity of the tax system. The discretion to disallow a person's nominated person status would not apply when the person they are acting for is their spouse, civil union partner, or de facto partner, or a person connected to them within two degrees either by blood relationship or adoption.

The Commissioner may exercise this discretion if, for example, the person was acting as a nominated person on behalf of others after having been removed from the list of tax agents.

Notification of refusal, disallowance or removal from list

New sections 124G(5) and (6) require the Commissioner to notify a person of her refusal to list them as a tax agent, or of the reasons for an exercise of her discretion to disallow the person as a representative or nominated person or to remove them from the list of tax agents. The Commissioner is required to consider any arguments against her refusal (or against the exercise of her discretion) that are provided within 30 days of the notice. However, the Commissioner may extend the stipulated 30-day period to a later date set by her if this is appropriate in the circumstances.

New section 124G(7) states that the requirement to notify the person of the reasons for their removal from the tax agent list, or for disallowing their status as a representative or nominated person, may be disregarded if the Commissioner considers it necessary in the circumstances to protect the integrity of the tax system.

[4] This could include, for example, where the person had been convicted of an offence under the Tax Administration Act 1994, or has been convicted of a crime involving dishonesty (within the meaning of section 2(1) of the Crimes Act 1961) and has been sentenced for that crime within the last seven years.

Modernising tax administration – Other items

OVERPAYMENTS OF PAYE INCOME

Sections CE 1, CX 10, RD 5, RD 7, RD 8, RD 8B, YA 1 of the Income Tax Act 2007

The amendments provide that an overpayment of employment income subject to PAYE which is not repaid to the employer remains taxable as PAYE income.

Background

Employers prioritise paying staff on time over complete accuracy. Overpayments can occur for a number of reasons, including the late receipt of information and anticipated leave where the employee resigns before the leave is due. In most situations the overpayment is repaid by the employee and the employer notifies Inland Revenue of an adjustment to the previously filed information. Notification results in a refund or credit of the PAYE and other deductions to the employer and a reduction in the employee's record of income and associated tax credits.

In some circumstances, the overpayment is not repaid. The amendment deems that where a PAYE-related employment overpayment is not repaid the amount is income subject to PAYE.

The amendment clarifies the taxable status of all employment overpayments in a way which minimises employer compliance costs and accords with the common-sense view that overpaid salary or wages, extra pays or schedular payments, were paid in connection with employment. As a consequence of the changes, the employer would be unable to recover PAYE on overpayments not repaid and the unrepaid amounts will remain on the employee's record of income for social policy purposes.

Key features

The amendments make PAYE-related overpayments income under section CE 1 if they are not repaid to the employer.

The amendments exclude overpayments made by the Ministry of Social Development ("MSD") and clarify the treatment for ACC overpayments.

The legislation also supports options for how the employer may adjust for any PAYE related overpayment and seek refund of the associated PAYE deductions. This includes the ability for the employer to report a PAYE-related overpayment as not PAYE income once sufficient agreement is made with the employee.

Regulations made under section 23N of the Tax Administration Act 1994 explain how to make adjustments to account for errors in employment income information that has been submitted to Inland Revenue. The amendments clarify to what extent an overpayment of PAYE income remains subject to PAYE and therefore whether an overpayment causes an error in employment income information.

An amendment is also made to ensure that an overpayment of employment income subject to PAYE does not amount to an employment-related loan on which a fringe benefit arises.

Application date(s)

The amendments come into force on 1 April 2019.

Detailed analysis

PAYE related overpayments defined in section RD 8B

New section RD 8B defines a PAYE-related overpayment and provides for the treatment when these amounts are paid.

Definition of a PAYE-related overpayment

A PAYE-related overpayment is an amount which is paid in error or as an advance payment (in the event that the employee does not become beneficially entitled to the amount), and where the amount is treated by the employer to be salary or wages, extra pay or a schedular payment when it paid to the employee.

Payments made by MSD are excluded from the definition of a PAYE-related overpayment but section section RD 8B(4)(ab), by reference to benefits or grants referred to in section RD 5(6)(a) to (c). This includes New Zealand Superannuation payments, and Veteran's pensions paid by MSD.

PAYE-related overpayments are differentiated by whether they are unrepaid (an unrepaid PAYE income overpayment).

NEW LEGISLATION

Definition of an unrepaid PAYE income overpayment

A PAYE-related overpayment will be an unrepaid PAYE income overpayment if the following conditions set out in RD 8B(3) are met:

- the amount is a PAYE-related overpayment;
- has not been repaid to the employer;
- is not repayable to the employer by the employee under an agreement between them;
- is not recoverable under section 248 of the Accident Compensation Act 2001; and
- does not include an amount of exempt income.

The definition of an unrepaid PAYE income overpayment therefore excludes an ACC overpayment if it remains recoverable pursuant to the Accident Compensation Act 2001. This provides a similar concept to when an overpayment is repaid/not repaid by distinguishing between overpayments made by ACC which are recoverable or non-recoverable. Section CF 1 of the Income Tax Act already excludes an overpayment of accident compensation which remains recoverable from the definition of taxable income.

Example

On 1 July 2019, employer Celery Treats Ltd records the wrong number of hours to Cory, and calculates his weekly pay as if he had worked 30 hours instead of 20 hours, this is calculated at his wage rate of $25.00 per hour. At the time of payment, Celery Treats Ltd treats this as a regular payment of salary and wages.

This means Cory is paid $750 ($122.82 in PAYE) for this week versus $500 ($75.60 in PAYE); $250 is an PAYE-related overpayment as it is paid in error and Cory's employer treats this as wages at the time of the payment.

PAYE related overpayments repayable under agreement

The amendments to section CE 1 provide that a person who received an amount that is an unrepaid PAYE income overpayment is treated as deriving the amount in connection with their employment or service for the income year that they receive that amount.

Amendments to this section also provide for what income year the income amount should be allocated to in the case where there is a subsequent adjustment to account for when the overpayment had been reported as repaid and the employee subsequently breached the agreement.

Example

Cory agrees with his employer to repay the $250 overpayment over the next five paydays. The $250 overpayment and associated PAYE and deductions are worked out by taking the difference from the total.

Overpayment: $750 – $500 (= $250), PAYE: $122.82 – $75.60 (= $47.22)

If Cory agrees to repay over five paydays, the employer accordingly apportions 1/5th of the difference to each payday where this is paid off. ($50 gross and $9.44 of PAYE and ACC levy)

Payday	Gross	PAYE + ACC levy	Note
1. 1 July	$750	$122.82	Payday when overpayment occurred
2. 8 July	$500	$75.60	Regular payday
3. 15 July	$450	$66.16	Agreed repayment commences

Example: Upfront adjustment

Celery Treats Limited have the option of reporting the overpayment once in Cory's 15 July payday information. This would reduce the gross payment reported by $250 and PAYE by $47.22.

Breaches of repayment agreements

Overpayments repayable under agreement between the employer and employee are excluded from the definition of an unrepaid PAYE related overpayment (effectively deemed to be repaid). New section RD 8B (3B) provides for when there is a breach of an agreement to repay. The subsection provides that repayable agreement is considered to be breached when the employee breaches the agreement (the repayment agreement is not compiled with) and/or the employer considers that the employee will not comply with the agreement in the future.

If an agreement is breached, the outstanding amount of the PAYE-related overpayment is income to the individual. The employer is required to adjust for the overpayment in the employee's employment income information. Amendments to section CE 1 then deem the outstanding PAYE-related overpayment to be income of the employee in the income year this adjustment is made.

Example: Breach of repayment agreement

If Cory does not comply with any further repayments, after 2 months or earlier if Celery Treats Limited considers that Cory will not comply with the agreement in the future. Celery Treats Limited will have to add the outstanding amount to Cory's next payday return:

Total overpayment = $250, total associated PAYE = $47.22

Overpayment repaid = $50, associated PAYE = $9.44

Unrepaid PAYE related overpayment = $200 gross with $37.78 of associated PAYE

Cory's payday to create the upwards adjustment:

Gross: $700, with PAYE of $113.38

Relationship with Regulations for error correction

Regulations made under section 23N of the Tax Administration Act 1994 provide for the mechanics of how to adjust for errors in employment income information.

Whether a PAYE related overpayment gives rise to an error in employment income information will depend on whether it is repaid. The legislative amendments provide that an amount is repaid if the amount has been repaid to the employer or if the amount is repayable under an agreement with the employer.

If a PAYE related overpayment is repaid or repayable under agreement the employment income information will contain an error and the regulations provide that the employer may correct this in one of the following ways:

(a) File an amendment to the original submission of information.

(b) Adjust (decrease in gross and associated deductions) for the employee in a subsequent payday for the total amount of the overpayment.

(c) Adjust incrementally in subsequent paydays as the overpayment is repaid to the employment.

If option (b) is chosen and the agreement to repay is breached, the employer must make an upward adjustment in a later payday.

Overpayments and employment related loans

Section CX 10 of the Income Tax Act explains when a fringe benefit may arise in relation to employment-related loans. New subsection CX 10(2)(bb) excludes an amount that is a PAYE-related overpayment from being an employment-related loan which gives rise to a fringe benefit.

This amendment clarifies that no liability for fringe benefit tax would arise because of the overpayment, even if the employer allowed an interest free period for it to be repaid.

MID YEAR ENTRY TO THE ACCOUNTING INCOME METHOD

Section RC 5(5B)(a) of the Income Tax Act 2007

Currently taxpayers who are otherwise eligible to pay provisional tax under the accounting income method (AIM) can only elect to use AIM prior to their first payment date under AIM. Once the income year has commenced this means they will have to wait until the next income year to use AIM. This amendment allows those taxpayers who currently use another provisional tax method (other than the estimation method) to switch to AIM at any time during an income year prior to the final payment due under AIM for that person.

Background

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 inserted a new provisional tax method into the Income Tax Act 2007. AIM allows taxpayers who meet the requirements within section RC 5(5B) to calculate their provisional tax payments on a pay-as-you-go basis.

Where a taxpayer who meets the criteria of section RC 5(5B) elects to use AIM they must make that choice "on or before the first instalment date for them under the AIM method". This allows new businesses to commence using AIM during an income year (as long as they choose to do this prior to their first AIM payment due for that year). Existing businesses must wait until the following income year to choose to use the AIM method.

In order to make the transition to AIM more attractive to taxpayers, it is proposed to allow those, who are otherwise eligible to use AIM, to switch to AIM during the income year rather than having to wait until the following income year.

Key features

The amendment allows an eligible taxpayer to switch to AIM from either the standard or GST ratio method at any time during the income year prior to the final due date for AIM for that taxpayer, as long as they have made the required payments under that prior method.

Application date(s)

The amendment will apply from the start of the 2019–20 income year.

Detailed analysis

Taxpayers who otherwise meet the criteria in section RC 5(5B) of the Income Tax Act 2007 will be permitted to switch to the AIM method at any time prior to the final AIM payment where:

- they use another concessionary provisional tax method (that is, either the standard or the GST ratio method); and
- they have made all payments due under those methods prior to the date of switching to the AIM method.

Example

McGarrett Enterprises Limited (McGarrett) is the maker of flower leis for tourist operators. McGarrett has historically made their provisional tax payments under the standard method. After talking with a number of other small business owners Steve, McGarrett's owner, decides that because of the seasonality of the lei business the AIM method would be the best way to pay provisional tax. McGarrett is part way through its 2020–21 income year. It has a March year end and has made its first two provisional tax payments totalling $5,000 on the 7th of August and 15th of January in full and on time.

McGarrett has already been using an AIM capable software product but has not turned the AIM function on. Steve does that at the end of January. This will mean his first AIM payment is due on the 28th of February. McGarrett switches on the AIM calculation part of its accounting software and it calculates that at the end of January McGarrett owes $6,200 in provisional tax. McGarrett makes an AIM payment of $1,200. Because McGarrett is switching from the standard method to AIM and has made all its payments due under the prior method, it can then make the switch to the AIM method during the year. McGarrett meets all the other requirements to use the AIM method.

Example

Dr Max's Malasadas Limited (DMM) is the manufacturer of specialty Hawaiian donuts. It has a turnover of $3.5m and uses accounting software to maintain its business records. That software is AIM capable and because of the volatility of DMM's sales, Dr Max, the owner, decides that it would be better to use the AIM method for provisional tax rather than the current standard method. DMM is part way through their 2021–22 income year and is just completing the September month end. It has a March balance date and DMM's first instalment of provisional tax was due on 7 August. Unfortunately, because of some cashflow issues DMM did not make that payment. DMM decides to switch to the AIM method and turns on the AIM capability in the software. However, as DMM has not made the payments required under the standard method it will be prohibited from switching to AIM during the year and will need to wait until the following income year to make the switch.

Taxpayers who pay or fund their provisional tax through a tax pooling intermediary will need to transfer any funds from the pooling entity to Inland Revenue prior to the switch from the previous method to the AIM method.

Example

Kono Kameras Limited (Kono) sells travel cameras which take photos that make the subjects always look like they are on Waikiki beach. This is a limited market but can be volatile as people see photos taken by a Kono Kamera on the internet and then want a Kamera rather than actually travelling to Waikiki. Because of cashflow difficulties Kono uses a tax pooling intermediary to finance its provisional tax payments. During the 2020–21 income year Kono decides that using the AIM method would better suit its cashflow situation and decides to make the switch. Kono already uses accounting software to keep its accounts in order and that software is AIM capable.

Kono has financed its first instalment of provisional tax which was due on the 7th of August 2020, those funds have not yet been credited to Kono's account at Inland Revenue. Prior to making the switch to AIM, Kono will need to transfer those funds to Inland Revenue as otherwise it will appear that Kono has not made the payments required under the prior method and it will not be permitted to switch.

AMENDING THE PAYMENT ALLOCATION RULES

Section 120F of the Tax Administration Act 1994

This amendment alters the current payment allocation rules to allow Inland Revenue to continue to apply payments towards use-of-money interest (UOMI) first but to the oldest debt within a period first. This method will result in a larger proportion of payments being allocated to core tax liabilities which will reduce any overall UOMI cost to taxpayers. It is required to facilitate a change to the way in which Inland Revenue's computer system allocates billing items within a period.

In no case will the new method of allocation result in a greater charge for UOMI than under the current payment allocation rule.

Background

The Tax Administration Act 1994 contains a payment allocation rule in section 120F which deals with how a taxpayer's payment is allocated to amounts payable within a period. This rule requires that where the taxpayer has unpaid tax and they are liable to pay UOMI on that unpaid tax then payments are allocated to interest liabilities first and then core tax and penalties.

This is primarily driven by the fact that UOMI is charged on a "simple" basis in that interest is not compounding (that is, interest does not accrue on interest). If there were a balance of UOMI outstanding on a taxpayer's account, there is little incentive to pay that amount as it is "interest free" debt.

This payment allocation rule works well when you consider tax liabilities within a period balance in that there is one liability within a period. Where there are multiple liabilities within a period this allocation rule can be problematic.

Inland Revenue's current technology platform FIRST uses a reverse and replace model for reassessments. When a taxpayer has their assessment of tax amended the current system reverses the old assessment and replaces that with the new assessment.

This means there is only one liability within a period for a taxpayer. A decision has been made to move away from this reverse and replace model to a new methodology termed a "delta" model. Instead of replacing the original assessment it adds the difference, or delta, as an additional billing item within the tax period. The delta model only applies to debit (or additional) assessments. The reverse and replace method continues for credit (or reduced) assessments.

Key features

This amendment requires the Commissioner to allocate payments in a specific order of UOMI and then core tax but clearing the oldest debt and UOMI first within a tax period. The amendment allocates payments to more core tax debt than interest than under the current rules.

Application date(s)

The amendment will apply from 17 April 2018, the date when the second release of Inland Revenue's processes transition to its new technology platform.

Detailed analysis

The Tax Administration Act 1994 contains a payment allocation rule in section 120F which deals with how a taxpayer's payment is allocated to amounts payable within a period. This rule requires that where the taxpayer has unpaid tax, and they are liable to pay UOMI on that unpaid tax, then payments are allocated to interest liabilities first and then core tax and penalties.

This is primarily driven by the fact that UOMI is charged on a "simple" basis in that interest does not compound. If there was UOMI outstanding on a taxpayer's account, there is little incentive to pay that amount as it is "interest free" debt.

This payment allocation rule works well when you consider tax liabilities within a period balance in that there is one liability within a period. Where there are multiple liabilities within a period, this allocation rule can be problematic.

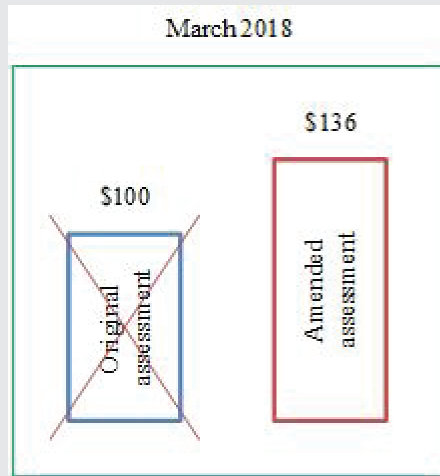
Inland Revenue's current technology platform uses a "reverse and replace" model for reassessments. When a taxpayers' assessment of tax is amended, the current system reverses the old assessment and replaces that with the new assessment.

This means there is only one liability within a period for a taxpayer. A decision has been made to move away from this reverse and replace model to a new method termed a "delta" model. The delta model only applies to debit (or additional) assessments. The reverse and replace method continues for credit (or reduced) assessments.

The difference between the "reverse and replace" and the "delta" models is that instead of the initial assessment being "reversed and replaced" with the new assessment amount under the delta model, the original assessment is left in the period and the additional amount, or delta, is added to the period. This amount may have the same or a different due date than the original assessment.

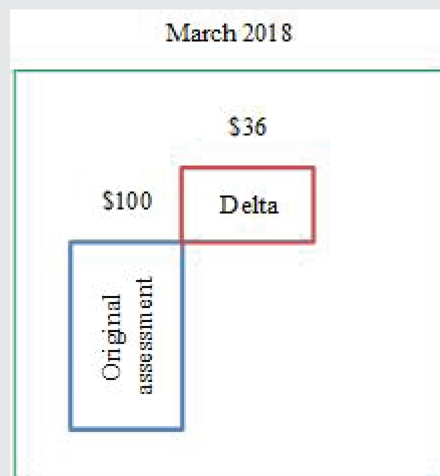
Example

A taxpayer files their return for the March 2018 goods and services tax period which has a tax payable amount of $100. In April the Commissioner of Inland Revenue amends that return and increases the tax payable amount to $136. Under a reverse and replace model the following occurs.



The original assessment in blue is replaced with the new assessment in red within the March 2018 period.

Under a delta model the following occurs:



The original assessment remains with the additional assessment (in red) added. This additional amount may, or may not, have a different due date but is treated as a separate billing item within the system.

In either scenario the taxpayer will see an assessment amount for $136 (although that amount may have sub-amounts due at different dates which will be stated).

Under the reverse and replace method there is only one billing item per tax period and the current payment allocation rules work well to ensure there is no leftover UOMI. Also, the billing to taxpayers is simple to understand as it displays one amount payable.

The delta model can have presentational and billing issues where payments received are not allocated first to the oldest billing item within a period balance. The result can be multiple statements issued for separate billing items with small balances within a period which could confuse the taxpayer. It can also result in amounts changing because of payment reallocations to reflect the "interest first" rule.

This could, in certain circumstances, result in an increased amount of interest being charged to taxpayers over the current position.

An amendment is required to the payment allocation rule that continues with the concept of interest first, but within billing items rather than the period balance. This essentially means a first-in-first-out system whereby the oldest billing item is settled first.

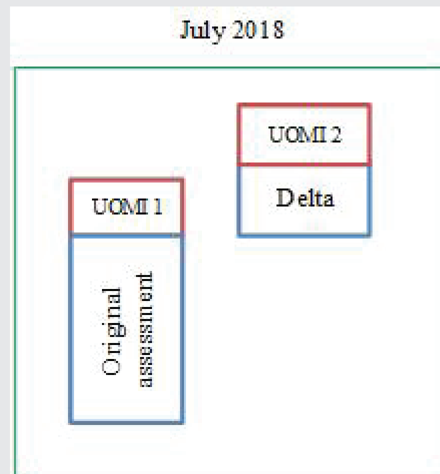
This model will simplify the system design and also lessen the impact on the taxpayer as the recalculation of interest, where there are multiple adjustments, will be eliminated. The payment allocation will continue to ensure there is no balance of "interest only" within a tax period as the payment will still apply to interest first within a billing item rather than the period.

Example

Dannos Drivers Limited (Danno) is a New Zealand ride sharing company. Danno has been in business for a few years and files its July 2018 GST return to Inland Revenue.

During a routine review of Danno's return, Inland Revenue finds than Danno has under declared the GST owing for the period. Inland Revenue issues Danno with a reassessment for that amount. Danno has already paid the amount of the original assessment a few days late and pays the remaining GST and resulting UOMI by the due date required by Inland Revenue.

Under the delta model the reassessment delta is illustrated as follows:



Under the new payment allocation rule the payment order would be:

UOMI 1
Original assessment
UOMI 2
Delta

The previous rule would require the following payment allocation:

UOMI 1 and UOMI 2
Original assessment and Delta

The amendment replaces existing section 120F(1) which rules on how payments are allocated. The current section provides for payments to be allocated to UOMI first and then core tax debt.

With the change to a delta model, the current payment allocation rule can create some difficulties with billing which could be confusing to taxpayers. The new section 120F(1) will continue with the general rule of applying payments to UOMI first, but will do this to the oldest debt within a period first. Most taxpayers will see no difference from the change in the payment allocation method, but some will see less UOMI being charged. This is because of a larger portion of a payment being allocated to core tax rather than UOMI. The legislation also includes an example to illustrate how the new rules will work.

Example: New section 120F(1) (illustrative only)

On 1 September 2019, an assessment of $100 tax to pay is raised for the 2018–19 tax year. This amount incurs $5 use-of-money interest. On 1 September 2020 a re-assessment of $120 tax to pay is raised for the 2018–19 tax year along with an additional amount of $3 UOMI. The taxpayer pays the balance of $128. Payments are applied against the $5 use-of-money interest (that is, interest on the earliest unpaid amount), then against the $100 tax. Next, payments are applied against the $3 use-of-money interest on $20 tax to pay, then against the $20 tax.

UPDATE OF OBSOLETE CROSS-REFERENCES

Sections RM 16(3), RM 22(5), RM 25(3) and RM 31(3) of the Income Tax Act 2007

This amendment corrects some cross-references in the Income Tax Act 2007 which refer to repealed section 120K of the Tax Administration Act 1994. The amendment references those sections more generally to Part 7 of the Tax Administration Act 1994.

Key features

The following four sections in the Income Tax Act 2007 refer to section 120K of the Tax Administration Act 1994, which has been repealed:

- RM 16(3);
- RM 22(5);
- RM 25(3); and
- RM 31(3).

The amendment references these sections to Part 7 of the Tax Administration Act 1994.

Application date(s)

The amendments will apply from 1 April 2008.

CORRECTION OF UNINTENDED CHANGE IN THE PROVISIONAL TAX AND USE-OF-MONEY INTEREST RULES

Section 120KB(2) of the Tax Administration Act 1994

This amendment corrects an unintended change to the application of the use-of-money interest (UOMI) rules to taxpayers who are not new provisional taxpayers but who are only required to pay provisional tax in one or two instalments. This amendment restores the intended policy position to that prior to the unintended change and includes a savings provision for a very limited number of taxpayers who have requested and received cancellation of UOMI under the unintended legislation.

Background

An unintended change to the policy intention of the rules which calculate UOMI was made when the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Bill 2005 was enacted that may have had the effect of changing the well-established position that UOMI was charged over an entire income year for all but new provisional taxpayers. This amendment clarifies the legislation to ensure it continues to reflect the correct policy intent.

Key features

The amendment restores the correct policy position on the application of UOMI to taxpayers who are not new provisional taxpayers but pay tax in one or two instalments instead of the usual three instalments. It was always intended that UOMI would apply across the three instalments of provisional tax, notwithstanding a taxpayer may only have one or two instalments.

Application date(s)

The amendment will apply from 1 October 2007 – the date the unintended change was enacted. A savings provision will apply to any taxpayer who has previously had use of money interest cancelled under the alternative interpretation of the legislation.

Detailed analysis

The Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Bill 2005 included changes to align the payment dates for provisional tax and goods and services tax with effect from 1 October 2007. As part of that Bill, section 120K of the Tax Administration Act 1994 was repealed and replaced with sections 120KB–KE. Section 120K(1) clearly stated a general rule for the calculation of UOMI on provisional tax which applied unless any of the subsections within it modified that position. It read:

> *"Except where this section requires otherwise, in a tax year, other than a transitional year, a provisional taxpayer's residual income tax is due and payable in equal instalments on each of the 3 instalment dates for the year"*

There were a number of exceptions to this rule and in particular new provisional taxpayers, safe harbour taxpayers and those in a transitional year had their own special rules.

Section 120K was essentially replaced with section 120KB(2) which reads:

> *"A provisional taxpayer's residual income tax is due and payable as set out in RC 9 of the Income Tax Act 2007"*

Again, this general rule does not apply to new provisional taxpayers, safe harbour taxpayers, or those in a transitional year.

For most taxpayers, this change in wording has no impact as most provisional taxpayers will pay their provisional tax over three instalments. However, a small subset of taxpayers who have not yet furnished their tax return for a prior income year, because of an extension of time, and who in the year before that year had residual income tax of less than $2,500 (and consequently were not a provisional taxpayer in that year) may interpret the wording differently. This wording change can arguably be read as suggesting that their residual income tax should only be apportioned over the number of instalments given by section RC 13 or 14 rather than over three instalments as intended.

At the time of the change there was no discussion of the change in policy for those particular taxpayers in any consultation process, nor was any change to that policy indicated in any Tax Information Bulletin at the time. In addition, Inland Revenue systems were not altered to reflect any policy change at that time.

This amendment clarifies the legislation to reflect the intended policy position of residual income tax being due and payable over three instalments where, because of those criteria, a person only has one or two instalments of provisional tax due. From the 2018–19 year, when changes were made to the standard method of provisional tax, which in most cases will result in taxpayers only being subject to UOMI from their final instalment date, the scope of this issue arising has reduced but it is not eliminated.

As this change in the wording of this section was untended, the amendment to clarify the wording will apply at the same date the wording was changed. However, officials are aware of a very limited number of cases where taxpayers have challenged this position and may have had UOMI cancelled to reflect this alternative interpretation. Therefore, for those taxpayers who have received a cancellation of UOMI, a savings provision will be inserted to preserve that treatment for taxpayers who have challenged that position prior to the introduction of this Bill and received a cancellation of UOMI.

Example

Kamekona Shrimp Trucks Limited (Kamekona) owns a fleet of shrimp trucks that sell world famous garlic shrimp and poke around New Zealand using a fleet of trucks. Kamekona started business in the 2010 year, and it struggled to earn substantial amounts and thus was never a provisional taxpayer in those years. In 2015 its residual income tax was $2,200 for example.

In the 2016 income year, as Kamekona's poke won the prestigious Chin Ho award for the best Hawaiian cuisine outside the Hawaiian Islands, sales from the trucks took off and the company had residual income tax of $120,000 for the 2016 year, making it a provisional taxpayer for that year. Kamekona uses a tax agent to manage its tax affairs and the company has an extension of time to file its tax return for the 2016 year.

Kamekona is not a new provisional taxpayer (as they had derived income from a taxable activity in the four years prior to the 2017 year) and it has an extension of time which means it does not need to file its 2016 tax return until 31 March 2017. Section RC 9(4)(c) of the Income Tax Act 2007 states that Kamekona does not need to pay provisional tax in three instalments. Section RC 9(10) then says that Kamekona can pay provisional tax in one instalment following the rules in section RC 14. Kamekona pays $200,000 in provisional tax on 7 May 2018 (the third instalment date) for the 2017 income year.

For the 2017 income year Kemekona's residual income tax actually works out to be $300,000. This amount should be apportioned over the three provisional tax instalment dates (P1 to P3) for the 2017 year and UOMI should be charged accordingly. At P1 and P2 UOMI should be calculated on $100,000 less the amount paid of zero from the respective payment dates through to P3 and then on $100,000 from P3 being the difference between the $300,000 residual income tax and the $200,000 paid.

It is arguable the current wording of the legislation would only apportion the residual income tax to Kamekona at P3, although this was not the policy intent as UOMI is a use of money charge and the taxpayer had the use of those funds throughout the entire year. The amendment clarifies the policy intent.

PROVISIONAL TAX PAYMENT ALLOCATION RULE

Section 120L of the Tax Administration Act 1994

Provisional tax payments have their own special payment allocation rule. Currently this can result in taxpayers being left with a balance of use-of-money interest (UOMI) owing which is not incurring interest itself. This is contrary to the policy intent behind the charging of interest. This section alters that payment allocation rule for provisional tax payments to ensure that taxpayers will not be left with a balance made up solely of UOMI.

Background

Provisional tax payments have their own separate allocation rule. This rule essentially requires that all payments made by a provisional taxpayer are allocated to core tax before UOMI until the date terminal tax is due.

This rule does not fit with the usual payment allocation rule which generally requires payments to be allocated to UOMI before core tax. The general rule ensures that there is never a balance of UOMI left in an account as that amount has no due date and does not incur further UOMI.

This amendment alters the provisional tax payment allocation rule to more closely align with the general rule and simplifies the system design so that only one payment allocation rule exists after the calculation of UOMI.

Key features

This amendment alters the provisional tax allocation rule so that payments made before the due date for instalment F (the final instalment) will be allocated to core tax. Payments made after that date will be allocated using the general payment allocation rule in section 120F of the Tax Administration Act 1994.

Application date(s)

This section applies for provisional tax paid on or after 1 April 2019 for the 2018–19 and later income years.

Detailed analysis

The Act contains a change to the general payment allocation rule in section 120F which first allocates payments to the oldest billing item within an account period while retaining the current rule that UOMI is always paid prior to core tax.

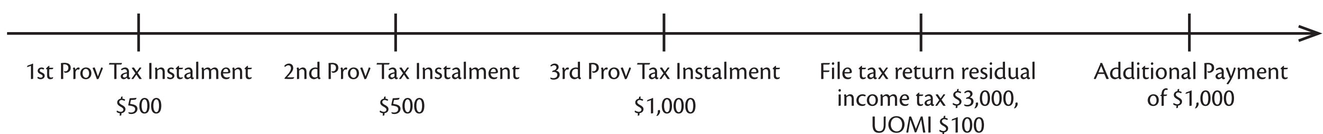
A separate payment allocation rule exists for provisional tax payments in section 120L of the Tax Administration Act 1994. This rule essentially applies any payment made prior to terminal tax date to core tax, notwithstanding there may be UOMI charged on the account. UOMI is charged to the account only when the taxpayer files their income tax return. The return gives Inland Revenue sufficient information to calculate any UOMI.

To simplify the system design within START, only one payment allocation rule should exist after UOMI has been charged on the period. The current provisional tax payment allocation rules contain two rules after the calculation of UOMI.

There are also a number of inconsistencies with the current payment allocation rule for provisional tax with the general position that UOMI should be paid first. Under the current rule, a number of cases have arisen where debts owed by taxpayers only include UOMI which is not desirable as UOMI has no due date and does not compound so the incentive to pay that debt is reduced.

This amendment addresses these inconsistencies and simplifies the payment allocation rules for taxpayers by adopting the general rule for payments made for income tax after the final instalment date for provisional tax for that taxpayer. This change will ensure that no debit balance of UOMI is left in the period and that it aligns the payment allocation rules.

The change in the allocation rule can be illustrated as follows:



Previous rule

The final payment of $1,000 would be apportioned totally to core tax rather than to UOMI first. This will leave a UOMI balance in the taxpayers account of $100 which has no due date and does not incur further UOMI.

New rule

Under the new rule, any payments made after the third instalment will be apportioned to UOMI prior to core tax, as is the usual payment allocation rule. In this example, the $1,000 will be apportioned to $100 of UOMI and $900 of core tax which will leave a balance of $100 of core tax which will continue to incur UOMI until that amount is paid.

Example

Lukela Helicopters Limited (Lukela) is a company that operates scenic flights around the Wellington region. Duke the owner takes care of the company's tax obligations. Lukela is a provisional taxpayer and for the 2021 tax year uses the standard method to calculate its provisional tax instalments which are based on 105% of the prior year. Duke calculates that Lukela is due to make three instalments of $25,000.

Lukela has a March Balance date and is due to make those payments on the following dates:

28 August 2020	$25,000
15 January 2021	$25,000
7 May 2021	$25,000

Duke makes the three payments on time. Each of those payments is allocated to provisional tax payments due on those dates. On 7 June 2021, Duke realises that Lukela has had a better year than he expected and calculates that the company has underpaid its provisional tax by $50,000.

Duke doesn't want to incur any additional UOMI charges and decides to pay that tax as soon as possible. On 14 June 2021, Duke pays $50,000. Up until 14 June, the UOMI that has accrued on that debt is $416.63, on the basis that Lukela has met all the requirements to have UOMI charged from the date of the third instalment.

As the payment made by Duke was made after the date of the final instalment of provisional tax it will be allocated according to the normal payment allocation rule in section 120F which allocates payments to UOMI before core tax. The payment will be allocated as follows:

UOMI	$ 416.63
Core tax	$49,583.37

This will leave a balance of core tax in the account of $416.63 which will continue to accrue UOMI.

INCREMENTAL LATE PAYMENT PENALTIES ON IMPUTATION AND MĀORI AUTHORITY CREDIT ACCOUNTS

Sections 139B(2B)(b)(bb) and (bc) of the Tax Administration Act 1994

As part of Budget 2016, the Government removed incremental late payment penalties on income tax, goods and services tax and working for families debt. This also removed incremental penalties on imputation and Māori Authority credit accounts as part of the migration of those accounts into the START technology platform.

Background

Inland Revenue research showed that in some situations, incremental late payment penalties can discourage taxpayers from resolving large tax debts. The government responded by removing incremental late payment penalties on certain tax types.

Within Inland Revenue's new technology platform START, the system design for imputation and Māori Authority credit accounts will differ from that in FIRST. In FIRST, they are treated as separate tax types – in separate tax accounts. Whereas in START, these credit accounts will be integrated as part of a single income tax account. Due to this, the imposition of incremental late payment penalties on debit balances in imputation and Māori Authority credit accounts will be inconsistent, as income tax debts will not incur these incremental late payment penalties.

Key features

The amendment removes incremental penalties charged on further income tax and imputation additional tax charged on imputation and Māori Authority credit accounts.

Application date(s)

The amendment will apply for further income tax and imputation additional tax imposed for the 2018–19 and later income years.

Detailed analysis

When a taxpayer fails to pay their tax on time they are charged an initial late payment penalty of 1% of the outstanding tax the day after the due date for payment, a further 4% seven days after the due date and incremental late payment penalties of 1% per month thereafter until the unpaid tax is resolved.

From 1 April 2017 incremental late payment penalties are no longer imposed on goods and services tax, income tax and working for families tax credit overpayment debts.

New Zealand's imputation regime ensures that the double taxation of income is reduced or eliminated for New Zealand residents by allowing companies and Māori Authorities to attach imputation or Māori Authority credits to distributions made to shareholders/members which offsets, partially or fully, the tax liability on the distributions.

One of the fundamental rules of the imputation regime is that a taxpayer cannot attach more credits than you have paid income tax (debit balance). A debit balance after 31 March of each year may incur "further income tax" which is the amount of the debit, plus a 10% penalty. Further income tax is also currently subject to incremental late payment penalties of 1% of the remaining balance per month. In the FIRST system, further income tax is treated as a separate tax type which interacts with the income tax account when payments are made in a cumbersome manner.

In Inland Revenue's new START technology platform "further income tax" is not held in a separate tax type, but rather integrated into the income tax accounts for taxpayers.

Integrating these tax accounts will simplify the system for taxpayers; however, because incremental penalties continue to exist for "further income tax" but not "income tax", this integration will be problematic. Removing incremental penalties from further income tax will enhance the integration of these accounts and simplify the billing for taxpayers.

Example

Lou's Leisurewear Limited (LLL) is New Zealand's preeminent manufacturer of authentic Hawaiian shirts. It has a huge demand for its products from New Zealand, Australia and the United States. During the 2021 tax year Lou Grover, the owner, decides that LLL should pay a dividend to shareholders of LLL as it has surplus cash.

LLL has a balance in its imputation credit account of 5,000,000 and the dividend is due to be paid on 10 January 2021. Lou decides to pay a dividend of $15,428,581 to which he attaches 6,000,000 giving a gross dividend of $21,428,581 on the basis that LLL will pay another $1,000,000 in provisional tax prior to 31 March 2021.

Unfortunately, due to an unusually bad summer in Australasia and a change to more flamboyant designs in the United States, LLL suffers an unexpected downturn in sales which means that LLL no longer needs to make any further provisional tax instalments for the year.

In his attempts to rebuild sales in those markets Lou forgets that the imputation credit account was in debit. LLL is charged further income tax of $1,000,000 and an imputation penalty tax payable of 10% on that of $100,000 as well as the initial late payment penalties of 1% and 4% seven days after. No further incremental penalties will be charged on that balance (although UOMI will continue to accrue on that amount).

ALTER THE TIME A CREDIT BECOMES AVAILABLE FOR CERTAIN INCOME TAX RETURNS FILED EARLY

Sections 173L of the Tax Administration Act 1994

This amendment changes the date an income tax credit that arises from tax withheld or deducted on their behalf is available where a taxpayer files a return of income before the end of the tax year for some reason. The credit will now be available from the day on or after the date the return is filed. Generally, this will apply to taxpayers who have died, migrated or liquidated.

Background

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 altered the date that a credit was available for GST purposes, aligning the date a credit could be used with the date the GST return relating to the credit was filed. Currently, an issue exists for those taxpayers who have too much tax deducted or withheld and whose annual income tax return has been filed early. This could be due to death, migration or insolvency.

For those taxpayers, any credit may not be available to them until sometime after they file their tax return which can delay the settlement of estates and dissolution of companies. Inland Revenue has been using a manual work-around to deal with these cases, however, this amendment provides a more permanent legislative solution to facilitate the earlier use of these credits.

This amendment replicates the current rule for GST returns for income tax returns. The availability of the credit would then align to the date the return is filed in the case of returns filed early. It is not appropriate to fully adopt the rules for GST returns due to extension of time arrangements for income tax returns. This change will only affect income tax returns filed before the end of the income year.

Key features

Excess income tax credits that arise from tax over withheld or deducted on the taxpayer's behalf will be available from the day on or after the date that an income tax return for the period is filed when that return is filed before the end of the income year for some reason such as death, migration or insolvency.

Application date(s)

The amendment will apply from 1 April 2019.

Example

Tanirey Tech Limited (TTL) is a technology consultancy business which provides advice relating to protecting businesses from cyberattacks. After receiving a number of threats to her personal safety from hackers Tani, the owner of the company, decides to quit the business and winds up TTL before moving to an unknown destination offshore.

Because of changes made to the scheduler payment rules, TTL has had tax deducted from payments made to it by customers. Because Tani wants to minimise her compliance costs, Tani made sure that the rate of withholding deducted by customers exceeded the actual tax liability of TTL to ensure she or the company did not have to pay provisional tax.

On wind-up TTL files a tax return for the 2021 income year prior to the end of the income year claiming those excess tax credits as a refund which amounted to $23,000. Tani filed TTLs return on 6 February 2021. Under the new provision that excess credit is available to be refunded or transferred on 6 February 2021.

Other policy matters

ANNUAL SETTING OF INCOME TAX RATES

Schedule 1 of the Income Tax Act 2007

The annual income tax rates for the 2018-19 tax year are the rates specified in schedule 1 of the Income Tax Act 2007.

Application date

The rates apply for the 2018-19 tax year.

PIE, UNIT TRUST AND OWNERSHIP INTEREST REMEDIALS

Sections HM 28, YA 1, YC 12, YC 18, YC 18B, YC 18C, YC 19B and schedule 29 of the Income Tax Act 2007

Remedial amendments have been made to the portfolio investment entity ("PIE") rules, public unit trust rules and the definition of ownership interest.

Application date(s)

The amendment to the notional single person concession for public unit trusts applies for the 2008–09 and later income years to align with the start of the Income Tax Act 2007.

The other amendments apply from 18 March 2019, the date of Royal assent.

Detailed analysis

Wind-up of a listed PIE

A listed PIE is a company that is listed on a recognised exchange in New Zealand and meets a number of other requirements to be a PIE. Like other types of PIEs, a listed PIE has a number of benefits over a non-PIE, such as the ability to distribute income, including capital gains, without further tax in the hands of the investor.

The eligibility requirements to become a listed PIE include a two-year transitional period for an entity intending to become a listed PIE. This transitional period allows an entity that is not listed on a recognised exchange to become a listed PIE provided it:

- has 100 shareholders or more;
- has resolved to become a company listed on a recognised exchange in New Zealand if it were to obtain the required consents;
- has applied to the Financial Markets Authority for an exemption from disclosing in a product disclosure statement its intention to become a listed company; and
- satisfies the Commissioner that the company would apply to become a listed company if it were to obtain the required consents.

If the company becomes a listed PIE under these criteria but is not listed on a recognised exchange within two years, it will lose its listed PIE status unless the Commissioner of Inland Revenue considers it is reasonable to grant an extension.

An equivalent provision has been added for a listed PIE delisting as part of the process of winding up. This prevents a distribution by a listed PIE while it is listed on a recognised exchange, and a distribution by a former listed PIE once it is delisted, being subject to different tax rules.

A listed PIE can retain its PIE status for up to two years, or longer if the Commissioner considers it reasonable, after it ceases to be listed on a recognised exchange if this cessation is part of the wind-up process. A listed PIE can elect under section HM 29, prior to delisting, that it will cease to be a PIE at a future date. This will provide the PIE with up to two years, or longer if the Commissioner considers it reasonable, to distribute its remaining assets.

PIE status for a listed PIE using this method will be lost at the earlier of:

- two years (or longer) from the date the listed PIE is delisted;
- the date specified in the HM 29 election; or
- when the number of shareholders reduces below 100.

Two changes have also been made to the definition of a listed PIE in section YA 1:

- paragraph (a) has been extended to include a listed PIE going through the wind-up process described above; and
- paragraph (c) and (d) have been repealed as they duplicate conditions that are already covered by section HM 7. This change is not intended to alter how the rules operate.

PIE maximum investor interest exemption

An entity listed on schedule 29 of the Income Tax Act 2007 can own up to one hundred percent of a PIE without the PIE breaching their minimum number of investors or maximum investor interest requirements, which are normally 20 investors and no investor with more than 20 percent respectively.

A small number of City and District councils and their subsidiaries had previously been included, or requested to be included, on schedule 29 as they invested in a PIE for the benefit of their ratepayers and were therefore considered equivalent to being widely held.

Schedule 29 has been amended to include local authorities and their wholly-owned subsidiaries. Consequently, Auckland Council and Quayside Holdings Limited have been removed from schedule 29 as they are covered by the local authority and subsidiary addition.

Damages, insurance and other compensation received in relation to land

Section HM 12 limits the income types that can be derived by a PIE. This restriction is designed to ensure a PIE largely earns passive income; which can include leasing of land from a non-associated person. New section HM 12(1)(b)(ivb) allows a PIE to derive insurance, indemnity, or compensation amounts in replacement for lease income. This is intended to cover situations where a PIE owns land that is, or is intended to be, leased and derives income to compensate them for foregone lease income such as insurance or compensation when the property has been damaged making it untenantable or is not repaired within a previously agreed time.

Public unit trusts investing in PIEs

Generally, a PIE (or class within a PIE) is required to have at least 20 investors with no investor holding more than 20 percent of the PIE. An exception to this is in section HM 22 which overrides this requirement if the investor meets 1 or more of paragraphs (a) and (c) to (e) of the definition of a public unit trust in section YA 1.

Paragraph (e) of this definition is designed for wholesale funds who have less than 100 investors but are invested into by other funds. Paragraph (e) has been extended to include funds that are invested into by a PIE as a PIE can always be considered widely held or equivalent to widely held. Previously most wholesale funds with PIE investors could already meet paragraph (e) as the PIEs would be a unit trust or other entity already listed in the paragraph, or had more than 50% of investment meeting the definition so that that the wholesale fund was mainly for investment by widely held vehicles. The primary change from adding PIEs is a fund relying on paragraph (e) will be able to have one or more listed PIEs owning 50% or more of the wholesale fund.

Notional single person concession for public unit trusts

Minimum shareholder continuity requirements are imposed on companies, including unit trusts, for the carry forward of tax losses and imputation credits. Exemptions to these continuity requirements apply when shareholding changes are between less than ten percent holders and a number of other requirements apply – referred to as the notional single person concession.

A public unit trust is a defined term that covers unit trusts meeting one of a number of criteria indicating the unit trust is widely-held by unassociated persons. This definition was introduced to further extend the shareholder continuity exception to unit trusts by treating a public unit trust as being held by a notional single person that:

- is not a company;
- exists as long as the unit trust exists; and
- holds nothing other than the shares in the unit trust.

However, the notional single person concession applies only where the public unit trust chooses to apply it. This optionality was included so that a public unit trust would not be disadvantaged by introducing the concession, for example if the existing unit holders in the public unit trust were deemed as selling all their units to this notional single person and therefore breaching shareholder continuity.

Previously the legislation assumed that a public unit trust would have chosen to apply the notional single person concession where it was advantageous to do so. However, the notional single person concession is also intended to apply to a chain of companies (or other entities) owned by that public unit trust including where the public unit trust is not a New Zealand tax resident. In this circumstance the public unit trust may not have chosen to apply the notional single person concession as they do not have a New Zealand tax liability and obtain no direct benefit from making this choice even though an entity they own would benefit.

Section YC 12(1B) has been added to allow a taxpayer who is, directly or indirectly, wholly or partially owned by a public unit trust to choose the treat the public unit trust as applying the notional single person concession without the public trust having to separately choose to apply it.

As this change is consistent with the existing policy intent and some taxpayers owned by public unit trusts may have already been applying the rules in this manner, the amendment applies for the 2008–09 and later income years to align with the start of the Income Tax Act 2007.

Example

A widely-held unit trust meets the definition of a public unit trust but has no association with New Zealand other than wholly owning a New Zealand incorporated company. During a certain period, there have been no ownership changes in the New Zealand incorporated company but the unit trust has had a number of ownership changes. As the unit trust has no dealings with the New Zealand tax system they have not chosen to apply the notional single person concession even though there is no disadvantage in doing so. Instead, the New Zealand company chooses to apply the notional single person concession to treat the public unit trust as being owned by a notional single person, and therefore not forfeiting losses or imputation credits because of a breach of shareholder continuity.

Ownership interest definition

The definition of "ownership interest" in section YA 1 originally cross-referenced to the definition in section YC 18(6) and applied only for the purpose of sections YC 18, YC 18B, YC 18C and YC 19B. The Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 inserted the definition of "ownership interest" directly into section YA 1 and applied it without restricting it to particular sections.

However, the original definition in YC 18(6) was not removed. While the two definitions are the same, the definition in section YC 18(6) was redundant and has now been removed. Consequential changes have also been made in sections YC 18B, YC 18C(5) and YC 19B(3) which previously referred to the former definition.

KIWISAVER ENHANCEMENTS

Sections 15, 18, 22, 33, 36, 56, 59A, 59B, 62, 64, 101C, 101G, 102, 104, 105, 106, 107, 108, 109, 110, 111, 112, 114, 112B, 241 and schedule 1 of the KiwiSaver Act 2006

Section MK 2 and schedule 28 of the Income Tax Act 2007

The Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 (the "ARMTARM Act") makes a number of enhancements to KiwiSaver, based on recommendations made in the Retirement Commissioner's 2016 review of retirement income policies.

Background

The Retirement Commissioner reviews retirement income policies every three years. Their most recent review, published in December 2016, included recommendations aimed at improving the effectiveness of KiwiSaver in helping New Zealanders save for their retirement and making KiwiSaver accessible to more New Zealanders. The amendments to the KiwiSaver Act 2006 are based on recommendations made in this review.

Key features

The following changes have been made to the KiwiSaver Act:

- Additional employee contribution rates of 6% and 10% have been introduced.
- The maximum contribution holiday period has been reduced from five years to one year.
- The "contribution holiday" has been renamed the "savings suspension".

- Over 65 year olds are able to opt-in to KiwiSaver.
- The five year lock-in period (which effects members who join KiwiSaver after the age of 60) has been repealed.
- A transitional rule has been introduced for members who are subject to the lock-in period at the date it is repealed.

The "member tax credit" has also been renamed the "Government contribution" – this change applies from 1 April 2019, in line with the timing of the majority of the KiwiSaver changes in the ARMTARM Act. The name "member tax credit" has caused some confusion for members and the new name is aimed at improving understanding of this KiwiSaver benefit. This name change does not require legislative amendment.

Application dates

The additional contribution rates, reduction of the contribution holiday period, and contribution holiday name change apply on and from 1 April 2019.

Over 65 year olds will be able to opt-in to KiwiSaver, the lock-in period will be repealed and the lock-in period transitional rule will be introduced on and from 1 July 2019.

KiwiSaver members who are subject to the lock-in period transitional rule, will have the option of exiting the lock-in period on and from 1 April 2020.

Detailed analysis

Additional 6% and 10% employee contribution rates

Section 64 of the KiwiSaver Act has been amended so that employees are now able to choose to contribute 6% or 10% of their salary and wages to their KiwiSaver account. These rates will be available to members in addition to the existing 3%, 4% and 8% employee contribution rates.

Reducing the maximum contributions holiday period and changing the name of the contribution holiday

Section 104(3)(b)(i) of the KiwiSaver Act has been amended so that that the maximum permitted contributions holiday period is reduced from five years to one year. Taking a five year contributions holiday can have a significant impact on members' long-term savings. And this change reflects that, for many members, five years is longer than necessary for their financial position to improve to a point where they could resume contributing to KiwiSaver.

This amendment will apply to all contributions holiday applications made after the change comes into effect (that is 1 April 2019), so existing contribution holidays will continue until they expire.

All references in the KiwiSaver Act to contributions holiday have been replaced with savings suspension. This name change more accurate describes what actually happens when a member takes a break from contributing to their KiwiSaver account.

Allowing over 65 year olds join KiwiSaver

From 1 July 2019, section 33(a) of the KiwiSaver Act will be repealed, meaning over 65 year olds will be able to opt-in to KiwiSaver. This change will give over 65 year olds the benefit of access to KiwiSaver as a provider of low-cost managed funds. No changes will be made to the existing law relating to automatic enrolment in KiwiSaver or the upper age of eligibility for the member tax credit and compulsory employer contributions (meaning over 65 year old KiwiSaver members, not subject to the lock-in period transitional rule, will remain ineligible for these entitlements).

Consequential amendments to the KiwiSaver invalid enrolment rules (in sections 59A and 59B of the KiwiSaver Act) provide that an over 65 year old opting-in to KiwiSaver under section 33 of the KiwiSaver Act will no longer be an invalid enrolment. And a consequential amendment to schedule 28 of the Income Tax Act 2007 removes the rule that complying funds are required to prevent over 65 year olds from joining.

Removing the lock-in period

Excluding other permitted early withdrawals, members either become eligible to make a withdrawal from their KiwiSaver account on reaching the New Zealand Superannuation qualification age (which is 65 years old) or the five year qualification date. The five year qualification date (referred to commonly as the lock-in period) only affects members who join KiwiSaver after the age of 60 (and therefore have not been a member for five years when they reach the New Zealand Superannuation qualification age).

The purpose of the lock-in period was to prevent people in the 60–65 age bracket from joining KiwiSaver to receive the $1,000 kick-start payment and then withdrawing their funds soon after. As the kick-start was repealed as part of Budget 2015, the lock-in period is no longer necessary. Allowing over 65 year olds to opt-in to KiwiSaver provides a further reason to repeal lock-in period, as over 65 year olds joining KiwiSaver may require access to their funds within their first five years of membership (such as if they become unable to support themselves through paid employment, or to address age-related needs).

From 1 July 2019, clause 4 of schedule 1 of the KiwiSaver Act will be replaced with a new withdrawal age rule. The new clause 4 allows members to withdraw their funds when they reach the New Zealand Superannuation age, regardless of how long they have been a KiwiSaver member (therefore effectively repealing the lock-in period).

Cross-references to clause 4 in sections 15, 36, 101C, 234C of the KiwiSaver Act and section MK 2 of the Income Tax Act 2007 have also been consequentially amended.

Lock-in period transitional rule

The new clause 4 also includes a transitional rule, meaning over 60 year olds that joined KiwiSaver before the repeal of the lock-in period (that is before 1 July 2019) would remain locked-in for the duration of their first five years of membership. They would also remain entitled to receive the member tax credit and compulsory employer contributions while they are locked-in.

However, from 1 April 2020, new clause 4(6) will allow over 60 year olds that are subject to the lock-in period transitional rule to exit the lock-in period and make withdrawals on reaching 65 years old (in doing so they would forfeit their entitlement to further member tax credits and compulsory employer contributions). These members will be able to do this by giving notice to their scheme provider of their election to exit the lock-in period – an application to make a post 65 withdrawal would suffice as notice. The 1 April 2020 application date for this feature, reflects that its implementation has some technical complexity.

Example: Repeal of the lock-in period and transitional rule

Scenario A

Matt joins KiwiSaver, aged 64, in August 2019. By the time Matt has joined, the lock-in period has been repealed and he will be able to make a withdrawal from his KiwiSaver account on turning 65, despite the fact he has only been a KiwiSaver member for 1 year.

Scenario B

Ben joins KiwiSaver, aged 64, in December 2018. As he joined prior to the repeal of the lock-in period and would not have been a KiwiSaver member for 5 years when it is repealed on 1 July 2019, he will be subject to the lock-in period transitional rule. Therefore, at the time of the repeal of the lock-in period, he would not be able to make a withdrawal from his KiwiSaver account.

In June 2020, Ben (now aged 65) decides to retire and take an overseas trip. To help fund this trip he would like to withdraw some of the savings he has accumulated in KiwiSaver over the last year and a half. As he is looking to do this after 1 April 2020, he will be able to exit the lock-in period transitional rule, by giving notice to his scheme provider that he wants to make a withdrawal. However, by opting out of the transitional rule he will no longer be eligible for the member tax credit or compulsory employer contributions for the rest of his first five years of KiwiSaver membership.

Transitional period for KiwiSaver scheme providers

New section 241 of the KiwiSaver Act grants transitional relief to KiwiSaver scheme providers who are non-compliant with product disclosure statement requirements or other requirements to file material information on the Disclose Register under the Financial Markets Conduct Act 2013, as result of the KiwiSaver changes in the ARMTARM Act. This period of transitional relief ends on 1 September 2019, meaning scheme providers have over five months relief post the enactment of the ARMTARM Act, before they will risk incurring penalties under the Financial Markets Conduct Act 2013.

TAXATION OF BLOODSTOCK

Sections CG 8B, CG 8C, EC 39, EC 39B, EC 39C, EC 47B to EC 47E, EZ 6B, YA 1, and schedules 18B and 18C of the Income Tax Act 2007

Section 225AB of the Tax Administration Act 1994

Background

In Budget 2018, the Government announced its intention to amend the tax treatment of expenditure incurred on high quality yearlings when an investor has an intention to breed for profit in the future.

The Government's expectation is that, on average, 20 thoroughbred and 10 standardbred yearlings will qualify each year. The policy objective is to encourage new investment in the New Zealand racing industry.

Key features

Generally, a person must have a bloodstock breeding business to qualify for tax deductions in relation to owning bloodstock.

These amendments allow investors that do not currently have a bloodstock breeding business to qualify for tax deductions in relation to owning bloodstock if they acquire "high priced yearlings" with an intention to breed in the future for profit.

High-priced yearling refers to bloodstock acquired, either directly or indirectly, from a premier yearling sale for an amount above the relevant price threshold set for that calendar year. Each year the thresholds are set by the Commissioner, taking into account the last year's sales results.

To qualify for tax deductions, investors must also:

- notify the Commissioner of Inland Revenue of their intention to use the bloodstock for breeding for profit in the future; and
- provide the information required by the Commissioner.

The sale of a high-priced yearling by a prospective bloodstock breeder is assessable income in accordance with the existing bloodstock rules. There are also recovery rules where a high-priced yearling is sold to a non-resident or exported without first racing or being used for breeding in New Zealand.

Application date

Most of the amendments apply from 1 January 2019. The amendments requiring the Commissioner to set and publish the national minimum price thresholds each calendar year apply from 1 January 2020.

Detailed analysis

Prospective bloodstock breeders treated as being in breeding business

New section EC 47C treats a prospective bloodstock breeder as having a bloodstock breeding business from the day that they acquire stud-founding bloodstock.

Stud-founding bloodstock means high-priced bloodstock acquired by a prospective bloodstock breeder before the yearling turns two years of age and where the notification requirements are met. This rule allows the syndication of a yearling that is high-priced bloodstock prior to the yearling turning two.

High-priced bloodstock is bloodstock that has been acquired at a premier yearling sale (these sales are defined in schedule 18B) for an amount greater than the relevant national minimum price threshold. For 2019, these thresholds are in the new section EZ 6B.

For the 2020 calendar year and beyond, the Commissioner must set and publish the national minimum price thresholds before the first premier yearling sale in the relevant calendar year. Where the Commissioner fails to do this, the most recently published thresholds will apply to sales occurring until the Commissioner sets and publishes thresholds for that calendar year.

A prospective bloodstock breeder means a person who acquires bloodstock when they do not have an existing bloodstock breeding business but intend to first race the bloodstock in New Zealand and use the bloodstock for breeding in New Zealand for profit.

Notification requirements of an intention to breed

Under the notification requirements the owner(s) must, within four months of acquiring the high-priced bloodstock, provide the Commissioner with the following:

1. Notification of intention to breed.
2. Sale and purchase documentation (and, if not included in documentation, lot number/sale name/horse identification (colt/filly, dam/sire etc)).
3. IRD/GST number of the owner. If multiple owners (syndicate/partnership) details of the entity, including all owners.
4. Contact details of all owners: physical address, phone number, e-mail address.
5. Balance date.
6. Owner's founding documents (syndicate/partnership agreement).
7. Breeding business plan that includes:
    a. A description of the business.
    b. The research undertaken on the yearling's breeding pedigree and future commercial breeding prospects.
    c. Location of activity.
    d. Racing programme designed to prove the horse's breeding value (how is horse to be raced/racing management?).
    e. Where and when is horse to commence breeding and who/how is this to be managed?
    f. Financial forecasts.
    g. Involvement of racing/breeding/syndicate manager (overall management of horse).
8. Veterinarian reports:
    a. For syndicates required to operate in accordance with the "Bloodstock Syndication Code of Practice", a copy of the veterinarian certificate obtained; and
    b. For all other syndicates, confirmation that an external physical examination was carried out by a veterinarian prior to purchase together with the details of the veterinarian who performed the examination.
9. Any other relevant communication within the syndicate prior to filing the application for a deduction for the cost of the high-priced bloodstock.

Meeting these requirements entitles a prospective bloodstock breeder to claim tax deductions for the write-down in the horse's value and other expenses, just like the owner of an existing bloodstock breeding business.

Notification requirements on change of intention to breed

There is significant uncertainty whether a particular high-priced yearling will be used in a breeding business. This is because many yearlings never get to be used in a bloodstock breeding business due to injury, being gelded and/or poor racing performance.

New section EC 47D applies when a prospective breeder has been allowed deductions in relation to their high-priced bloodstock and change their intention or the horse is no longer expected to be used for future breeding. The owner is treated as having disposed of the high-priced bloodstock at the bloodstock's market value on the day their expectation or intention changes.

When the owner(s) of high-priced bloodstock changes their intention to breed from the bloodstock in the future for profit, the Commissioner requires them to provide the following information:

1. If horse is gelded or deceased, a copy of the invoice noting the date of gelding or death.
2. If exported, a copy of the export documentation.
3. Copies of any change of ownership forms.
4. All communication relating to any change of intention to breed.
5. Financial statements (or financial statements summary IR10 form, where no other financial statements have been prepared) tax reconciliations and bloodstock schedules.

Other bloodstock owned by a prospective bloodstock breeder

New section EC 47C also has rules relating to other bloodstock owned by a prospective bloodstock breeder. If a prospective bloodstock breeder concurrently owns bloodstock that is not stud-founding bloodstock, that bloodstock is not treated as part of the prospective bloodstock breeder's bloodstock breeding business.

Bloodstock breeding business commences

When a bloodstock breeding business commences with the stud-founding bloodstock, the existing bloodstock rules apply.

Where a prospective breeder commences breeding using bloodstock that is not stud-founding bloodstock section EC 47E applies. The breeding business owner can apply to the Commissioner to have the stud-founding bloodstock treated as being used in the existing bloodstock breeding business. The application must be made within one month after the day that the bloodstock business commences. If the application is approved, then the recovery rules that apply to stud-founding bloodstock removed from New Zealand or sold to non-residents no longer apply.

Recovery rules

If stud-founding bloodstock is removed from New Zealand before first being raced in New Zealand or used for breeding in New Zealand, the owner can make deductions in relation to that bloodstock, and the bloodstock is expected to be able to be used for future breeding, then the owner is treated as having disposed of the high-priced bloodstock. New sections CG 8B and CG 8C apply as appropriate in these circumstances.

These sections recover the greater of the amount of the consideration received for the sale of the high-priced bloodstock or the total deductions that have been allowed in relation to that bloodstock.

TAX STATUS OF PUBLIC PURPOSE CROWN CONTROLLED COMPANIES AND PUBLIC AUTHORITIES

Sections CW 38B, YA 1 and schedule 35 of the Income Tax Act 2007

Sections 2 and 6 of the Goods and Services Tax Act 1985

Section 32E of the Tax Administration Act 1994

Certain Crown controlled companies listed in schedule 4A of the Public Finance Act 1989 have been given their own income tax exemption, and a goods and services tax ("GST") provision comparable to that of public authorities to help ensure that GST input tax can be claimed back.

The qualifying public purpose Crown controlled companies (PPCCCs) are listed in a new schedule to the Income Tax Act 2007, and there is an Order in Council mechanism to facilitate amendments to this schedule.

A number of Crown/Parliamentary entities have also been added to the definition of "public authority" in the Income Tax Act 2007 and Goods and Services Tax Act 1985 (the "GST Act").

The purpose of these amendments is to effectively reinstate the tax outcome that the companies had before a Crown Law interpretation reduced who qualifies as a "public authority". This reinstatement will reduce compliance costs without reducing government revenue or creating economic distortions.

Background

Based on advice from Crown Law, in 2015 Inland Revenue revised its interpretation of the definition of "public authority" for tax purposes. This resulted in fewer entities qualifying as public authorities, including most of the Crown controlled companies listed in schedule 4A of the Public Finance Act 1989.

For a company to be listed in schedule 4A, it must meet all of the following criteria:

- the Crown holds more than fifty percent of the company's issued ordinary shares;
- the company's shares are not listed on a registered market; and
- the company is not a Crown entity or a State Enterprise.

In response to the revised interpretation, tax policy officials undertook to review whether the schedule 4A companies should be given their own income tax exemption, and a GST provision comparable to that of public authorities to help ensure that GST input tax can be claimed back. This review concluded that it was appropriate to have such provisions when the companies, or their subsidiaries, also meet the following requirements:

- The only other shareholders, if any, in the company are local authorities, that is, there are no private sector shareholders; and
- Their primary purpose is to carry out one of the Government's public policy objectives. This does not preclude their making a profit, but any profit has to be subsidiary to the public policy objective. This requirement distinguishes such companies from state enterprises, whose primary purpose is to make a profit.

Ten companies meet these criteria. In addition, a number of other entities were identified as warranting being deemed to be public authorities.

Key features

Public purpose Crown-controlled company amendments

Who's on schedule 35

New section CW 38B provides a specific income tax exemption for those companies listed in the new schedule 35 of the Income Tax Act 2007. The schedule lists the following ten companies that are either fully Crown owned or Crown controlled, shareholding being measured through the standard voting interest test:

- City Rail Link Limited;
- Crown Asset Management Limited;
- Crown Infrastructure Partners Limited;
- Education Payroll Limited;
- Otakaro Limited;
- Research & Education Advanced Network New Zealand Limited;
- Southern Response Earthquake Services Limited;
- Tamaki Redevelopment Company Limited;
- Tamaki Regeneration Limited; and
- The Network for Learning Limited.

Nine of these companies are listed on schedule 4A of the Public Finance Act 1989, with the remaining company being a majority Crown-owned subsidiary of a section 4A company.

Future changes

To expedite future changes, companies will subsequently be added to or removed from the schedule by Order in Council, which is consistent with the way companies are added to and removed from schedule 4A of the Public Finance Act 1989. Section CW 38B includes a power to make such Orders in Council. The policy criteria for an Order in Council will still be that the company is listed in schedule 4A or it is a subsidiary of a schedule 4A company, has no private sector shareholders and its primary purpose is to carry out one of the Government's public policy objectives.

Subsidiary companies

Specifically listing subsidiaries of schedule 4A companies rather than considering them to be automatically covered if the parent is listed in the schedule is so that there is a public record of all parties that are claiming the exemption.

However, it is possible that a company might establish a significant number of 100% owned subsidiaries over time. To avoid the need to frequently update schedule 35 just to include these subsidiaries, a 100% owned subsidiary of a company listed in schedule 35 is able to self-assess whether it also meets the requirement that its primary purpose is the carrying on of a public policy objective of the Government of New Zealand and is, therefore, a PPCCC.

Associated changes to other Acts

An amendment has been made to the GST Act to extend section 6(1)(b) to include PPCCCs, so as to ensure a GST treatment comparable to that for public authorities. This will help ensure that the companies can claim back the GST paid on their purchases.

A consequential amendment has also been made to section 32E(2)(k) of the Tax Administration Act 1994 so that PPCCC are, like public authorities, eligible for a RWT exemption certificate.

Public authority amendments

The definition of "public authority" in the Income Tax Act 2007 has been extended to specifically include:

- The New Zealand Lottery Grants Board;
- The Office of the Clerk of the House of Representatives;
- The Ombudsman;
- The Parliamentary Commissioner for the Environment; and
- The Parliamentary Service.

The definition of "public authority" in the GST Act has been amended to include the Lottery Grants Board.

The GST Act's "public authority" definition has also been amended to include PPCCCs. This excludes a PPCCC from being a "company" under the Act, which ensures that a PPCCC is not considered to be an associated person with any other government owned/controlled entity for GST purposes. A flow-on implication is that a PPCCC comes within the Act's definition of "person".

Application date

The amendments come into force on the date of enactment. Up to that date, Inland Revenue was applying its administrative discretion to treat the companies as if they were still public authorities until the legislative changes were made.

OVERSEAS DONEE STATUS

Section YZ 5 and schedule 32 of the Income Tax Act 2007

The following charities have been granted donee status for the 2018–19 and later income years:

- Books for Cambodia Trust
- Children of the Light
- Effective Altruism NZ Charitable Trust
- Flame Cambodia
- Forgotten Sherpas of Nepal
- Flow Foundation (formerly Talkingtech Foundation Trust)
- Global Development Group Limited
- Good Trust
- INF Humanitarian Aid Trust
- LIFT International (formerly NVADER)
- Nyingje Trust
- New Zealand Memorial Museum Trust – Le Quesnoy
- Rwenzori Special Needs Foundation (NZ)
- St Columban's Mission Society Trust Board

The Act also updates the name of another charity listed on schedule 32:

- "Circuit International" replaces "Partners Relief and Development NZ" with effect from 10 April 2016.

Background

New Zealand-based charities that apply some, or all, of their funds for overseas purposes and want donors to receive tax benefits for any gifts in money paid to the charity, must be named as a donee organisation on the list of recipients of charitable or other public benefit gifts in the Income Tax Act 2007.

Donee status entitles individual donors to a tax credit of 331/3 percent of the amount of the gift in money to these organisations, up to the level of their taxable income. Companies and Māori Authorities are eligible for a deduction for gifts in money up to the level of their net income.

Application dates

The new insertions apply for the 2018–19 and later income years. The other changes to the schedule apply from the dates specified above.

New Zealand Memorial Museum Trust – Le Quesnoy

New section YZ 5 of the Income Tax Act, gives the New Zealand Memorial Museum Trust – Le Quesnoy donee status for a limited period. Gifts of money paid to the Trust between 1 April 2018 and 18 March 2022 will be eligible for tax benefits.

FRINGE BENEFIT TAX ON EMPLOYMENT RELATED LOANS – MARKET INTEREST RATE

Section RD 35 of the Income Tax Act 2007

This amendment provides an alternative definition of market interest that banks and other money lenders can elect to use for valuing the fringe benefit of a loan provided to an employee. The new definition of market interest for a given employee and loan type is the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee. The amendment is intended to address the over-taxation of employment related loans that occurred under the original definition of market interest.

Background

A fringe benefit arises when an employer provides a loan to an employee. There are two ways in which the benefit of an employment-related loan can be valued. Employers not in the business of lending money are required to use a prescribed interest rate provided by legislation to value the benefit of employment related loans. However, banks and other money lenders may instead elect to value the benefit of employment related loans using the market interest rate as they have the data to accurately calculate the market rate readily available.

The market interest rate for a group of employees was originally defined as the rate their employer would offer to an arm's length group of persons with a comparable credit risk to the group of employees. Under this definition, different money lenders would therefore have different market rates as the market rate was based on the rates a given lender offers to its customers.

The market interest rate rules were based on the practices banks and other lenders were using at the time the rules were developed. Money lenders would advertise rates and, in general, customers would receive these rates if they met the necessary conditions for a loan. However, some lenders would also offer discounts to certain groups of customers. For example, a bank may have offered employees of a local respected employer a discount of 0.3 percentage points below the advertised rates. The market interest rate rules would allow either the advertised rates or the group discount rates to be offered to employees as the market interest rate without banks and other similar lenders incurring fringe benefit tax (FBT).

However, it is now common practice for banks and other similar lenders to individually negotiate loan rates with customers. Individually negotiated loans cannot be used for determining the market rate as the rates received by customers through this process have not been offered to a group.

As such, the true market rate, being the interest rate an arm's length customer receives, was often likely to be lower than the market rate calculated under the original definition. This resulted in the over-taxation of employment related loans. Furthermore, because of this over-taxation many employees of banks and other money lenders may have been able to receive better loan rates from lenders other than their employer.

Key features

The amendment adds a second option to the current market interest definition. Banks and other employers eligible to use the market interest rate for calculating FBT on employment related loans will be able to use either the original definition or the new definition of market interest.

The new definition of market interest for a given employee and loan type is the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee.

Application date(s)

The amendment came into force for FBT payment periods beginning on or after 1 April 2019.

Detailed analysis

The amendment gives employers the choice between using the original market interest definition or a new market interest definition. The original definition is now contained in section RD 35(5)(a) of the Income Tax Act 2007 and the new definition is contained in section RD 35(5)(b).

As noted above, the new definition of market interest for a given employee and loan type is the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee. The various aspects of this definition are explained below.

Similar profile

The new definition only allows loans made to customers with similar profiles to the given employee receiving a loan to be used for calculating market interest. An employee and a customer would have similar profiles if, on the factors considered by the money lender as relevant to the interest rates it offers to customers, they have similar characteristics. Factors a money lender may consider when offering loans include, but are not limited to, a customer's risk profile, amount of security, or loan to value ratio.

Ordinary course of business

The new definition only allows loans given to customers in the ordinary course of business to be used for calculating the market rate. Whether a particular loan has been made in the ordinary course of business will always be a matter of fact and degree. However, some examples of what constitutes the ordinary course of business are detailed below.

Example: Loan made in the ordinary course of business

Carlos, an employee of Third Man Bank, wants to receive a fixed rate home loan from his employer. The lowest rate Third Man Bank has offered on this type of loan to customers who meet similar lending criteria as Carlos is 4%. Only one customer has received this rate. However, a number of other customers with similar profiles have all received loans close to this rate (4.01–4.05%). The loan made at the rate of 4% will therefore be considered as having been made in the ordinary course of business. As such, the market rate for Carlos will be 4% and FBT will only be payable if Carlos receives a rate below this.

Example: Loan not made in the ordinary course of business

Fernanda, a customer of Square Leg Bank, has received a home loan rate of 2% as part of a special promotion giving one lucky customer an extraordinarily low interest rate. The rate received by Fernanda has therefore not been given in the ordinary course of business and cannot be used for determining the market interest rate.

Example: Loan made in the ordinary course of business

Caroline, a customer of Extra Cover Bank, has received an interest rate of 3.5%. No other customers with a similar profile to Caroline have received a rate that low or close to it. However, the loan was made using Extra Cover Bank's ordinary processes and Caroline received no special treatment compared to other customers. This loan has therefore been made in the ordinary course of business.

Around the same time

The new definition requires employers to calculate the market rate based on loans given to customers around the same time a loan was given to an employee. In calculating the market rate for a given employee, employers would generally be required to use loans given to customers in the same quarter that a loan was given to the employee. However, if it is not practicable for the employer to calculate the market rate using loans given to customers in the same quarter that a loan was given to the employee, they would instead be able to calculate the market rate using loans given to customers in the quarter immediately prior to the quarter in which the loan was given to the employee.

Requirement to notify commissioner of change in method

An amendment to section RD 35(4) means an employer is not required to notify the commissioner if they want to change from using the original definition to the new definition of market interest or vice-versa.

SECURITISATIONS

Sections HR 9, HR 9BA, HR 9B, HR 10, HZ 9, HZ 10, and YA 1 of the Income Tax Act 2007

Background

A securitisation is a funding mechanism that involves issuing marketable securities that are backed by the expected cash flows from specific assets. Securitisations can have a number of commercial benefits compared with other funding mechanisms, such as risk management and lower cost of funding.

New Zealand businesses with assets, such as large books of trade credits or other receivables, may wish to raise funding through a securitisation. To undertake a securitisation, a company (referred to as the originator) that owns income-producing assets transfers those assets to a special purpose vehicle (SPV). The SPV (typically a trust in New Zealand) is usually structured to be bankruptcy remote from the originator, which means that the SPV's assets cannot be accessed by the originator's creditors. The SPV then borrows from third parties on the strength of the assets that have been transferred to it and remits the borrowed funds to the originator as the purchase price for those assets.

An important commercial objective of a securitisation is maintaining tax neutrality while ensuring the SPV is bankruptcy remote from the originator. It is particularly important to ensure that the SPV itself is not exposed to a tax liability, as this can affect its credit rating (and so the interest rate at which it can borrow).

There is a concern that the current tax rules for trusts may not achieve tax neutrality for the SPV, and so may discourage securitisations. The financial arrangement rules can also trigger a tax liability on any receivables transferred into the SPV. There is also concern about the compliance costs the tax rules impose on securitisations.

The Income Tax Act 2007 already contains a securitisation regime (sections HR 9 – HR 10). Those rules were introduced as a result of the Reserve Bank of New Zealand's response to the global financial crisis. The effect of the rules is that no tax consequences arise from the securitisation transactions between the financial institution and the SPV.

However, these rules originally only applied to financial arrangements held by financial institutions. The amendments extended the rules to non-financial institutions and other asset types.

Key features

The amendments extended the securitisation regime so it applied to general corporate securitisations, rather than just to financial institutions and financial arrangements (as defined in section EW 3).

The aim of the amendments is to reduce compliance costs and tax disincentives to undertaking corporate securitisations, by taxing them in accordance with their economic substance. This is achieved by treating qualifying SPVs as transparent. The key features of the amended regime are as follows:

- It will cover securitisations involving excepted financial arrangements as well as financial arrangements and non-financial institutions as well as financial institutions.
- The accounting consolidation requirement will be met if the securitised assets are recognised in the consolidated financial statements of the either the originator or another company in the same wholly-owned group.
- The regime will be elective.
- The regime only applies to New Zealand residents.

Application date(s)

The amendments will come into force for income years starting on or after the date of enactment.

Detailed analysis

Amended section HR 9 (like the previous section) makes the SPV transparent, so that its assets and liabilities are treated as held by the originator for tax purposes. This means that the transfer of assets to the SPV by the originator is ignored, and the SPV itself is not subject to tax (with any tax on its activities being payable by the originator instead). This removes a disincentive to securitisations, in that transfers to an SPV that is economically within a wholly-owned group of companies will not have tax implications.

The SPV must be a New Zealand resident. A new definition of "debt funded special purpose vehicle" is inserted into the Income Tax Act 2007, which sets out the criteria a SPV must meet to use the new securitisation regime. This definition builds on the previous definition of a "financial institution special purpose vehicle", which will now be repealed.

The new regime will apply where the SPV issues securities to multiple investors, or where the SPV borrows (backed by its assets) directly from a bank or other lender.

Extension of the regime

The previous rules were limited to financial institutions and particular financial arrangements – New Zealand residential mortgages or loans secured by such mortgages. This limit arose out of the context in which the rules were introduced – the rules were introduced to remove any tax obstacles to the Reserve Bank of New Zealand's response to the global financial crisis, and in order to expedite their introduction they were limited to that context. However, there is no fundamental policy reason why the rules should not apply more broadly. Accordingly, the amendments extend the securitisation regime to non-financial institutions.

Non-financial institution securitisations may involve a broader range of assets, and indeed assets that are not financial arrangements, such as trade receivables and operating leases. The amended regime will, therefore, apply to securitisations of both financial arrangements and excepted financial arrangements.

Multiple originators

The amendments allow for securitisations with multiple originators, provided all the originators are part of the same wholly owned group. This reflects a common commercial practice where multiple group members will transfer their receivables to a SPV for securitisation. Each originator must also be a New Zealand resident, in order to prevent the amended regime from being used for cross border transfers of financial arrangements. A new definition of "originator" has been inserted into section YA 1 of the Act, which contains these requirements.

Where there are multiple originators, each originator is treated as if it continued to hold the particular assets it transferred to the SPV.

Accounting consolidation requirement

The current rules for securitisations by financial institutions require that the securitised assets are treated as held by the originator (the financial institution) in its consolidated financial statements under IFRS. This is to ensure that the SPV is part of the same economic group as the originator. While this requirement was suitable for securitisations involving the financial arrangements covered by the previous rules, it would be too restrictive for other securitisations.

Often in corporate securitisations, the securitised assets are de-recognised by the originator but are recognised in the consolidated financial statements of another group company. Therefore, under the expanded rules, the accounting consolidation requirement will be met if the securitised assets are recognised in the financial statements of the originators, or in the consolidated financial statements prepared by one of the originators or another company in the same wholly-owned group as the originators.

In addition, the previous requirement for the SPV to have audited IFRS financial statements has been relaxed. Under paragraph (f) of the new definition of a "debt funded special purpose vehicle" in section YA 1, the SPV itself does not need audited IFRS accounts. Instead, the SPV's assets only need to be included in financial statements that are prepared using IFRS and audited (so for example they could be included in the consolidated group financial statements prepared by an originator).

Election into the regime

The amended regime is elective for financial institutions and other corporates alike. New section HZ 9 sets out the process for making an election.

Taxpayers will be able to elect into the amended rules for both new securitisations and for securitisations in existence before the amendments come into force. The election will have effect from the beginning of the income year in which the originator returns the income and expenditure of the SPV (being an income year starting on or after the date the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 comes into force).

If a taxpayer elects to apply the new rules to an existing securitisation, the SPV will be treated as no longer owning the assets for tax purposes from the effective date, while the originator will be treated as owning the assets from that date. Section HZ 10 has been inserted to ensure that this change in ownership of the assets for tax purposes does not result in adverse tax consequences for the originator or the SPV.

Section HZ 10 broadly provides that the originator should be treated as "stepping into the shoes" of the SPV. This means that the originator is treated for the post-election period (which includes the income year in which the election is made) as if they had always owned the assets and had paid and received any consideration paid or received before the election date by the SPV. The SPV in turn is treated as if they had never held the assets or paid or received any consideration. This means that the SPV does not need to carry out a base price adjustment following an election to apply the new rules. In addition, no income or expenditure should arise as a result of the election itself.

Unwind of a securitisation

Existing section HR 10 has been redrafted to accommodate the extension of the securitisation regime and to clarify its intended operation. The section broadly provides that, if the securitisation is unwound and the regime ceases to apply, the originator is treated as disposing of all the securitised assets and related liabilities (which are legally owned by the SPV but treated as owned by the originator for tax purposes under section HR 9) to the SPV for their market value. This was the original policy intent of section HR 10. Accordingly, the effect of the new section HR 10 on the unwind of a securitisation should be the same as the old section HR 10.

Financial arrangement rules – spreading methods

The consistency requirements for the financial arrangement rules require that a taxpayer use the same spreading method for all its financial arrangements to which that method applies. This is to stop taxpayers from choosing different spreading methods for different financial arrangements in order to minimise their tax. The consistency requirements are set out in sections EW 24 to EW 25B.

Because the SPV's assets are treated as owned by the originator for tax purposes, the originator would ordinarily be required to use the same spreading methods for the SPV's financial arrangements as it uses for its own. However, the SPV is a separate legal entity to the originator and a different spreading method may be more appropriate for it.

Therefore, the opening words of section HR 9 provide that the originator will not be treated as owning the SPV's assets for the purposes of the consistency requirements in sections EW 24 to EW 25B. This will allow the originator to use a different spreading method in respect of the SPV's financial arrangements than it uses for its own. That spreading method will however need to be consistently applied to all of the SPV's financial arrangements.

LAND TAINTING AND HOUSING NEW ZEALAND CORPORATION

Sections CB 9, CB 10, CB 11, CB 15, CB 15C, CB 15D, CV 1, CV 2, FM 9 and FM 15 of the Income Tax Act 2007

Amendments have been made to the Income Tax Act 2007 to exclude the Housing New Zealand corporate group (HNZ) from the land tainting rules.

Consequential amendments have been made to sections CB 15, CV 1, CV 2, FM 9 and FM 15 to ensure the exclusion achieves its intended effect.

Background

Land tainting

The land tainting rules in sections CB 9(2), CB 10(2) and CB 11(1) provide that land owned by an associate of a person who deals in, develops, subdivides, or improves land is "tainted" if the land is acquired or improved at the time the dealer, developer, sub-divider or builder was in business. This means that such land will be taxable if disposed of within 10 years of acquisition or improvement, despite not ordinarily being taxable. The rules were introduced to prevent taxpayers from undermining the land sale rules.

The land tainting rules led to an incorrect result from a policy perspective. For example, a sale of a property in HNZ's rental portfolio became taxable under the land tainting rules because of the development or building activities of another group member, despite not being ordinarily taxable under the land sale rules and there being no concern that HNZ is trying to undermine the rules. The rules impeded HNZ's ability to implement the Government's building programme, distorted the decision-making of the group and imposed excessive compliance costs.

Transactions between associated persons

Section CB 15(1) governs the transfers of land between associated persons. It was introduced to ensure that the substantive provisions which render land disposals taxable are not circumvented by transfers between associated persons.

It provides that where there is a transfer of land between associated persons, any amount that the transferee of the land derives from its sale (if that amount is greater than the cost of the land to the transferee) will be taxable to the transferee under whichever of sections CB 6 to CB 14 would have applied to the transferor had the intermediate transfer not taken place.

HNZ established a subsidiary, Housing New Zealand Build Limited (HNZBL), to undertake its building activities. Without an amendment to section CB 15, all capital gains derived by HNZ since the purchase of social housing properties from HNZBL would be subject to tax on disposal, despite not being taxable if HNZ purchased the properties from a non-associated party.

Wholly-owned and consolidated groups

Section CV 1 treats an amount as income when a company that is part of a wholly-owned group derives an amount that would not ordinarily be income of the company but would be income of the wholly-owned group if it were one company.

Section FM 9 does the same thing as section CV 1, but for consolidated groups. The amount is then treated as income of the company under section CV 2.

These provisions are intended to prevent intra-group arrangements where assets are transferred and re-characterised to avoid tax.

Absent the amendment, any land sold by an entity in the HNZ wholly owned or consolidated group, even if excluded from the land tainting rules under new section CB 15D, would have been taxable to the group because of the development or building activities of another group member.

Amortising property and revenue account property

The consolidated group rules in subpart FM ensure that a consolidated group of companies are treated as a single company for tax purposes. This enables tax-free intra-group asset transfers to take place and is designed to simplify the tax administration of a group of companies.

Section FM 15 provides that where property is transferred between two companies in a consolidated group, the transferee is treated as acquiring the property at the original acquisition cost and acquisition date of the transferor.

Without the amendment, capital gains accrued by HNZ would effectively become taxable on a disposal of property by HNZBL to a third party. This is because property disposed of by HNZBL is taxable due to its building activities, and its deduction on disposal is limited to HNZ's acquisition cost.

Key features

Land tainting and transactions between associated persons

New section CB 15D of the Income Tax Act 2007 provides an exclusion from the land tainting rules contained in sections CB 9(2), CB 10(2) and CB 11(1)(b)(ii), and from the rule for transactions between associated persons in section CB 15(1), for Housing New Zealand Corporation or a company in the same wholly-owned group.

Wholly-owned and consolidated groups

New section CB 15D(2) ensures that income does not arise under the wholly-owned group rules in section CV 1 for transactions that would otherwise be exempt under CB 15D(1).

Similarly, new section CB 15(2) also ensures that income does not arise under the consolidated group rules in sections CV 2 and FM 9.

Amortising property and revenue account property

Section FM 15 has been amended to provide that the section does not apply to Housing New Zealand Corporation or a company in the same wholly-owned group.

Application date

The amendments apply from 1 July 2017.

AMENDMENT TO THE BANK ACCOUNT REQUIREMENT FOR OFFSHORE PERSONS: APPLICATION DATE

Section 55B of the Tax Administration Act 1994

Offshore persons are required to provide evidence of a New Zealand bank account before an IRD number can be issued to them.

Following an earlier amendment, from 29 March 2018, the Commissioner can issue IRD numbers to offshore persons without New Zealand bank accounts if the Commissioner is satisfied with their identity and background. This provides a remedy for instances when the bank account requirement made it difficult or impossible for offshore persons to comply with their New Zealand tax obligations, while at the same time ensuring that Inland Revenue's identity checks remain robust.

This amendment changed the application date for the Commissioner discretion amendment from 29 March 2018 to 1 October 2015.

Application date

The amendment applies for applications for IRD numbers made on or after 1 October 2015.

NOISE MITIGATION EXPENDITURE

Sections CB 28, DB 46, EK 2, EK 11, EK 12, EK 20, EK 23, YA 1, schedule 19 of the Income Tax Act 2007

The amendment ensures that the expenditure incurred by businesses for remediating noise is deductible under section DB 46 of the Income Tax Act 2007, on the same basis as other pollution remediation expenditure.

Background

Before this amendment, certain expenditure incurred for remediating noise pollution was not deductible, while expenditure for remediating other types of pollution was deductible. Additionally, noise remediation expenditure may not create an asset for the taxpayer, so would not be depreciable. Therefore, noise remediation would result in "black hole" expenditure – being business expenditure that taxpayers cannot deduct for income tax purposes, either immediately or over time.

Key features

To remedy this inconsistency between noise and other pollution remediation expenditure, sections CB 28, DB 46, EK 2, EK 11, EK 12, EK 20, EK 23, YA 1 and schedule 19 of the Income Tax Act 2007 have been amended.

The proposed amendments result in the noise remediation deduction being spread over the expenditure's useful life under the pollution remediation rules. Taxpayers using the provision are required, from the application date, to spread the cost of the remediation expenditure.

Application date

The amendment applies from 1 April 2018.

GST AND ASSETS SOLD BY NON-PROFIT BODIES

Sections 20(3K), 5(13AA), 5(24B), 20(3KB) and 20(3KC), and 88 of the Goods and Services Tax Act 1985

Background

Input tax deductions can be claimed by a GST-registered non-profit body ("NPB") for all GST incurred for any activity other than an exempt activity (such as one involving the supply of donated goods). The receipt and payment of donations is outside the scope of GST rather than specifically exempt. NPBs can therefore claim input tax deductions (often in the form of refunds) for the GST costs involved in fundraising and distributing funds or providing free social or public good services. As a result, of the 19,000 NPBs that are registered for GST purposes, 7,000 are registered despite the fact that their annual turnover does not exceed the $60,000 compulsory registration threshold.

To be GST-registered, an NPB must be carrying on a "taxable activity" – that is a continuous or regular activity involving the making of supplies of goods and services for consideration. Following consultation, Inland Revenue had concluded that, despite earlier views expressed, a taxable activity does not include activities undertaken by the NPB that do not have a sufficient connection with the activity of making supplies for a consideration. So, when there are two activities, one of which involves making supplies for consideration and the other of which involves making supplies for no consideration, the question to consider is whether the two activities have a sufficient connection with each other to be treated as one taxable activity or whether they should be treated as two activities, one taxable and one not.

The May 2018 officials' issues paper, *GST on assets sold by non-profit bodies*, set out the following example:

NEW LEGISLATION

Example 1: Asset not part of the taxable activity

A charity for the homeless owns two buildings – one a headquarters dedicated to fundraising and one an emergency accommodation facility which charges a fee based on the facility's costs for its services. The funds raised assist towards researching issues about homelessness and finding local and national solutions.

The charity has claimed input tax deductions for capital, maintenance and overhead costs relating to both buildings. Following Inland Revenue's revised interpretation, the charity might not be required to pay output tax on a sale of the fundraising headquarters because the sale would not have been made in the course or furtherance of the taxable activity of providing emergency accommodation. This situation arises because:

- unlike other GST payers, NPBs are entitled to input tax deductions for all GST incurred unless it relates to making exempt supplies – so deductions can be claimed for fundraising activities; and
- the fundraising activity does not on balance have a sufficient connection with the activity of providing accommodation to the homeless for a fee to be part of the charity's taxable activity.

The officials' issues paper included proposals that followed an announcement by the Minister of Revenue that assets sold by NPBs and in respect of which input tax deductions had been claimed would be subject to GST from 15 May 2018. The main proposals were to:

- treat any goods and services for which an NPB has claimed input tax deductions to be subject to GST as part of the NPB's "taxable activity" if later sold by the NPB (or an equivalent event arose such as receipt of an insurance payment or the NPB's de-registration from GST);
- for NPBs that did not expect to pay this GST, allow a 12-month period (in the ensuing legislation a 24-month period) in which GST input tax claimed can be repaid so as to treat the asset in question as never having been part of the NPB's taxable activity; and
- include a savings provision to preserve all relevant tax positions taken by NPBs before 15 May 2018.

These proposals are now reflected in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act enacted on 18 March 2019.

Key features

Section 20(3K) allows non-profit bodies ("NPBs") to claim input tax deductions for most goods and services even if they do not directly relate to the making of taxable supplies. This provision is amended to ensure that an asset sold by an NPB is subject to GST on sale or an equivalent event if GST input tax deductions have been claimed by the NPB in respect of the asset. This amendment is supported by a number of new provisions:

- Section 5(13AA) relating to insurance payments.
- Section 5(24B) relating more generally to goods and services used in the course of a non-taxable activity.
- Sections 20(3KB) and (3KC) allowing an election to be made to treat a good or service as not being part of a taxable activity by effectively repaying the GST previously claimed.
- Sections 88(1) and (2) which do not allow a tax position taken before 15 May 2018 to be changed by an NPB making a non-taxable supply.
- Sections 88(3) to (5) which allow an election similar to that in sections 20(3KB) and 20(3KC) to be made when an NPB de-registers for GST purposes.
- Sections 88(6) to (8) which match a second-hand goods input tax credit by certain parties acquiring goods and services from an NPB who has made an election under the provisions to the amount of output tax paid under the election.

Application date

The enactment date of the changes is 18 March 2019 with effect from 15 May 2018. Relevant tax positions taken before 15 May 2018 cannot be changed.

Detailed analysis

Section 20(3K) – main provision

Section 20(3K) replaces the previous section. Instead of deeming goods and services used other than for making exempt supplies to be used for making taxable supplies, the new section 20(3K) refers to goods and services used in the course or furtherance of an activity that is not a taxable activity. It then provides that such goods and services are treated as being used in the course or furtherance of the taxable activity of the registered person to the extent that the goods and services are not used for the making of exempt supplies. There is an exclusion to this if an election is made under section 20(3KB).

This difference in wording is intended to reflect that it is possible to have an activity that is not part of a taxable activity or part of an exempt activity and that an NPB in that situation can claim input tax deductions under section 20(3) in relation to goods and services used in the first activity. The alternative view had been that, once an NPB had a taxable activity, all activities, other than exempt activities, were part of that taxable activity.

Example 2: Goods and services used in an activity that is not part of an NPB's taxable activity and not part of an exempt activity

In example 1 the charity for the homeless incurs numerous costs. For the fundraising activity this includes the capital and maintenance costs as well as general overheads in relation to the fundraising quarters. It also includes specific fundraising costs such as advertising and promotional goods and services.

Under section 20(3K) and, as with the previous provision, these costs will be treated as relating to the charity's taxable activity and input tax will be allowed for GST incurred on these goods and services under section 20(3) to the extent that they do not relate to exempt supplies or the charity has not made an election under section 20(3KB).

Section 5(24B) – deemed taxable supply

Section 5(24B) provides that if a registered person claims a deduction under sections 20(3K) and 20(3) for goods and services used in an activity that is not a taxable activity, a supply by the registered person of goods and services used in the course or furtherance of the activity is a taxable supply. An exception to this applies if the person has made an election under section 20(3KB).

Section 5(24B) therefore reflects the policy intent of the changes that goods and services supplied by an NPB as part of an activity in relation to which input tax deductions have been claimed are subject to output tax unless an election has been made by the NPB to remove the goods and services from the GST base.

Section 5(13AA) – insurance payment a supply

Payments under a contract of insurance that are received by a registered person in the course or furtherance of a taxable activity are generally deemed to be consideration for a supply of services by the registered person in the course or furtherance of the taxable activity. In this way, the GST Act treats the receipt of an insurance payment in respect of the loss of an asset by a registered person as equivalent to a sale of the asset.

Section 5(13AA) provides that if a registered person claims a deduction under section 20(3K) and section 20(3) for goods and services used in an activity that is not a taxable activity, section 5(13) will apply to a payment under a contract of insurance as if the relevant asset were part of a taxable activity of the registered person. An exception applies if the person has made an election under section 20(3KB).

Section 5(13AA) therefore reflects the policy intent of the changes that insurance payments received by an NPB as part of an activity in relation to which input tax deductions have been claimed are subject to output tax unless an election has been made by the NPB to keep the asset out of the GST base.

Sections 20(3KB) – election that not part of taxable activity

New section 20(3KB) applies if a GST-registered NPB that carries on an activity that is not a taxable activity uses goods and services solely in that activity to which section 20(3K) would apply. The section allows the NPB to exclude goods and services from the effect of section 20(3) and section 20(3K) (that is, deny itself input tax deductions and not pay output tax) if they make an election before 1 April 2021. If they make this election before supplying goods and services used in the non-taxable activity, section 5(24B) will not treat the excluded goods and services as a taxable supply.

Under paragraph (b), if the NPB makes such an election, each asset used in the non-taxable activity is treated as being disposed of on the election date in the course or furtherance of the NPB's taxable activity and reacquired for use in the non-taxable activity. This excludes from the GST base assets solely relating to the non-taxable activity of the NPB at the time of the election. Section 20(3KC) determines the output tax that must be paid by the NPB on assets on hand at the time of election in respect of which input tax credits have been claimed.

Example 3: Electing to exclude an activity from the GST base

A GST-registered charitable trust owns a historic nineteenth century church in the Bay of Plenty region in which religious services have been regularly held. In 2013 the trust built a hall next to the church for the use of parishioners but also for the use of the general public for a small fee (which has never in total exceeded the $60,000 compulsory registration threshold). The trust has claimed tax deductions for the GST incurred in acquiring the hall, for the maintenance costs of both buildings and for general overhead costs.

The trust had received an "on balance" view from its tax accountant in 2013 that, if the church was sold, output tax would not be payable on the sale proceeds notwithstanding full input tax deductions could be claimed for expenses related to both the hall and the church. The trust claimed the input deductions on this basis.

The GST treatment on the sale of assets by NPBs has now changed so that it is clear that, if the church is sold, GST will be payable by the trust (or zero-rated with no input tax deduction if the purchaser is GST-registered). On 1 April 2020 the trust therefore elects under section 20(3K) to treat the church as not being part of any taxable activity and exclude it from the GST base. It stops claiming any input tax deductions in relation to the capital and operating costs of the church. Output tax is no longer payable if the church is sold.

Section 20(3KC)(a) – how to make an election under section 20(3KB)

New section 20(3KC)(a) sets out the process for making an election under 20(3KB). The election must be made by notifying the Commissioner on or before the election date, in a way acceptable to the Commissioner of the election, the election date and the information required by the Commissioner relating to the election.

The information required by the Commissioner is:

- a general description of the asset/s to which the election is to apply;
- the legal description of the land (for example, Lot123/DPN4567) if the asset is land;
- the address of the land;
- when the asset was acquired; and
- a repayment estimate or calculation.

Any elections or queries about an election should be sent by email to **Charities.Queries@ird.govt.nz**.

Section 20(3KC)(b) – determining amount of GST payable under election

Section 20(3KC)(b) sets out the GST that must be paid following an election.

In the return for the taxable period in which the election date occurs, output tax must be included of an amount equal to all input tax claimed in relation to the capital cost of the asset, and input tax relating to the operating costs of the asset in the past 7 year period, before the election date. In both cases, an estimate may be made using a method acceptable to the Commissioner if adequate records are not held.

Example 4: GST payable following an election

Consider the case in Example 3. The charitable trust did not claim any GST expenses on the acquisition of the church building since it has acquired long before the introduction of GST. However, it has incurred considerable costs in maintaining the building and incurred operational and overhead costs.

Any GST claimed for expenditure that is included in the cost of the church (capital costs) will need to be repaid by the trust. Because the trust has been required to maintain the church in its original state, the only capital costs have been for replacement of the church organ. Since the replacement occurred more than 7 years before the election, the trust has limited records of these costs. However, it does know that the organ was replaced in the 1990s and the trust's accountant is able to estimate a cost using the present value of a church organ and replacement costs (which is a method acceptable to the Commissioner).

The main operating costs of the church in the last 7 years include rewiring, replacement of some broken stained-glass panels, and replacement of a few floorboards.

The trust therefore includes in its return in the period it makes the election the estimated GST cost of the new church organ and the operating costs of the church in the last 7 years for which a GST deduction has been claimed.

As long as no further input tax deductions in relation to the church building are claimed, the building will not attract GST on sale (or an equivalent event), on GST-deregistration of the trust, or if the trust receives an insurance payment in relation to the building.

Example 5: GST payable following an election where a second-hand goods claim made on an asset

A GST-registered university in Wellington provides a free student counselling service close to its campus in a former state-owned house.[7] The house was purchased by the university in 1990 from its owner-occupier for $360,000. The university claimed a second-hand goods input tax credit of $40,000.

Student demand for the service has been rapidly increasing. As the building is now valued at $1.5m, the university is considering selling the building for the long-term sustainability of the service. Concerned about the GST cost of such a sale, on 31 March 2020 the university makes an election under sections 20(3KB) and 20(3KC).

In addition to the second-hand goods claim, the university has also been claiming input tax deductions for expenses specific to the building relating to the counselling services including repairs and maintenance of the building and overheads specific to the building such as rates, insurance and electricity. The university is required to repay the $40,000 second-hand goods input tax deduction and the GST on the costs for which input tax deductions have been claimed in the last 7 years before the election. A few of the records are no longer available so the university pays GST equal to the GST input tax credits estimated to have been claimed in the period.

As in Example 4, following the election and repayment of the GST, input tax credits can no longer be claimed by the university in respect of the building and there are no GST consequences on a sale of the building or similar event.

Section 88(1) and (2) – positions taken before 15 May 2018

An NPB that makes a supply in relation to a non-taxable activity cannot, on or after 15 May 2018, take a different tax position to that in a GST return before that date. This restriction acknowledges the lack of certainty before 15 May 2018 about what was included in an NPB's non-taxable activity and what was not and validates the GST treatment based on either interpretation. It also prevents an NPB from changing the position taken in its GST return before 15 May 2018.

Sections 88(3) to (5) – deregistration election

Sections 88(3) to (5) provide that an NPB may deregister from GST by making an election and repaying GST input tax credits claimed before the election in a similar way to the main election provisions, sections 20(3KB) and 20(3KC).

Sections 88(3) to (5) apply to an NPB that is de-registered on or after 15 May 2018 and before 1 April 2021 and to assets used in the course or furtherance of an activity that is not a taxable activity immediately before de-registration. The provisions change the effect of section 5(3) and section 10(7A) which provide that, when a person ceases to be registered for GST, they must pay GST on the assets held at the time of deregistration based on the open market value of the assets.

[7] In the officials' issues paper, *GST on assets sold by non-profit bodies* (May 2018), chapter 3 uses a similar example (Example 3) where the building is bequeathed rather than purchased. The example incorrectly suggests that a second-hand input tax deduction can be claimed in these circumstances, so the facts have been changed here.

Section 88(4) provides that an NPB that meets the conditions in question may elect that the value of the relevant supplies on de-registration is the amount of the input tax claimed in respect of any capital costs of the relevant asset or assets and the amount of input tax claimed in respect of the operating cost of the asset/s for the 7 years before deregistration.

Section 88(5) provides that an election under section 88(4) is made by notifying the Commissioner in a way acceptable to the Commissioner of the election and the information required by the Commissioner relating to the election. The election should be made when the NPB provides their GST return on deregistration – usually their final GST return.

Any election or query about an election should be sent by e-mail to **Charities.Queries@ird.govt.nz**.

Example 6: Deregistration

A community trust in Southland owns a building used for a range of community activities and has one taxable activity of hiring out life jackets. The trust acquired the building in 1989 and was advised to GST-register so that it could claim an input tax deduction for the capital cost of the building and other expenses on which GST is charged.

A local hunting and fishing store has recently been selling life jackets that meet the current legal requirements and there is now less demand for the hire of life jackets from the community trust. There has also been a sharp decline in the community activities in the area. The trust therefore decides to wind up, meaning that it will also de-register for GST purposes. The date of the trust's deregistration is 30 September 2019.

The trust is aware that GST is payable on the market value of its assets held on deregistration, including on the building. To mitigate the GST cost, the trust therefore makes an election under section 88(4) and 88(5) to base the GST on the input tax credit claimed in 1989 for the capital cost of the building and on operating costs related to the building for the 7 years prior to the date of deregistration.

Note that market value must still be applied to other assets that form part of a taxable activity on deregistration.

Sections 88(6) to (8) – limitation to second-hand goods input tax credit of registered recipient

Sections 88(6) to (8) limit the input tax credit that may be claimed by a registered recipient of a second-hand good that has been subject to an election under sections 20(3KB) and 20(3KC) to the amount of GST paid by the NPB under the election.

The purpose of the second-hand goods input tax deduction is to allow previously unclaimed GST to a registered person acquiring a second-hand good from a non-registered person. The same principle should apply if the registered recipient acquires a second-hand good from a registered person who has excluded an asset from the GST base.

However, without the rules in sections 88(6) to (8) there could be an incentive for an NPB to apply the election and reduce its GST cost while selling the asset to a registered person so that the person can claim a second-hand goods input tax credit based on the sale price or market value of the sale. This would provide an unjustifiable tax benefit because the input tax deduction would not be limited to the GST actually incurred.

Section 88(6) and section 88(7) therefore provide that section 88(7) applies to NPBs who, within 5 years of having made an election under sections 20(3KB) and 20(3KC), sell a second-hand good to which the election applied to a person associated with the NPB, another NPB or a person associated with an NPB. The input tax deduction for the recipient is limited to the output tax paid by the vendor NPB under the election.

Section 88(8) requires the vendor NPB, or an associate of the NPB that has the necessary information, to provide details of the output tax paid under the election to a recipient of the second-hand good (being an associate of the NPB, another NPB or associate of another NPB) if requested to do so by the recipient.

Example 7: Sale of asset subject to election

Consider the case in Example 5. The university is aware that, given the increased demand for student counselling services, and the current state of the property market in Wellington, selling the building in which the services are provided could assist with the long-term sustainability of the service.

The building is sold to a mental healthcare trust on 1 October 2020 which continues to provide the same services to students. The mental healthcare trust is registered for GST and claims a second-hand goods input tax credit in relation to the property.

The university has advised the trust that an election had recently been made to remove the building from its wider taxable activity. At the request of the trust, it also provides details of the output tax paid under the election. The trust limits its second-hand goods input tax credit claim to the amount paid by the university under the election.

ADVERSE EVENT INCOME EQUALISATION SCHEME

Sections CB 7, CX 51, DQ 2, EH 1(2), (3), EH 4(5), EH 35(3)(b), EH 37 to EH 62, EZ 80, MZ 3 and definitions relating to the adverse event income equalisation scheme in the Income Tax Act 2007

Background

The adverse event scheme is an essential component of the Primary Sector Recovery Policy administered by the Ministry for Primary Industries. The scheme provides for a deferral of tax payable from forced sales of livestock because of a localised adverse event (for example, damage to pasture caused by a flood on a farming unit). This scheme is one of several income equalisation schemes available to primary industries.

The scheme was based entirely on the action of a farmer (person carrying on a farming or agricultural business on land in New Zealand) that involves the farmer:

- self-assessing that a localised adverse event has occurred;
- disposing of livestock because of that self-assessed adverse event and not replacing that livestock in the same "accounting year" (a defined term); and
- making a deposit into the adverse event scheme account.

However, a review of the scheme identified that few farmers have used the adverse event scheme since its inception. Instead, most farmers preferred to make deposits into the main income equalisation scheme (main scheme) for forced sales of livestock. This was mainly because of confusion about the terms and conditions of the adverse event scheme and to take advantage of the more flexible terms within the main scheme for deposits and withdrawals.

Key features

These amendments:

- repeal the adverse event income equalisation scheme (adverse event scheme);
- transfer existing balances in the scheme to the main income equalisation scheme (main scheme); and
- apply from the first income year commencing after the date of enactment.

The main scheme continues to provide for a deferral of tax for farmers, which is consistent with the objective of the adverse event scheme.

The amendments also:

- ensure future deposits arising from a forced sale of livestock due to a self-assessed adverse event can be made to the main scheme; and
- permit deposits relating to future self-assessed adverse events to be made to the main scheme.

Application date(s)

The amendments apply to:

- a farmer's adverse event scheme account as at the beginning of their first accounting year commencing after 18 March 2019; and
- future deposits relating to forced sales of livestock relating self-assessed adverse events, from the beginning of the farmer's first income year after 18 March 2019.

They also transfer the balance of a farmer's adverse event scheme account to the farmer's main scheme account, effective at the beginning of their first accounting year commencing after 18 March 2019.

Detailed analysis

The amendments reflect the outcomes of a review of the provisions of the adverse event scheme in considering whether the scheme should be incorporated into Inland Revenue's START computer platform. That review concluded that:

- the adverse event scheme and the main income equalisation scheme operated in very similar ways;
- the policy objectives of deferring tax on forced livestock sales due to an adverse event can be achieved within the main scheme;
- the terms of the now-repealed adverse event scheme were inflexible, it has a low-level of use and, consequently, the adverse event scheme is largely redundant;

- most farmers already used the main scheme for localised adverse events that result in forced sales of livestock;
- the operation of the main scheme for self-assessed adverse events is consistent with the objectives of the Primary Sector Recovery Policy administered by the Ministry for Primary Industries;
- the repeal of the adverse event scheme reduces administration costs and eliminates the potential for confusion between it and the main scheme; and
- a single interest rate should apply to all income equalisation schemes for farmers.

Repeal of adverse event scheme

The adverse event scheme is repealed from the first day of a farmer's accounting year that begins after the date of enactment (18 March 2019).

For example, for a farmer with an accounting year ending on 30 June:

- the adverse event scheme is repealed from 1 July 2019 for the accounting year ending 30 June 2020 and rationalised with the main scheme provisions for the farmer;
- after that date (1 July 2019), future deposits relating to self-assessed adverse events are included in the calculation of the maximum deposit that can be made to the main scheme (the main maximum deposit) – the difference between all income derived and expenditure incurred in that that year);
- prior to this repeal, deposits may be made to the self-assessed adverse event scheme. This includes any amount deposited to the adverse event scheme during the month of July 2019 provided the Commissioner is notified that this deposit is for the 30 June 2019 year;
- the total amount deposited in the farmer's adverse event scheme account (including accrued interest) for the period ending 30 June 2019 (including deposits made in July 2019 for that earlier accounting year) will be transferred to the farmer's main scheme account as at the beginning of the June 2020 year. This transfer is not a refund and is not income of the farmer;
- the adverse event scheme account is terminated after completing the transfer of the balance of that account to the farmer's main scheme account under new section EZ 80;
- after 30 June 2019, a farmer must make all new income equalisation deposits, including for a self-assessed adverse event, to the farmer's main scheme account.

Self-assessed adverse event definition

The concept of "self-assessed adverse event" is retained as discretionary refunds may continue to be made under the main scheme for such events. In addition, a self-assessed adverse event continues to be factored into the Primary Sector Recovery Policy administered by the Ministry for Primary Industries. This recovery policy guides Government decisions on recovery assistance following adverse climatic events, natural disasters and biosecurity incursions impacting farms.

Ability to make deposits after year end

Under the repealed adverse event scheme, deposits that were deductible for a farmer's accounting year could be made during that year or within one month after the end of that year. A farmer making such a deposit after year end had to notify the Commissioner that the deposit is to their adverse event scheme account for the earlier year.

Under the main scheme (section EH 4), it is possible for a farmer to make a deposit after the end of the financial year, provided it is made within 6 months of that year (or within a further period that the Commissioner allows). In making such a deposit, the farmer must notify the Commissioner that the post-year deposit is for the financial year that has just ended.

It is not necessary to specify that the deposit arises from a self-assessed adverse event as the main scheme provisions that apply for self-assessed adverse events relate only to refunds. However, the amount deposited must also take account of the unchanged limitation on the total deposits for each accounting year (main maximum deposit).

Refunds from the main scheme to fund the replacement of livestock

A feature of the now repealed adverse event scheme was the ability of a farmer to receive a refund from the adverse event scheme on request. This differs slightly from the refund provisions in the main scheme for a self-assessed adverse event, which require the Commissioner to be satisfied that the refund is to be used to replace livestock disposed of because of a self-assessed adverse event. Historically, such refund requests have always been granted.

Although a refund cannot usually be made if the deposit has been in the scheme for less than 12 months, under the main scheme a refund can be requested for all, or part, of a deposit under section EH 15(3). The Commissioner has a discretion to refund an amount to fund the purchase of replacement livestock for a self-assessed adverse event.

As few farmers used the adverse event scheme, it was apparent that this difference in refund mechanisms was not a critical feature for farmers' decisions to use the main scheme for self-assessed adverse events deposits. Both Federated Farmers and CA ANZ have acknowledged that the discretionary refund mechanism in the main scheme for adverse events had always been exercised in favour of the farmer's request.

To request a refund to purchase replacement livestock arising for a self-assessed adverse event, a farmer should either complete the online form "*Income equalisation deposit/refund form (IR155)*" or request in writing a refund[8] stating:

- the name and IRD number in which the deposit is held;
- the amount to be refunded;
- the income year in which the refund is to be assessable; and
- the name and contact phone number of the person making the request for an early refund due to a self-assessed adverse event.

As was the case under the now-repealed adverse event scheme, when an application for a refund is made, the amount of the refund is gross income in the year in which the application for a refund is received, or the prior year, if the taxpayer makes the appropriate election in the application.

Minor amendment in main scheme for self-assessed adverse event deposits

Under section EH 4, a farmer may normally make only one deposit per accounting year to the main scheme. Under the now-repealed adverse event scheme, a farmer could make a deposit for each self-assessed event that occurred during an accounting year.

The amendment to section EH 4(5) applies when a farmer has received a refund in one year to use to acquire replacement livestock due to an earlier self-assessed adverse event. If another self-assessed adverse event occurs after that refund, the amendment to section EH 4(5) ensures that a farmer can make another deposit to the main scheme provided that the Commissioner is satisfied that the earlier refund has been fully used in acquiring that replacement livestock.

Transfers of existing deposits from adverse event scheme

Interest on deposits made to the adverse event scheme prior to the repeal will continue to attract the 6% daily rate until the balance of the scheme is transferred to the main scheme under section EZ 80.

On the repeal of the adverse event scheme, section EZ 80 applies to transfer the closing balance in the adverse event scheme account to the main scheme account at the beginning of the next day.

For example, if a farmer has a 30 June accounting year, section EZ 80 applies as follows:

- The closing balance of their adverse event scheme account, as at 30 June 2019 (including accrued interest and any amounts deposited in July 2019 for the year to 30 June 2019 would be transferred to the taxpayer's main scheme account on 1 July 2019.
- If the taxpayer does not have a main scheme account, the Commissioner is required to open a new main scheme account for the taxpayer for this purpose and the closing balance of the farmer's adverse event scheme account is transferred to that new account.
- The transferred amount from the adverse event scheme account is not counted as a deposit when determining the limits for deposits to the main scheme account for the "transfer year" (section EH 4 does not apply to the transferred amount).
- The farmer is not allowed a deduction for the transfer of the closing balance of the adverse event account to the main account and nor is the transfer income for the farmer nor is it included in family scheme income under section MZ 3(3).
- Interest is calculated on that opening balance under section EH 6.

Adverse event scheme provisions repealed

The following adverse event scheme provisions are repealed with effect from the application date: sections CB 27(b), DQ 2, EH 1(2)(b), (3)(b), EH 35(3)(b)(ii), and EH 37 to EH 62.

[8] Inland Revenue, PO Box 39010, Wellington.

Consequentially, the following cross-references and relevant defined terms are also repealed: sections CX 51 (cross-reference to section EH 42 removed), MZ 3(3) and in section YA 1, "adverse event deposit", "adverse event income equalisation account", "adverse event income equalisation scheme", and "adverse event maximum deposit".

DISABILITY SUPPORT PAYMENT INCOME TAX EXEMPTION

Section CW 52B of the Income Tax Act 2007

Background

New disability support payment options have been introduced as part of a wider transformation of the disability support system aimed at giving disabled people and their families greater control over their lives and supports.

Prior to these reforms, disability support arrangements did not generally involve payments being made directly to people or their family members. Instead, people were allocated disability support services and products, based on their needs. These arrangements are not treated as the person's income, meaning no income tax obligations arise.

The following direct funding disability support payments to be used by recipients for the purchase of disability support services are available as part of the disability support system reforms:

- "Enabling Good Lives Waikato" payments which have been made to disabled people (or a person on their behalf) in the Waikato DHB region since the middle of 2015.
- Personal Budget payments being made to disabled people (or a person on their behalf) as part of the "Mana Whaikaha" disability system transformation prototype in the Mid-Central DHB region since October 2018.
- "I Choose" payments which are being made available to unpaid full-time carers over the course of 2019, allowing them to purchase disability support services, to enable them to take a short break from their role as a full-time carer.

If no amendment was made, these direct funding disability support payments would be treated as taxable income for income tax purposes to the payment recipient.

Key features

New section CW 52B of the Income Tax Act 2007 provides that where a person receives a direct funding disability support payment – this being a payment made by the Ministry of Health or a District Health Board to a disabled person, a person on their behalf, or their un-paid carer, to purchase disability support services – the payment will be treated as exempt income. Therefore, it will not be subject to income tax.

This will ensure that recipients of direct funding disability support payments, including the payments described above, are not financially worse-off than they would be under disability support arrangements where no direct payment is made. The amendment would also ensure that any future direct funding disability support payments, that are of the same substantive nature as the payments above, are also exempt from income tax.

Application date

To ensure the exemption applies to all tax years direct funding disability support payments have been made in, the amendment applies for the 2015–16 and out tax years.

TAXATION OF ACC ATTENDANT CARE PAYMENTS

Sections CW 35, CZ 35, DF 4 and LB 7 of the Income Act Act 2007

Several amendments have been made to the Income Tax Act 2007 to eliminate incidences of double taxation that arise in circumstances where a backdated personal service rehabilitation payment is paid to an ACC claimant.

Background

ACC make payments to a number of ACC claimants who do not have full capacity and are unable to look after themselves. These payments are known as personal service rehabilitation payments and are paid under the Accident Compensation Act 2001 to help provide key aspects of rehabilitation such as attendant care, child care, home help, and training or transport for independence. The payments are treated as schedular payments and ACC withholds tax at a rate of 10.5%. The ACC claimants who are recipients of these payments can then on-pay this income to carers (attendant care payments) who provide services to the ACC claimants.

Section CF 1 provides that accident compensation payments are income, including personal service rehabilitation payments. Section CW 35 provides that these payments are exempt income of a claimant to the extent that they are on-paid to another person (caregiver) for providing them with rehabilitation services. This means that, where the ACC claimant passes on the full amount of the payment to the carer, this will be exempt income to the claimant. Where the claimant passes on part of the personal services rehabilitation payment to the carer, section DF 4 allows the claimant to claim a deduction for that amount.

Carers return the income they receive from the ACC claimant, including claiming the 10.5% tax credit to account for the withholding tax deducted by ACC.[1] This scheme of levying withholding tax on ACC attendant care payments and not taxing the ACC claimant on payments on-paid to carers achieves its intended outcome where ACC provides the payments in the same year that the care is provided. That is not the case, however, with backdated ACC payments.

The issue that arose prior to this amendment was that, where a backdated payment was paid to a claimant, the payment was effectively double taxed (taxed in both the hands of the claimant when received from ACC, and in the hands of the carer who paid tax at their marginal rate when the income was derived). This double taxation arises because section CW 35 provides that the payment is only exempt to the claimant in situations where the claimant has paid the full amount, or more, to the caregiver. The payment is not on-paid to the carer since it simply reimburses past care payments that have been paid. Section CW 35 therefore did not allow the claimant an exemption from tax, and the amount of the payment was taxable to the claimant where they filed a return, and subject to withholding tax when ACC made the payment. Furthermore, the application of sections DF 4, LB 7 and LB 8 meant that where a reimbursement payment was paid to a claimant, there would be no deduction for the claimant where some of the back payment related to amounts that had been on-paid to the caregiver in prior years.

Key features

Amendments to sections CW 35, DF 4 and LB 7 ensure that personal service rehabilitation back payments received from the 2018/19 tax year assume the same tax treatment as such payments that are paid to the claimant in the year in which the entitlement is derived.

New section CZ 35 is a transitional provision that applies retrospectively for back years. It provides that back-paid personal service rehabilitation payments that have in the past been paid on to a person providing social rehabilitation services are tax exempt in the hands of the person receiving such payments.

Application date(s)

The amendments to sections CW 35, DF 4 and LB 7 apply from 1 April 2018.

New section CZ 35 is treated as coming into force on 1 April 2008 and applies for the 2008/09 to 2017/18 income years.

Detailed analysis

Personal service rehabilitation back payments that relate to the 2018/19 tax year or later

Section CW 35 has been amended with application from 1 April 2018 to make backdated ACC rehabilitation payments exempt income. Section LB 7 has also been amended with application from 1 April 2018 to provide that, for the purposes of section LB 7 and LB 8, the payment of a personal service rehabilitation payment for a period includes a payment made that is received as a reimbursement payment in a later period. Section DF 4 has been amended similarly. This means that, on a go forward basis, where a claimant receives a reimbursement payment and the claimant has on-paid to the carer an amount that is greater than or equal to the amount of the reimbursement, the reimbursement is exempt income to the claimant and the caregiver receives the full tax credit. Where the claimant has on-paid an amount that is less than the reimbursement payment, the claimant gets a deduction for the amount paid to the carer and the remainder is assessable income. The tax credit will be shared between the claimant and the carer on a pro rata basis.

[1] Where the claimant retains part of the personal service rehabilitation payment, section LB 8 of the Income Tax Act 2007 shares the tax credit between the claimant and the caregiver pro-rated based on how the ACC payment is shared.

Example

Peter suffered a work accident in 2014 and is unable to look after himself. Peter pays Sarah $10,000 pa to care for him out of his own pocket.

2014/15 tax year: Peter pays Sarah $10,000. Sarah pays tax on this at her marginal rate.

2015/16 tax year: Same as above ($10,000).

2016/17 tax year: Same as above ($10,000).

2017/18 tax year: Same as above ($10,000).

2018/19 tax year: ACC accepts that Peter is entitled to ongoing daily care. For the 2018/19 tax year payment, ACC pays Peter $8,950 net of tax (10.5% (or $1,050) withheld and remitted to IRD for tax). Peter passes on the full net amount to Sarah. Sarah's income for tax purposes is $10,000 and she receives a tax credit of $1050. As Peter has fully used the payment he received, it is treated as exempt income.

It is also determined that Peter is entitled to personal service rehabilitation payments for the previous 4 years. ACC pay Peter a lump sum of $40,000 to account for this. The effect of the amendments mean that the treatment of this back payment is the same as the treatment applied to entitlements that are on-paid in the year in which they are received. As Peter has previously paid an amount to his carer that is equal to the reimbursed amount he received from ACC, amended section CW 35 treats the $40,000 lumpsum as exempt income to Peter (Peter will receive $35,800 net of tax after ACC have remitted 10.5% tax to IRD). Under amended section LB 7, Sarah will receive a tax credit equal to the amount withheld by ACC on the reimbursement payment (10.5%).*

Example 2

If we assume a variation of the previous example where all the facts remain the same, but ACC assesses Peter to have a $12,000 yearly entitlement under the personal service rehabilitation payment scheme. This means that Peter paid a lower amount to the carer ($10,000 per year) than the backdated entitlement ($12,000 per year) and therefore CW 35 does not apply to make the payment exempt income in the hands of Peter.

As Peter has on-paid to the carer an amount less than the reimbursement payment, amended section DF 4 allows Peter to claim a deduction for the amount he passed on to the carer. ACC will pay Peter $42,960 (10.5% or 5040 withheld and remitted to IRD for tax).

Peter is taxable on the $48,000 payment less a deduction equal to the pre-tax equivalent of the amount he paid Sarah, which is $40,000, making his net taxable income $8,000. Peter receives a proportional amount ($840) of the total tax credit of $5040. This means Peter will pay tax on $8,000 (receiving a tax credit of $840) and receives $42,960 in the hand. Sarah will receive the remaining $4200 as a tax credit.

* Further work is going on to clarify the treatment of the tax credit. In respect of a reimbursement payment, it is intended that the tax credit be assigned to the claimant as opposed to the carer. This ensures the claimant is sufficiently reimbursed for the amount they paid the carer in prior years, and ensures the carer does not receive a credit to which they are not entitled to.

New section CZ 35 is a transitional provision that applies from the 2008/09 tax year, which is when levying withholding tax on personal service rehabilitation payments was first introduced, until the 2017/18 income year. It provides that back-paid personal service rehabilitation payments that have in the past been paid on to a person providing social rehabilitation services are tax exempt in the hands of the person receiving such payments. This tax treatment is consistent irrespective of whether the full amount of the back paid entitlement was paid to the carer at an earlier date or a lesser amount.

The 2008/09 application date for this provision coincides with the time period whereby withholding tax was first applied to personal service rehabilitation payments. The effect of the provision is that, where a claimant pays a carer out of their own pocket for care received in years prior to 2008/09, this will fall under application of this rule provided that the lump sum payment paid by ACC to the claimant is made in the 2008/09 year or later.

Example

Mary was involved in a car accident in 2008 which reduces her ability to care for herself. Mary pays Mandy $10,000 pa to care for her out of her own pocket.

2008/09 tax year: Mary pays Mandy $10,000. Mandy pays tax on this at her marginal rate.

2009/10 tax year: Same as above ($10,000).

2010/11 tax year: Same as above ($10,000).

2011/12 tax year: Same as above ($10,000).

2012/13 tax year: ACC accept that Mary is entitled to ongoing care. For the 2012/13 tax year payment, ACC pays Mary $10,000 less tax withheld ($1,050). Mary passes on the full net amount to Mandy. Mandy's income for tax purposes is $10,000 and she receives a tax credit of $1050. The $10,000 payment for the 2012/13 tax year is exempt income to Mary. However, because ACC did not pay any ACC attendant care payments to Mary for the previous 4 tax years, they pay her a lumpsum of $40,000 less tax withheld ($4,200).*

Treatment of this $40,000 under the law as it applied prior to the enactment of CZ 35

The effect of section CW 35 as it applied in the 2012/13 tax year meant that a payment a claimant receives from ACC will only be exempt income in the hands of the claimant if the amount they on pay to their carer is equal to or more than the amount the claimant receives from ACC. The $8,950 (net of tax) Mary received in relation to the 12/13 tax year is exempt income to Mary but the $40,000 ($35,800 net of withholding tax) in back-dated payments is not exempt income. If Mary files a tax return or completes a PTS she will have to pay any additional tax owing on the payment at her marginal rate.

Treatment of the $40,000 under new section CZ 35

In accordance with new section CZ 35, the $40,000 less tax withheld that Mary received during the 2012/13 tax year would be exempt income. This means that, if Mary had filed a return in 2012/13 and paid tax at her marginal rate on this income, she could, under section 113 of the Tax Administration Act 1994, request the Commissioner to amend her assessment. The Commissioner would accept this request which would result in Mary being owed a substantial tax refund.

* As per amended LB 7 the carer will receive the $4,200 tax credit. Further remedial work is going on to ensure that the tax credit is paid to the claimant and not the carer where a reimbursement payment is made.

It is noted that, although the effect of CZ 35 is to exempt back-paid personal service rehabilitation payments from tax in the hands of the ACC claimant, this only applies where CZ 35(2) is met. Under CZ 35(2), if the Commissioner is satisfied that the tax obligations relating to the personal service rehabilitation payment have been met, the payment is treated as exempt income for the income year in which the person derives the payment.

Where an ACC claimant wishes rely on CZ 35, the claimant must provide the Commissioner with:

- The name and IRD number of all caregivers paid
- The amounts paid, dates of payment and amounts withheld by ACC

In most cases this information should be readily available to the claimant, as the claimant is required to keep full and accurate records under current practice as noted in **https://www.ird.govt.nz/yoursituation-ind/acc-recipients/acc-service-payments-caregivers-clients.html**

The Commissioner will review the information and, where she is satisfied that the caregiver has met their tax obligations, the ACC claimant will be able to treat the payments received as exempt income.

Further amendments to the ACC attendant care payment rules

As previously noted by the appended comments in the above examples, further work is going on in respect of the ACC attendant care payment rules to clarify the treatment of the tax credit where a reimbursement payment is made.

ACCESS TO BACK YEAR WORKING FOR FAMILIES TAX CREDITS ENTITLEMENTS WHERE TAXPAYER IS NOT AN IR3 FILER

Section 227G of the Tax Administration Act 1994

A transitional provision has been added to the Tax Administration Act 1994 to allow a person who is not required to file an income tax return, to file a tax return after the time limit for issuing a personal tax summary to obtain WfFTCs or enable WfFTCs to be squared up.

Application date(s)

The provision applies for the period of time that the law on income statements (personal tax summaries) was in force, being from the 2000-01 income year to the 2018-19 income year.

Background

When a person wishes to apply for WfFTCs for a previous tax year, they will receive the tax credits as a lump sum and must file a tax return or be issued with a personal tax summary (PTS) to establish the amount to which they are entitled.

Section 108(1A) of the TAA provides that the Commissioner must not issue a PTS if 4 years have passed since the end of the tax year that follows the tax year to which the PTS would apply. This means that a person who is not required to file an income tax return, and is therefore a PTS filer, cannot file a return to access their WfFTC entitlement.

IR3 filers are able to file a return at any time to obtain an entitlement to WfFTCs for an earlier year and meet their income tax obligations. If a tax return has not been filed, Inland Revenue can issue a default assessment which will enable the person's WfFTCs to be squared-up.

This amendment ensures that PTS filers are also able to obtain any WfFTC outside the time limit for issuing a PTS.

Detailed analysis

New section 227G provides that an individual with a WfFTC entitlement who was not required (and therefore unable to) file a return may, despite the time bar on issuing a personal tax summary, choose to file a return for that tax year.

Example

John realises that he was entitled to WfFTCs for the 2013/14 tax year. John is a salary and wage earner and does not derive any income of a nature that would require him to file an IR3 tax return. As it is currently, John cannot be issued with a PTS for the 2013/14 tax year to obtain his tax credits as the time bar applies.

Currently, John is not entitled to file an IR3 to claim his WfFTCs. Under the proposed amendment, John would be able to file an IR3 and claim the WfFTCs for the 2013/14 tax year.

Remedial items

WORKING FOR FAMILIES ABATEMENT RATES AND THRESHOLDS

Sections MD 3, MD 13, and MF 7 of the Income Tax Act 2007

Sections 2, 48–51 and 57 of the Families Package (Income Tax and Benefits) Act 2017

The average abatement rate, threshold and family tax credit rate have been repealed as they are no longer required.

Background

The 2017 Families Package legislation increased the Working for Families tax credit abatement rate from 22.5% to 25% and the abatement threshold from $36,350 to $42,700 a year from 1 July 2018. The family tax credit rates for most children also increased from 1 July 2018.

The changes took affect from part way through the 2018–19 tax year. The Families package legislation set out an average abatement rate, threshold and family tax credit rates for that year. The average rates assumed that the family earns income evenly across a year and claims tax credits for the whole year. The end-of-year reconciliation (or square up) ensures the correct amount of tax credits have been paid relative to the family's actual income and circumstances over the year and used the average annual figures.

The end-of-year process has been built in START, Inland Revenue's new computer system. This means that it is possible to make the reconciliation process more accurate. The actual income earned before 1 July will be reconciled using the old abatement rate and threshold and the income earned from 1 July will be reconciled using the new rate and threshold. This means that the average annual rates are no longer required.

Key features

The Working for Families tax credit average abatement rate, threshold and family tax credit rates for the 2019 tax year have been repealed.

Application date(s)

The amendment applies form 1 July 2018, the date the changes to Working for Families took effect.

CLARIFICATION THAT INLAND REVENUE CAN PAY WORKING FOR FAMILIES TAX CREDITS TO BENEFICIARIES

Section 80KN of the Tax Administration Act 1994

Section MF 2 of the Income Tax Act 2007

The amendment clarifies that Inland Revenue can pay Working for Families tax credits, including the Best Start tax credit to recipients of an income-tested benefit.

Background

During the implementation of the Families Package legislation it was not clear that the legislation allowed Inland Revenue to pay Working for Families tax credits payments, including Best Start, to recipients of an income-tested benefit, when the entitlement was unabated.

Key features

The amendment clarifies that Inland Revenue can pay Working for Families tax credits to recipients of an income-tested benefit whether the entitlement is abated or not.

Application date(s)

The amendment applies from 1 July 2018.

INTERACTION BETWEEN BEST START AND PAID PARENTAL LEAVE

Section MC 6 of the Income Tax Act 2007

The amendment clarifies that a person can receive the Best Start tax credit and paid parental payments for the same child.

Background

When the Best Start tax credit was introduced, it was intended that a person could receive paid parental leave and once it ceased to be payable, Best Start payments should be made for the rest of the eligible period. This prevents a person getting paid Best Start and paid parental leave at the same time for the same child.

However, the legislation did not reflect the policy intent and meant if a person received paid parental leave, they were not entitled to receive any Best Start payments for that child.

Key features

The amendment ensures that when a person has received paid parental leave they are entitled to receive Best Start payments for the rest of the entitlement period.

Application date

The amendment applies from 1 July 2018, the date the Best Start tax credit took effect.

PARENTAL TAX CREDIT AND PRO-RATA PAYMENT

Section MD 11 of the Income Tax Act 2007

Section KD 2AB of the Income Tax Act 2004

Section KD 2AB of the Income Tax Act 1994

A minor retrospective amendment has been made to enable the payment of the parental tax credit on a pro-rata basis to qualifying persons. The amendment reflects the original policy intent.

Background

The parental tax credit was repealed in 2018. It was not available if the person was in receipt of a specified payment (for example, a Ministry of Social Development benefit), or had a suspended entitlement to such a benefit, or if they claimed paid parental leave.

The original policy intent was to permit the payment of the parental tax credit for the days when there was no such payment of a Ministry of Social Development benefit.

However, an amendment in 2002 inadvertently resulted in the removal of the ability to pay the parental tax credit on a pro-rata basis.

Inland Revenue continued to make pro-rata payments to qualifying persons inadvertently, contrary to the effect of the 2002 amendment.

Key features

The amendment clarifies that the parental tax credit could be paid on a pro-rata basis to qualifying persons.

Application date

The amendment applies from the 1 July 2002, the date the 2002 amendment took effect.

ADJUSTMENTS TO WORKING FOR FAMILIES PAYMENTS TO PREVENT UNDER OR OVERPAYMENTS

Section MF 4 of the Income Tax Act 2007

The amendment clarifies that Inland Revenue can adjust interim payments of Working for Families tax credits to improve their accuracy, reducing the possibility of under or overpayments.

Background

During the implementation of the Families Package legislation it was not clear that the legislation supported adjustments of interim payments when a potential Working for Families under or overpayment is identified. The legislation was silent as to whether adjustments could be applied to the Best Start tax credit (Best Start).

Key features

The amendment clarifies that the Commissioner of Inland Revenue has discretion to adjust interim payments of Working for Families to ensure the recipient receives as close as possible to their correct entitlement during the year (thereby reducing the risk of any underpayment or overpayment which would need to be paid back).

Adjustments do not apply to Best Start. Best Start was introduced in the Families Package legislation and is "intended to give all families extra support in the first year of a child's life and targeted support for low and middle income families with children aged one or two".[9] Adjusting Best Start would be contrary to that intent.

Application date

The amendment applies from 1 April 2019.

GST REMEDIAL AMENDMENTS

A number of minor amendments to the Goods and Services Tax Act 1985 have been made to remedy situations where the legislation previously did not give effect to the policy intent, or where there were obvious errors.

Exceptions to the requirement to make an adjustment

Section 21(2) of the Goods and Services Tax Act 1985

An amendment clarifies that a registered person may not make an adjustment if one or more of the criteria listed in section 21(2) of the Goods and Services Tax Act 1985 apply.

It is possible that some may have interpreted the section as meaning that it allows (but does not require) adjustments when any of the criteria listed apply. The amendment is intended to remove any doubt.

Application date

The amendment came into force on the date of enactment, being 18 March 2019.

Notification to the Commissioner of a change in company constitution

Section 53(1)(a) of the Goods and Services Tax Act 1985

A registered person is required to notify the Commissioner within 21 days of a change in status. Changes in status include changes to a registered person's name, address or principal taxable activity or activities.

An amendment removes the requirement for a registered person to notify the Commissioner of a change in constitution, as this information is generally not necessary or relevant to Inland Revenue's operations and it would only be in extremely rare circumstances where a change in a company's constitution may have an impact on its GST position.

Application date

The amendment came into force on the date of enactment, being 18 March 2019.

[9] Explanatory note to the Bill.

GST refund for regional fuel tax rebates paid to unregistered persons

Section 20(3)(bb) and (bc) of the Goods and Services Tax Act 1985

The current GST rules allow the New Zealand Transport Agency to claim a GST refund from Inland Revenue in respect of regional fuel tax that it has rebated to a GST registered person.

An amendment allows the New Zealand Transport Agency to also claim a GST refund in cases where the rebate is paid to a person who is not registered for GST (such as an individual or micro business). This will ensure the correct GST outcome, of no net GST, in all cases where the regional fuel tax was rebated.

Application date

The amendment applies on and after 1 July 2018.

Outdated references to the former principal purpose test

Sections 5(13A), 10(3A), 20A(4), and 55(7)(db) of the Goods and Services Tax Act 1985

An amendment removes the outdated references to the former "principal purpose" test in section 55(7). Under new section 55(7)(db), a change in use adjustment is required to be made by the representative member of a GST group when:

- a person (the "new member") who previously acquired goods and services for their business or private use joins the GST group; and
- the extent of taxable use of those goods and services by any group member differs from the new member's previous percentage of taxable use of those inputs.

Amendments to section 5(13A), 10(3A) and 20A(4) replace references to the former principal purpose test with a requirement that the registered person intends to use the goods and services for making taxable supplies.

Application date

The amendments apply on and after 1 April 2011.

Cross-references

Sections 2A(4), 10(3C) and (3D) of the Goods and Services Tax Act 1985

A couple of omitted cross-references have been inserted into the GST Act:

- Section 2A(4) aggregates the interests of two associated people for the purposes of paragraphs 2A(1)(a) and (b). However, section 2A(4) does not aggregate the interests of two people associated under paragraph 2A(1)(bb). An amendment inserts this cross-reference.
- Sections 10(3C) and (3D) link to services treated as being made in New Zealand by section 8(4B). Services treated as being made in New Zealand by section 8(4B) are subject to a reverse charge under section 5B. However, sections 10(3C) and (3D) are not linked to zero-rated remote services that are instead subject to a reverse charge under section 20(3JC). An amendment inserts this cross-reference.

Application date

The amendment to section 2A(4) came into force on the date of enactment, being 18 March 2019. The amendments to section 10(3C) and (3D) apply on and after 1 October 2016.

FINANCIAL ARRANGEMENT RULES – TREATMENT OF SOME FOREIGN CURRENCY AGREEMENTS FOR THE SUPPLY OF GOODS AND SERVICES

Sections EW 32 and EW 33D

Certain taxable income or tax deductions, which can arise from contingent payments under a foreign currency denominated ASAP (agreement for the sale and purchase of goods or services), have been removed from the tax base. Previously these contingent payments were regarded as being interest and thus were automatically in the tax base.

This arises from an unintended outcome following the 2014 alignment of tax with accounting for these ASAPs. This alignment was to simplify compliance and remove the volatility of foreign currency movements that resulted from the previous tax treatment.

[10] An accounting term for the purchase of a block of assets that between them can be used as a stand-alone business.

The rules apply to taxpayers who return for tax purposes financial arrangement income and expenditure from foreign currency ASAPs; and either:

- purchase businesses accounted for as "business combinations"[10] where the purchase price is contingent on future events, usually financial performance of the assets purchased; or
- sell businesses where the purchase price is contingent on future events, usually financial performance of the assets purchased.

Background

A business can be purchased/sold in two different ways. One way is by purchasing/selling the shares. The other is by purchasing/selling the assets/liabilities that comprise a business. Both of these situations are dealt with in NZ IFRS 3 (Business Combinations) for the purchaser and the tax results of ASAPs denominated in a foreign currency (foreign ASAPs) follows the accounting treatment. When the assets/liabilities are purchased, it may result in positive or negative goodwill in the standalone financial statements of the purchaser. When the shares are purchased goodwill for the purchaser only arises on consolidation. NZ IFRS 3 does not apply to sellers of businesses.

The unintended outcome was treating any resulting adjustment to the purchase price caused by contingent amounts as "interest" for tax purposes rather than as an adjustment to the purchase price. This "interest" was then assessable or deductible over the term of the ASAP. Conceptually, the adjustment should not be treated as interest under the financial arrangements rules. Under the foreign ASAP rules it should be either part of positive or negative goodwill for the purchaser when the assets/liabilities are purchased; or adjust the purchase price of shares acquired. For the seller it will increase/decrease the sale price of the assets/liabilities or shares sold, which may result in adjustments to depreciation on sale or income/expenditure for assets held on revenue account.

Application date(s)

The new rules apply from 18 March 2019, the date of Royal assent.

Example

A foreign ASAP for the purchase of the net assets of a business (not the acquisition of the shares of a company) includes contingent consideration of NZ$90,000 payable in two years' time, based on the performance of the business acquired. The consideration of $90,000 is payable in the form of a variable number of shares to the acquirer at the market price of the shares in two years' time. NZ IFRS 3 business combinations accounting for the purchaser treats the $90,000 contingent amount as a liability at inception at its current present value, including the probability of its payment (a liability of $32,653 at inception).

If the contingent consideration of $90,000 is paid in two years' time, the difference between $90,000 and the initial liability of $32,653 ($57,347) is debited to the purchaser's Income Statement. Under the previous tax rules, this amount would have been deductible as interest. If the contingent consideration is not paid, the initial liability of $32,653 is credited to the purchaser's Income Statement and this amount would have been assessable as interest under the previous tax rules. Both of these tax outcomes are unintended and incorrect under the policy settings for the financial arrangements rules.

Under the new rules, the debit and credit amounts for contingent consideration in the purchaser's Income Statement are not treated as interest under the financial arrangements rules. Any separate amounts in the Income Statement for deferred consideration will continue to be treated as interest for tax under the financial arrangements rules.

The value of purchasers' property or services included in foreign ASAPs of IFRS taxpayers for other purposes of the Act (for example, cost for tax depreciation or revenue account property) will continue to be the accounting values recognised under NZ IFRS 3 at the acquisition date. The accounting does not subsequently adjust the fair values initially recognised under NZ IFRS 3 for any subsequent contingent payments.

The contingent amounts in question are therefore not included in the value of the underlying assets and liabilities of the business purchased for other tax purposes – for example, calculating tax depreciation. The amounts subsequently recognised for contingent consideration should be treated as part of positive or negative goodwill on purchase.

The vendor will account for a gain/loss above carrying value on sale of the assets/shares (not via NZ IFRS 3). The contingent consideration will be treated as part of the sales proceeds for tax. As a result it may affect depreciation recovered or assessable income for revenue account property.

However, when the business combination is achieved by the sale and purchase of the shares of the company being purchased, the purchaser's value of the shares acquired will need to be adjusted by any contingent consideration subsequently paid and not included in the original accounting or reversed (if included in the original accounting).

Non-IFRS taxpayers' also have new rules that apply the same approach as for IFRS taxpayers.

RESIDENTIAL AND MAIN HOME EXCLUSIONS

Sections CB 16, CB 16A, CB 17 and CB 18 of the Income Tax Act 2007

Background

The rules for taxing land sales contain exclusions where land is used as a person's main home. As a result of the re-write, these exclusions contained minor errors, which meant that they did not operate as intended.

Prior to the rewrite of the income tax legislation, the residential exclusion in what is now section CB 17(2) would clearly have allowed a person without a family member living with them to use the residential exclusion. However, this was not clear on the rewritten wording of the provision. The rewrite also inadvertently introduced slight wording differences between the various residential exclusions.

The residential exclusion in section CB 16 cannot be used if the person has engaged in a regular pattern of transactions. Before the rewrite, it was clear from the legislation that to be disqualified from using the exclusion, the transactions in the regular pattern had to involve dwellings used mainly as the taxpayer's residence. This was not apparent from the wording of the rewritten legislation.

The issue was also inadvertently replicated in the wording of the main home exclusion (section CB 16A) from the bright-line test, when those rules were introduced.

Key features

Amendments have been made to the residential and main home exclusions from the land sale rules in the Income Tax Act 2007 to:

- ensure that the residential exclusion in section CB 17(2) applies whether or not the taxpayer has a family member living with them, and to align the wording in the various residential exclusions; and
- ensure that the "regular pattern" carve-outs from the residential exclusion in section CB 16 and the main home exclusion in section CB 16A operate as intended, so that a pattern of transactions will only prevent the exclusions being available if it involves buying and selling, or building and selling, houses that were the person's residence or main home.

Application dates

The amendments to sections CB 16, CB 17, and CB 18 apply from 1 April 2008.

The amendment to section CB 16A applies from 1 October 2015.

BRIGHT-LINE TEST FOR RESIDENTIAL LAND

Section 6A(4) of the Income Tax Act 2007

Sections 6, 7, 45, 46, 93, 95, 107, 108, 110, 111, 231, 234 and 257B of the Taxation (Annual Rates for 2017–2018, Employment and Investment Income, and Remedial Matters) Act 2018

Background

The bright-line test for sales of residential land has been extended to apply to disposals of land within five years (from two years originally). The five-year bright-line test will apply if someone first acquired an estate or interest in the land they are disposing of on or after 29 March 2018. The two-year bright-line test will continue to apply to disposals of land if a person first acquired an estate or interest in the land on or after 1 October 2015 but before 29 March 2018.

This application date for the five-year test gave rise to the wrong policy result in two situations:

- for freehold estates converted from leases with a perpetual right of renewal; and
- for land that was purchased off the plans.

In addition, the rule for purchases off-the-plans originally only applied to freehold estates. From a policy perspective, this rule should also apply to leasehold estates, which are commonly used for central city apartments.

Key features

Amendments have been made to ensure that the application date for the five-year bright-line test works as intended in two circumstances:

- For leases with a perpetual right of renewal (Glasgow leases) that are converted to freehold estates, whether the two-year or five-year bright-line applies depends on when the leasehold estate was granted, rather than when the first interest in the freehold was acquired.
- For purchases off-the-plans, whether the two-year or five-year bright-line applies depends on when the contract to buy off the plans was entered into, rather than when the first interest in the land was acquired (which will not be until the title is issued).

An amendment has also been made to ensure that the bright-line test applies to off-the-plans purchases of both freehold and leasehold estates in land.

Application dates

The amendment to section 6A(4) of the Income Tax Act 2007 applies from 1 October 2015.

The amendments to sections 6, 7, 45, 46, 93, 95, 107, 108, 110, 111, 231, 234 and 257B of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 apply from 29 March 2018.

FIF COST METHOD

Section EX 56 of the Income Tax Act 2007

Background

The foreign investment fund (FIF) rules provide for the taxation of equity investments that New Zealand tax residents hold in foreign entities they do not have a controlling interest in. There are five different calculation methods for determining the amount of FIF income a person has for the year.

The cost method can be used if market value of the FIF interest can only be determined by an independent valuation. Generally, an independent valuation is required on entry into the cost method. However, it was intended that investors in FIFs who use the cost method for calculating their FIF income would have the option to reset their cost base (the "opening value") once every five years through an independent valuation. However, the legislation as enacted may make the five-yearly revaluation mandatory, not optional.

Key features

The cost method has been amended to ensure the ability for a person to reset their cost base every five years through independent valuation is optional not mandatory.

Application date

The amendment will apply from 1 April 2008.

RESETTLEMENT OF TRUSTS WITH FOREIGN SETTLOR

Sections HC 15, HC 16(2)(c), HC 27(3) of the Income Tax Act 2007

Background

The amendments address some technical issues identified during an administrative review of the taxation of trusts relating to a trustee of a foreign trust that settles property of that trust (the head trust) onto a sub-trust (a resettlement).

Prior to these amendments, the trustee of the head trust was treated as a settlor in relation to the resettled property. If there are multiple trustees of the head trust and at least one trustee of the head trust is resident in New Zealand, the sub-trust became taxable on its world-wide trustee income. This was an unintended outcome as it was originally intended that the settlor of the head trust (being a foreign trust) would be the settlor of the sub-trust, with that sub-trust being treated as a foreign trust while it's settlor remains a non-resident of New Zealand.

In addition, it was identified that the valuation rules for distributions, transmissions and gifts of property in subpart FC of the Income Tax Act 2007 resulted in:

- the trustee of the head-trust being treated disposing of the resettled property at market value; and
- the trustee of the sub-trust being treated as having acquired the resettled property at market value.

When applying these valuation rules to a resettlement of property on a sub-trust, this could result in the trustee of the head trust being treated as deriving a capital gain from an associated person. If the head trust was treated as deriving a capital gain from an associated person, this could result in that gain distributed as part of the resettlement being a taxable distribution and be:

- excluded from the corpus of the sub-trust; and
- treated as trustee income of the sub-trust.

Key features

The amendments apply to a resettlement of property by the trustee of one trust (the head trust) onto a new trust (the sub-trust) if the settlor of the head trust is non-resident (or treated as non-resident) at the time of the resettlement. The amendments clarify:

- the relationship between foreign sourced trustee income derived by the sub-trust and the exempt income rule in section CW 54 of the Income Tax Act;
- if the head trust is a foreign trust, the extent to which the value of the resettled property is corpus of the sub-trust; and
- if the head trust is a foreign trust, due to the valuation rules applying to resettlements. that a capital gain deemed to be derived by the trustee of the head trust from the resettlement of property is not included in a taxable distribution, unless the settlor of the head trust is a controlled foreign company.

The amendments do not affect the general operation of the settlor definition. In addition, the amendments do not affect the requirement that a settlor of a foreign trust must not have been resident in New Zealand since the current trust rules were originally enacted.

Application date

The amendments came into force on the date of Royal assent (18 March 2019). However, a transitional provision (section 161(3) of the Taxation (Annual Rates, Modernising Tax Administration, and Remedial Matters) Act 2019) validates tax positions taken prior to the date of enactment for those tax positions taken that are consistent with the outcome given by the amendments.

Detailed analysis

Exempt income: trust with resident trustee and non-resident settlor

Prior to the amendments to section HC 27, for a resettlement by trustees of a trust (the head trust) onto a sub-trust:

- The resettlement of trust property of a trust (the head trust) resulted in the trustee of the head trust being treated as a settlor of the sub-trust.
- If the head trust was a foreign trust, foreign-sourced income derived from trust property would have been exempt income of the foreign trust under section CW 54 of the Income Tax Act.
- If at least one trustee of the head-trust is a New Zealand resident, the New Zealand sub-trust would have a New Zealand resident settlor. This would result in trustee income derived by that sub-trust being taxable in New Zealand on a worldwide basis.

A resettlement of property of a foreign trust is not intended to have this outcome.

The amendments to section HC 27 ensure the sub-trust is correctly treated as a trust with a non-resident settlor under section HC 28(5) by excluding the trustee of the head trust from being a settlor of the sub-trust if:

- the settlor of the head trust has non-resident at the time of the resettlement;
- there is more than one settlor for the time being at the time of the resettlement, all the settlors are non-resident at that time; and
- if no settlor is alive or has ceased to exist prior to the time of the resettlement, the deceased settlor or the entity that has ceased to exist are treated as the settlor at the time of the resettlement.

The amendments ensure that the resettlement of property of a foreign trust on a sub-trust does not affect the entitlement of that sub-trust to the exemption from tax under section CW 54 for foreign sourced trustee income derived by a resident trustee, provided the sub-trust meets the requirements of section HC 26.

Resettlements, corpus, and trustee income

When a trustee of a head trust resettles property on another trust, section HC 4 may apply to exclude part of that resettlement from corpus. Section HC 4 excludes a settlement of property from corpus of the sub-trust to the extent that, it the settlement was a distribution to a beneficiary resident in New Zealand, that distribution would be either beneficiary income or a taxable distribution.

Sections FC 1(f) and FC 2 treat a resettlement of trust property as made at market value. As the resettlement is a distribution, it may include a realised capital gain from a transaction with an associated person (the resettlement will generally be made with an associated person).

If the resettlement is made by the trustee of a foreign trust, prior to the amendments to section HC 15, it was possible for a capital gain arising from the resettlement to be excluded from corpus and taxed to the trustee. This was not intended.

The amendments to section HC 15 ensure that the capital gains treated as a taxable distribution from a foreign trust (the head trust) and excluded from corpus (and treated as trustee income) are those that arise from a transaction or series of transactions:

- other than the resettlement, but only to the extent the value of the transaction or transactions exceeds market value; or
- involving a resettlement by a trust for which a controlled foreign company is the only settlor at the time of the resettlement.

Resettlements of a foreign trust, the valuation of the resettlement and capital gains excluded from taxable distributions rules applying to distributions

A valuation rule (in subpart FC) applies to a resettlement of property on a sub-trust. For income tax purposes, this rule treats the resettlement of property on a sub-trust as a disposal and purchase at market value. If the head trust is a foreign trust, this could result in the head trust deriving a capital gain from an associated person (a tainted gain) for the definition of taxable distribution from a foreign trust. To the extent the value of resettlement includes such a tainted gain, that gain would be excluded from the corpus of the sub-trust and taxed as trustee income in the sub-trust.

The amendments ensure that, in most circumstances, when a foreign trust resettles property on a sub-trust, the valuation rules applying to a resettlement of property on a sub-trust:

- do not result in a tainted gain being included in the value of the resettlement; and
- provide that the full value of the resettlement is corpus of the sub-trust.

BINDING RULINGS AND RECORD-KEEPING REQUIREMENTS

Section 91C(1)(ec)(i), and (1B) of the Income Tax Act 2007

Background

The amendment clarifies that the Commissioner of Inland Revenue may make a binding ruling for any record-keeping requirement in the Tax Administration Act 1994.

Key features

The Commissioner of Inland Revenue has a power to rule on the record-keeping requirements of the Goods and Services Tax Act 1985. However, no such explicit power exists in the Tax Administration Act 1994 for other revenue types.

For consistency, the amendment ensures that the Commissioner can rule on record-keeping requirements for all tax types.

Application date

The amendment applies from 18 March 2019, the date of Royal assent.

BEPS REMEDIALS – INTEREST LIMITATION

Sections GC 16 and GC 17 of the Income Tax Act 2007

Key features

The following amendments have been made to the interest limitation rules enacted in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018:

- The restriction on using only unsecured debt for the optional credit rating in sections GC 16(11) and GC 17(c) has been removed.
- Identifying the member of the worldwide group with the most debt should be based on the member with the most third-party debt rather than related-party debt.
- Allowing a borrower to base the group credit rating on the member of the group reasonably considered to have the highest rating if the group has no third-party debt.
- Section FE 5(6) has been removed as it was redundant.
- The deferred tax liability adjustment to the non-debt liability amount in the thin capitalisation debt percentage calculation has been made optional.

Application date(s)

These amendments apply from the same date as the BEPS changes, which are generally for income years commencing on or after 1 July 2018.

Detailed analysis

Optional credit rating and secured debt

The optional credit rating method allows a borrower who is subject to the restricted transfer pricing rule to use a credit rating for related party debt that is based on the credit rating implied from significant third-party debt. The interest rate paid to a third party represents an actual cost to the group so would not be inflated to reduce taxable income. This credit rating can be applied for related-party debt up to four times the value of the third-party debt. This limit prevents a borrower from taking on a small amount of expensive third-party debt and using this to justify a higher interest rate on a much larger amount of related-party debt, giving rise to a tax saving on the related-party debt that is greater than the additional interest cost on the third-party debt.

The optional credit rating was originally based on unsecured debt only, as this debt represents the credit risk of the borrower as a whole compared with secured debt which represents some reduction in credit risk by virtue of the secured lenders preferential ranking relative to the unsecured lenders in the event of a default. Usually, a well secured loan will have an interest rate that implies a higher credit rating than that of the lower ranking debt of the entity, such as unsecured or subordinated debt. Where a borrower has both secured and unsecured third-party borrowing, it would be appropriate for the optional credit rating to be based on the lower credit rating implied from the unsecured debt.

However, some borrowers have only secured debt or have more than four times as much related party debt as third-party unsecured debt while also having secured debt. Although a borrower would typically choose to use any unsecured debt for the optional credit rating rather than secured debt it is not necessary for the legislation to prevent use of secured debt where it is beneficial to the borrower. Accordingly, sections GC 16(11)(a) and (b), and GC 17(a) have been amended so they refer to "long-term senior debt" instead of "long-term senior unsecured debt".

The use of "long-term senior unsecured debt" has been retained for the purpose of determining the group member with the most debt which is covered further below.

Determining a credit rating for the group member with the most debt

A borrower that chooses to, or is required to, use the group credit rating must determine their credit rating based on the member of the worldwide group that has the highest long-term senior unsecured debt. It was always intended that this be the member of the group with the highest third-party debt as a proxy for the highest rated member of the group on the basis a group would seek to minimise their external debt funding costs. This proxy is not suitable if applied to related-party debt as a group may not seek to minimise related party interest as it does not represent a cost to the group when viewed as a whole.

Accordingly, sections GC 16(10)(a) and GC 17(a) have been amended so the group credit rating will be based on the group member with the greatest long-term senior unsecured debt and not related-party debt or debt between associated non-residents.

Both related-party debt and debt between associated non-residents has been carved out as related-party debt is a defined term in section RF 12H(1) which requires that expenditure arises for the borrower for which they are allowed a deduction.

Group credit rating where there is no third party debt

As noted above, the group credit rating is based on the member of the group with the most long-term senior unsecured third-party debt as a proxy for identifying the member of the group with the highest credit rating. In a small number of circumstances, a New Zealand borrower may be part of a worldwide group that has no long-term senior unsecured third- party debt. It is still necessary to identify the credit rating of a group member to apply the group credit rating; however, previously the legislation did not specify how to do this.

New sections GC 16(10)(ab) and GC 17(ab) allow a borrower to use the credit rating of the group member with the highest credit rating. These sections specifically allow this group member to be identified without having to consider the credit ratings of other group members that are reasonably considered to be unlikely to have the highest credit rating. This is intended to reduce compliance costs of identifying the relevant group member. Officials expect that in most situations the relevant group member will be easy to identify such as the main trading entity, the highest operating company in the ownership chain, or the entity with the largest balance sheet. Likewise, other entities, such as an entity operating in a third country, should be able to be disregarded unless there was a reason to consider them further (for example, if those operations were more significant than those in the parent jurisdiction).

Section FE 5(6) has been repealed

In the thin capitalisation rules, the allowable debt percentage of a group where the worldwide group is the New Zealand group has been reduced from 110% to 100%. Prior to the introduction of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, several iterations of the drafting were considered in order to implement this policy. One of these iterations introduced subsection FE 5(6). As the drafting developed other changes were made to sections FE 5 and FE 6 to implement the policy and section FE 5(6) became unnecessary. However, FE 5(6) was not removed from the Bill and was subsequently enacted.

As section FE 5(6) is redundant, it has now been removed.

Optionality of deferred tax liability adjustment

The thin capitalisation debt percentage calculation was amended by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 so that it became debt/(assets – non-debt liabilities). This meant that for a given level of debt and assets, an increase in non-debt liabilities would result in a higher debt percentage. Deferred tax liabilities are a form of non-debt liabilities; however, certain deferred tax liabilities can be subtracted from non-debt liabilities, which will decrease the group's debt percentage.

As only certain deferred tax liabilities can be removed from the calculation, groups will incur compliance costs in identifying these specific deferred tax liabilities. In many circumstances, the compliance costs of this calculation may exceed any tax saving from adjusting for these deferred tax liabilities. This will mostly occur when a group is below the 40% restricted transfer pricing or 60% thin capitalisation thresholds. It may also occur where the taxpayer is above one of these thresholds but the cost of obtaining the data and completing the calculation exceeds any reduction in interest deductible.

Page 97 of the Officials' report to the Taxation (Neutralising Base Erosion and Profit Shifting) Bill recognised the calculation of deferred tax liabilities is complex and technical, and therefore proposed "an option" to exclude certain deferred tax liabilities amounts from non-debt liabilities. Although the ability to exclude certain deferred tax liabilities was included, this was not made optional. The calculation of the non-debt liability adjustment in section FE 16B(1)(e) has been amended so that taxpayers are not required to remove deferred tax liabilities unless they choose to do so.

BEPS REMEDIALS – CHANGES TO HYBRID AND BRANCH MISMATCH RULES

Sections FH 3, FH 4, FH 10, FH 12 and FH 15 of the Income Tax Act 2007

Some technical changes have been made to the hybrid and branch mismatch rules which were introduced by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

Background

The hybrid and branch mismatch rules were introduced by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018. The technical changes contained in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 ensure that some aspects of the hybrid and branch mismatch rules operate as intended.

Key features

Payee tax and ordinary income

The definition of "payee tax" in section FH 3(5)(b) has been amended so that it incorporates the concept of ordinary income, as recognised by the payee jurisdiction. This ensures that the original policy intent of the rule is achieved in the circumstance of a payment that is recognised as income in the payee jurisdiction, but is also eligible for a tax credit or some other type of tax relief. Tax payable on such a payment does not qualify as "payee tax" under the amended definition.

Timing recognition for defensive hybrid financial instrument rule

For timing mismatches, the defensive hybrid financial instrument rule in section FH 4 now requires that income is recognised at the time in which a deduction is recognised in the payer jurisdiction for the relevant payment.

Dual resident companies without foreign deductions

The dual resident payer rule has been amended such that it does not apply to the extent that the dual resident company has expenditure that is not deductible under the relevant foreign jurisdiction's laws due to that expenditure's connection with income that is not taxable in the foreign jurisdiction.

Payer tax status and surplus assessable income

The definition of "unrecognised" in section FH 12(4)(d) has been amended to include income that is not taxed in another country because of the tax status of the person deriving that income in that country.

Definition of mismatch amount and mismatch situation

The definitions of "mismatch amount" and "mismatch situation" have been amended. The former definition has been amended to refer to adjustments to deductions or income under the entity-based hybrid mismatch rules, rather than to what happens to such amounts if there is surplus assessable income. The latter definition has been amended to clarify that a person can have a mismatch situation even if there are no mismatch amounts arising from that mismatch situation.

Application date(s)

The changes apply to income years beginning on or after 1 July 2018, which is consistent with the general application date of the hybrid and branch mismatch rules.

BEPS REMEDIAL – SECTION GB 54 – PERMANENT ESTABLISHMENT AVOIDANCE

Section GB 54 of the Income Tax Act 2007

This section makes some remedial amendments to section GB 54 of the Income Tax Act 2007.

GB 54(1)(b) – supply by facilitator

Section GB 54 is a permanent establishment anti-avoidance rule. The rule applies if (amongst other things) a supply is made by a non-resident to a recipient in New Zealand, and a related party (referred to as the "facilitator") carries out an activity for the purpose of bringing about that supply. However, the rule is also intended to apply if:

- the non-resident makes a supply to an intermediary;
- the intermediary then on-supplies the goods to a recipient in New Zealand; and
- the facilitator carries out an activity for the purpose of bringing about the intermediary's supply to the recipient.

Section GB 54(1)(b) originally referred to an activity carried out by the facilitator for the purpose of bringing about the non-resident's "facilitated supply" to the "recipient". However, if an intermediary is involved, the facilitated supply is made by the non-resident to the intermediary, not by the non-resident to the recipient. Accordingly, section GB 54(1)(b) is amended so that it refers to an activity carried out by the facilitator for the purpose of bringing about either the facilitated supply to the recipient, or the supply by the intermediary to the recipient.

The amendment applies retrospectively from the commencement of section GB 54.

Section GB 54(1)(i) – purpose or effect of tax avoidance

Section GB 54(1)(h) refers to an arrangement that has a purpose or effect of tax avoidance. Section GB 54(1)(i) refers to this same arrangement, but only requires that the arrangement have a more than merely incidental purpose of tax avoidance. For consistency, section GB 54(1)(i) is amended to also refer to a purpose or effect of tax avoidance.

The amendment applies retrospectively from the commencement of section GB 54.

Section GB 54(h) – tax avoidance

Section GB 54(1)(h) refers to arrangements for the avoidance of income tax. The intention is for the section to also apply to arrangements that avoid other kinds of tax, such as non-resident withholding tax (NRWT). The Commentary to the Taxation (Neutralising Base Erosion and Profit Shifting) Bill also stated that the application of section GB 54 could result in NRWT becoming payable. Accordingly, the current drafting does not achieve the intended effect.

Section YA 2(3) contains an expanded definition of income tax, which includes NRWT. Accordingly, section YA 2(3) is amended to also apply to section GB 54.

The amendment applies for income years commencing after enactment of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019.

BEPS REMEDIAL – SECTION YD 4(17D)

Section YD 4(17D) of the Income Tax Act 2007

This section makes a remedial amendment to section YD 4(17D) of the Income Tax Act 2007.

Background

Section YD 4(17D) provides that income has a source in New Zealand if New Zealand has a right to tax it under a double tax agreement. Sections YD 4(15) to (17) contain source rules under which only a portion of the relevant types of income have a source in New Zealand. The Income Tax Act 2007 sets out apportionment methods for these types of income in sections YD 6, YD 8 and EY 48. These apportionment methods should still apply if income with a source under sections YD 4(15) to (17) also has a source under section YD 4(17D). However, it would be helpful to clarify this by amending section YD 4(17D).

Key features

Income from a source under sections YD 4(15) to (17) is excluded from the application of section YD 4(17D).

Application date

The amendment applies retrospectively from the commencement of section YD 4(17D).

MISCELLANEOUS REMEDIAL – SECTION DB 18AA – APPORTIONMENT OF EXPENSES FOR DUAL USE PREMISES

Section DB 18AA of the Income Tax Act 2007

This section makes a remedial amendment to section DB 18AA of the Income Tax Act 2007.

Background

Section DB 18AA of the Income Tax Act 2007 contains a simplified method for taxpayers to claim deductions for dual use (business/personal) premises. There is a technical problem with the formula used to calculate this deduction. The formula provides for the total mortgage interest and rates, or rent, for the property (premise costs) to be multiplied by the percentage of the building (for example, the house) used primarily for business purposes. The intent is for the building's curtilage (the land immediately surrounding the building) to effectively be disregarded when carrying out this calculation. For example, say there was a 100m^2 house on a 500m^2 section, with a 10m^2 home office and $50,000 of interest costs for the mortgage per year. The formula is intended to ignore the 400m^2 of curtilage, and instead multiply the $50,000 of interest by the 10% of the house used for business purposes, giving $5,000 of deductions.

However, because "premises" are defined to refer only to a building, there is an issue as to whether the premise costs need to first be apportioned between the curtilage and the building, with only the portion attributable to the building then being apportioned under the formula between the building's business and personal use. Under this approach, in the example above,

the $50,000 of interest would first need to be apportioned between the building and the 400m^2 of curtilage. If, say, 50% was apportionable to the building, this means that the mortgage deduction would only be $2,500 ($50,000 × 50% apportionable to building × 10% apportionable to business use) instead of the intended $5,000.

The current formula in section DB 18AA(2) also assumes there is only a single building on the property. Accordingly, it cannot be applied literally where there are multiple buildings on the same property.

Key features

Section DB 18AA is amended so that expenses do not need to be apportioned between buildings and curtilage. Where a house is on something like a farm, with land extending beyond the curtilage, the intent is for the expenses to be apportioned between the building + curtilage and the non-curtilage land before applying the formula.

In addition, the policy intent is for the formula to work in the same way for multiple buildings on a property as for a single building. Therefore, section DB 18AA is amended so that, for multiple buildings, the area of each building on a property is added together to give a total combined building area (ignoring the curtilage). The fraction of business use is then determined by dividing the total area used primarily for business purposes in all buildings by the total combined area of those buildings.

For example, say there were 2 buildings of 100m^2 each, one of which contained a 10m^2 home office and one of which contained a 10m^2 business related storage area. The formula now works by adding the area of each building together, to give a total of 200m^2. The 10m^2 home office area is then be added to the 10m^2 storage area, to give a total area used for business purposes of 20m^2. To work out the business use percentage, the 20m^2 business use area is divided by the 200m^2 total building area. As a result, 10% of any premises costs can be claimed as a deduction under the formula.

Application date

The amendments applies retrospectively from the date section DB 18AA first came into effect (the section came into effect on 1 April 2017 with effect for the 2017–18 and later income years).

MISCELLANEOUS REMEDIAL – SECTION HG 11 – LIMITED PARTNERSHIP LOSS LIMITATION RULE

Section HG 11 of the Income Tax Act 2007

This section makes a remedial amendment to the loss limitation rule for limited partnerships in section HG 11.

Background

A limited partner (unlike an ordinary partner) is not legally liable for the debts of a limited partnership. To reflect this, a limited partner is prevented from claiming deductions for the losses of a limited partnership under section HG 11 to the extent the losses exceed the partner's economic exposure to them.

The loss limitation rules technically limit a partner's share of the limited partnership's gross deductions, rather than its net losses. This is because a limited partnership, as a transparent entity, technically does not have net losses under the Income Tax Act 2007. The distinction between gross deductions and net losses is usually irrelevant. However, in some unusual circumstances, limiting a partner's gross deductions (instead of losses) can result in the partner being deemed to derive net income from a loss-making limited partnership.

The loss limitation rules were only ever intended to limit net losses from a limited partnership, and were never intended to result in additional net income arising. The rules were also described by Inland Revenue as limiting net losses in its explanatory material. This is also how the rules are generally understood as operating in the private sector.

Key features

Section HG 11 is amended to ensure that the loss limitation rules only deny a partner's share of the net losses from a limited partnership (that is, the excess of the partnership's deductions over its assessable income) and cannot result in a limited partner deriving net income from a loss-making partnership.

Application date

The amendment applies retrospectively from the commencement of the limited partnership regime (1 April 2008, for income years starting on or after 1 April 2008).

INFORMATION SHARING WITH POLICE

Schedule 7, Part C, clause 29 of the Tax Administration Act 1994

New schedule 7, Part C, clause 29 of the Tax Administration Act 1994 corrects an unintended drafting error with the previous section 81(4)(z) of the Tax Administration Act 1994.

Background

Section 81(4)(z) permitted the Commissioner to share certain information with a "member of the New Zealand Police". Under the Policing Act 2008, the term "member of the New Zealand Police" must be read as a reference to a "constable". Constables are Police employees who have taken the constable's oath (a sworn member).

The policy intent of section 81(4)(z) has always been to allow the Commissioner of Inland Revenue to disclose information to Police officers who have been authorised by the Commissioner of Police to receive the information. Often these officers will be in the Police's Financial Intelligence Unit and will not be constables.

Key features

New schedule 7, Part C, clause 29, which replaces section 81(4)(z), now allows the Commissioner of Inland Revenue to disclose information to authorised officers of the Police.

Application date

The amendment applies from the date of Royal assent.

COMPANY SPLITS (DEMERGERS) BY AUSTRALIAN ASX LISTED COMPANIES REMEDIAL AMENDMENTS

Sections CD 29C and EB 2B of the Income Tax Act 2007

Remedial changes have been made to the dividend and quantification rules in the Income Tax Act 2007 as they apply to shares received by New Zealand shareholders because of a company split (demerger) by Australian Stock Exchange (ASX) listed Australian companies.

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.

In 2018 the dividend rules in the Income Tax Act were amended with effect from the 2016–17 income year, to provide that the receipt of shares by a New Zealand taxpayer, when those shares are the result of a demerger by a listed Australian company, is not a dividend. The new rules rely on the transfer of shares not being treated as a dividend under Australian tax law. An explanation of the 2018 amendments can be found at **https://www.ird.govt.nz/resources/c/4/c4d9f47c-9839-4041-bec0-f3e96ecbce38/tib-vol30-no5.pdf** (pages 77 to 79).

Amendments have been made to the demerger rules for ASX-listed Australian companies to clarify their effect. The changes respond to tax practitioner concerns regarding the scope of the new rules as they applied to demergers within a group of companies, and practical problems with applying the ownership interest tests in section ED 2B(1)(c) and ED 2B(2).

Broadly, for New Zealand income tax purposes, if a transfer of shares by an ASX-listed Australian company pursuant to a demerger is not a dividend under Australian tax law, the equivalent treatment applies in New Zealand. Taxpayers can refer to statements from the Australian Tax Office or the company's demerger documents to help determine this.

Key features

The scope of section ED 2B(1) has been expanded to include situations when a demerger is undertaken in the context of a group of companies. The expanded provision now also includes situations when the shares in the splitting company are retained within the wider group of companies.

The proportional ownership tests that used to be in sections ED 2B(1)(c) and (2) have been repealed. Demergers by ASX-listed Australian companies are already subject to ownership tests under the Income Tax Assessment Act 1936 (Australia) and these tests must be met by the demerging company or group of companies if the share transfer is not to be treated as income under that Act.

Section CD 29C has been drafted to be consistent with the core provisions of the Income Tax Act.

Application date

The remedial changes apply from the 2016–17 income year.

SHARING INFORMATION WITH CUSTOMS AND ANTI-MONEY LAUNDERING AND COUNTERING FINANCING TERRORISM REGULATORS

Schedule 7, Part C, clauses 24 and 25 of the Tax Administration Act 1994

Two minor amendments allow Inland Revenue to disclose information to ensure taxpayer compliance with the Anti-Money Laundering and Countering Financing Terrorism Act 2009 and the Customs and Excise Act 2018. This information sharing facility is authorised under existing legislation and these amendments inserts parallel authorisations into the Tax Administration Act 1994 ("TAA").

Background

This is under section 102(8) of the Customs and Excise Act 2018 for transfer pricing arrangements, and sections 140(1) and (2) of the Anti-Money Laundering and Countering Financing Terrorism Act 2009 for suspicious transactions. Inland Revenue can disclose information to New Zealand Customs Service and Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulators.

The secrecy provisions of the TAA do not allow sharing of taxpayer information, unless an exception for a specific purpose is made. Consequential amendments needed to be included in the TAA introducing new exceptions to the secrecy provisions to enable the disclosure of information.

Key features

The new schedule 7, Part C includes new clauses, 24 and 25:

- clause 24 enables the Commissioner to disclose information to a government agency or an AML/CFT supervisor for ensuring compliance with AML/CFT legislation; and
- clause 25 enables the Commissioner to disclose information to the New Zealand Customs Service in relation to a transfer price arrangement for assessing the suitability of any such arrangement in relation to the use of provisional values under the Customs and Excise Act 2018.

Application date(s)

The amendment applies from date of Royal assent.

DISCLOSING INFORMATION TO DIGITAL SERVICES PROVIDERS

Schedule 7, Part B, clause 18 of the Tax Administration Act 1994

An amendment to allow disclosure of information to digital services providers to enable a broader range of services to be provided to taxpayers.

Background

Currently, Inland Revenue has two legislative provisions to disclose information to taxpayers – one enabling disclosure to the taxpayer directly, and another enabling disclosure to someone using a software package on their behalf. However, the current legislative provisions are too narrow to enable a broad range of digital services to be provided to taxpayers.

This amendment will make it easier for taxpayers to comply with their tax obligations by enabling them to view their tax liabilities, tax transactions and other financial assets and liabilities information and to pay their tax in one place, for example, through their banking app.

Key features

The new schedule 7, Part B, clause 18, enables a broader range of services to be provided to taxpayers digitally, by communicating a person's tax information to an accepted digital services provider.

Application date(s)

The amendment applies from date of Royal assent.

TRUST REMEDIALS

Sections FC 2(4), HC 10(2)(a)(ii), HC 16(6)(c), HC 27, HC 30(3)(a), (b), (c), (4)(a), (b), HC 36(1) and HC 37(1) of the Income Tax Act 2007

Background

The amendments relate to some matters identified in an administrative review of a 1989 Tax Information Bulletin item on the taxation of trusts. The outcome of that review was published in *IS18/01 Taxation of Trusts – Income Tax*.

Key features

The amendments:

- ensure there is internal consistency within the Income Tax Act in relation to the tests for tax residence and some trustee elections;
- correct unintended legislative changes arising from the rewrite of the Income Tax Act; and
- clarify internal cross-references and relationships with other parts of the Income Tax Act.

Application date

The amendments apply from 18 March 2019, the date of Royal assent.

Detailed analysis

Transitional residence and election to be a complying trust

A foreign trust loses its status as foreign trust when a settlor of that trust migrates to New Zealand, with a deferral of that effect if the settlor elects to be a transitional resident. That trust may then choose to become a complying trust. If that choice is not made, the trust becomes a non-complying trust, which affects the taxation of distributions made from the trust that are not beneficiary income.

A period is given to make this election (a grace period) and that period ends on the election expiry date – 12 months after migration or one year after the settlor ceases to be a transitional resident.

The amendment to section HC 10(2)(a)(ii) confirms that a transitional resident must make their election by the election expiry date. This resolves an inconsistency that existed before the amendment between sections HC 10(2)(a)(ii) and HC 30(2).

Transitional residence, ordering rules, and distributions

Prior to the amendments to section HC 30(3), the law was unclear about the tax treatment of distributions from trustee income derived by a foreign trust in the year in which a migrating settlor ceases to be a transitional resident. This uncertainty could result in such a distribution being subject to economic double taxation because:

- the foreign trust becomes taxable on world-wide trustee income from the beginning of the income year in which the migrating settlor ceases to be a transitional resident; and
- if the distribution is a taxable distribution to a New Zealand resident beneficiary, that distribution is taxed at the marginal rate of the beneficiary with no credit for the New Zealand tax paid for income derived in the part-year before the settlor ceases to be a transitional resident.

The policy intent is that a distribution from such accumulated income in that part-year period should not be subject to economic double taxation. The amendments clarify this by treating a distribution from this part-year period as being from a complying trust (that is, not taxed to the beneficiary unless it was distributed as beneficiary income).

Election to be a complying trust

The amendments to section HC 16:

- relate to the election for a foreign trust to become a complying trust when a settlor migrates to New Zealand; and
- correct an unintended legislative change arising from the rewrite of the provision by clarifying that this election may be made by any settlor, trustee, or beneficiary of the trust.

Capital gains derived from an associated person and the ordering rules

The ordering rules are clarified to correct an unintended legislative change arising in the rewrite of the provision.

The amendment ensures that a capital gain derived from an associated person is treated as income derived by the trustee for the ordering rules. This restores the intended timing effect for when such a capital gain is treated as distributed.

Minor beneficiary income

The amendments to sections HC 36 and HC 37 correct an unintended legislative change arising in the rewrite of the minor beneficiary rules. The broad intent of these rules is to tax beneficiary income distributed to minors at the trustee rate of 33%. There is intended to be an exclusion from this broad intent if certain requirements (in sections HC 36 and HC 37 of the Income Tax Act) about the trust are satisfied (for example, in some circumstances, minor beneficiary income derived that relates to a protected person under the Domestic Violence Act 1995).

However, the current law does not work as intended as it presently requires all listed circumstances to be satisfied before the exclusion applies. The amendment clarifies that the exclusion applies if the requirements of either section HC 36 or HC 37 are satisfied.

No value in the beneficiary relationship for section HC 14

There is an inconsistency between the rules applying to distributions, transmissions and gifts in subpart FC and the definition of distribution. The issue is that under subpart FC, a distribution of property may be treated as a purchase and disposal of that property at market value; whereas, in the definition of distribution, the beneficiary receiving property is treated as providing no value for a distribution by the beneficiary status.

The main purpose for the rules in subpart FC is to ensure that, for the trust making the distribution, the value of transferred revenue account property is correctly taken into account in calculating the trust's trustee income.

The new subsection FC 2(4) confirms that the rules in subpart FC do not apply for applying the definition of distribution. This will ensure that a distribution will continue be determined by whether an actual transfer of value has been made to a beneficiary and not by the deemed value rule in section FC 2.

CHARITIES AND DONEE ORGANISATIONS

Sections CW 42, EE 47, LD 3, GB 55, HR 12, DB 41, DV 12 of the Income Tax Act 2007

Sections 3, 41A and 120VD of the Tax Administration Act 1994

Background

Amendments have been made to the tax rules for charities and donee organisations to improve the integrity and coherency of the tax system as it applies to these entities.

The changes to the rules for deregistered charities ensure that if an entity has claimed tax exemptions as a charity and has accumulated assets, these assets are destined for a charitable purpose, even if the entity is deregistered under the Charities Act 2005.

Key features

Amendments to the Income Tax Act 2007 and the Tax Administration Act 1994 ensure that:

- the charitable business income tax exemption is restricted to charities registered under the Charities Act 2005;
- the deemed disposal provision for depreciation recovery income applies when a taxable entity becomes a registered charity;
- the disclosure requirements which apply to foreign trusts also apply to foreign trusts that are registered charities;
- organisations seeking donee status for donation tax credit, gift deduction or fringe benefit tax exemption purposes must be approved by the Commissioner of Inland Revenue;

- organisations with charitable purposes must be registered charities in order to obtain donee status;
- relevant penalty, interest and avoidance provisions apply to donation tax credits;
- only gifts of money, including payments made by way of cash, electronic bank transfers, credit cards, and cheques, qualify as gifts eligible for donation tax credits and gift deductions. They do not include gifts in kind or debt forgiveness; and
- the tax rules for deregistered charities better align with the policy intent, specifically to:
  - address the tax treatment of land owned by deregistered marae charities;
  - prevent potential double-deduction for monetary gifts made within one year of deregistration;
  - prevent potential over-taxation of deregistered charities in group structures in circumstances where multiple members in the group deregister together;
  - address the disposal of wholly-owned subsidiaries by a charitable group for market value;
  - clarify the valuation of assets and liabilities at the date of deregistration; and
  - include a de minimis threshold for charities with a low value of accumulated net assets.

Application date(s)

A range of application dates apply to the amendments as specified in the discussion below.

Detailed analysis

Application of the charitable business income exemption

Registration under the Charities Act 2005 carries with it a number of reporting obligations, which improves transparency and promotes public trust and confidence in the charitable sector.

Entities are required to be registered as a charity in order to access the charitable tax exemption for non-business income under section CW 41.

Before this amendment, entities were not required to be registered under the Charities Act 2005 in order to access the charitable exemption for business income under section CW 42. Business income was exempt if it was derived by a registered charity or by a separate entity carrying on a business "for, or for the benefit of" a registered charity.

A small but increasing number of businesses have sought to take advantage of the business income exemption without being registered charities themselves. This risked undermining public trust and confidence in the charitable sector. It also increased the extent to which Inland Revenue was involved in charity oversight and regulation. This did not align with the government policy that regulation of the charitable sector should sit primarily with the Charities Services (the Department of Internal Affairs).

This amendment to section CW 42 ensures that the business income exemption applies only to organisations that are registered under the Charities Act 2005.

The application date is the 2020–21 and later income years.

Application of the deemed disposal provision and depreciation recovery income

Under the depreciation rules, a change in the use of an asset is treated as if that asset was disposed of for the market value of the asset. One of the events which could trigger this deemed disposal occurs when a business changes its constitution or rules in order to meet the legal requirements for an exemption from income tax (for example, if a registered charity buys all of the shares in a business, and that business registers as a charity under the Charities Act 2005).

Before this amendment, if there was a deemed disposal, any excess depreciation deductions were clawed back as depreciation recovery income arising in the following income year. However, if the change of use of the asset was from a taxable use to being used for exempt purposes (for example, for charitable purposes), then it was not possible to claw back the excess depreciation deductions because by the following income year the entity was exempt from income tax.

The amendment inserts section EE 47(2B) to ensure that depreciation recovery income arises immediately before the entity is treated as being exempt from income tax.

The application date is 28 June 2018, being the date of introduction of this Act.

More information about the change of use of an asset is provided in a QWBA article of this *Tax Information Bulletin.*

Disclosure requirements for charities that are foreign trusts

Before this amendment, if a New Zealand registered charity was also a "foreign trust" (a trust established in New Zealand but where no settlor is resident in New Zealand at any time), then it was not subject to the foreign trust disclosure requirements in the Tax Administration Act 1994, including the new foreign trust disclosure requirements implemented by the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017. The historic reason for this exclusion was that such foreign trusts were already subject to public disclosure and regulation requirements under the Charities Act 2005, so no further disclosure requirements were considered necessary.

However, the 2017 foreign trust disclosure requirements now require some information that is not collected under the Charities Act 2005. The additional information involves identifying particulars and contact details for settlors, trustees and beneficiaries.

This amendment to the definition of "resident foreign trustee" in section 3 of the Tax Administration Act 1994 ensures that registered charities are no longer exempted from the foreign trust disclosure requirements. Foreign trusts that are also registered charities will be required to make annual disclosures to Inland Revenue like any other foreign trust.

The application date is 1 April 2019.

Donee status – approved donee list

Before these amendments it was possible for an organisation to self-assess that it satisfied the criteria for donee status without informing the Commissioner. Such an organisation could issue donation receipts to donors that qualified for a donation tax credit or gift deduction without being on Inland Revenue's list of donee organisations.

To ensure public transparency and to strengthen the integrity of the tax system, these amendments to section LD 3(1)(a) and sections 41A(14) to (16) of the Tax Administration Act ensure organisations that want to qualify for donee status must be on the list published by Inland Revenue.

Donee organisations must be on the list published by Inland Revenue if they are described in section LD 3(2)(a) (most donee organisations), (ab) (certain deregistered charities), (b) (public institutions), (c) (funds), or (d) (public funds). There is no change for entities described in section LD 3(2)(ac) (community housing entities), (bb) (Boards of Trustees), or (bc) (tertiary education institutions).

In practice, most donee organisations have their donee status approved by the Commissioner and their names are published on the donee list immediately after registering as charities. This approval process will not change as a result of this amendment.

An organisation can check if it is on the approved donee list at **www.ird.govt.nz/donee-organisations/**. If any organisation considers it should be on the list, but is not, it may contact Inland Revenue through myIR Secure Online services or email at **Charities.Queries@ird.govt.nz**. It should provide its IRD number, Charities Services registration number and a copy of its latest trust deed, constitution or other governing documents.

This amendment does not remove the requirement for all donee organisations to continually (at least annually) self-assess whether they meet the donee status requirements. For example, donee organisations must apply their funds wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand (unless they are listed in schedule 32). If an existing donee organisation no longer meets these requirements, it must immediately cease to issue tax donation receipts, inform the Commissioner and its name will be removed from the donee list.

The application date is 1 April 2020.

Donee status – application to organisations with charitable purposes

Before this amendment, organisations with charitable purposes could obtain donee status without being registered under the Charities Act 2005.

This amendment to section LD 3(3) will require all entities with charitable purposes, that qualify for registration under the Charities Act, to register under the Charities Act 2005 in order to qualify for donee status. This will ensure that all charitable organisations that can issue donation receipts that qualify for a donation tax credit or gift deductions are subject to the same reporting and regulatory requirements.

This change will have no impact on donee organisations that are currently registered under the Charities Act 2005 or on donee organisations that have benevolent, cultural or philanthropic (but not charitable) purposes that are not registered under the Charities Act 2005.

Affected donee organisations will have several choices:

(i) register as a charity under the Charities Act

(ii) if they are unable to register as a charity under the Charities Act, confirm with Inland Revenue that they wish to retain donee status and advise which donee status category applies, or

(iii) if (i) and (ii) do not apply, their donee status will be removed from 1 April 2020.

Any enquiry about how this law change affects your donee organisation may be sent through myIR Secure Online services or emailed to **Charities.Queries@ird.govt.nz**.

The application date is 1 April 2020.

Application of penalties, interest and anti-avoidance provisions

Before this amendment, debit use-of-money interest and other penalties could not be applied when donation tax credit claims were overstated by donors. Anti-avoidance provisions also did not apply to overclaimed donation tax credits made to donors.

Amendments have been made to sections 3 and 120VD of the Tax Administration Act and a new specific anti-avoidance provision has been introduced in section GB 55 of the Income Tax Act. The Tax Administration Act amendments will ensure that all relevant penalty and debit use-of-money interest apply in relation to donation tax credits that are overclaimed by donors. The anti-avoidance provision can apply when a person enters into an arrangement and the arrangement has a purpose or effect of defeating the intent and application of section LD 1.

The application date is 1 April 2019.

Debt forgiveness and gifts

A 2018 court decision in Roberts v Commissioner of Inland Revenue (the Roberts case) held that debt forgiveness qualified as a gift under section LD 3 of the Income Tax Act 2007 in the particular circumstances of that case. This potentially meant that debt forgiveness was more widely eligible for donation tax credits and gift deductions.

This decision, which is being appealed by the Commissioner, was inconsistent with the policy intent, which is that only gifts of money – including payments made by way of electronic bank transfers, credit cards, and cheques – qualify as gifts. This does not include gifts in kind or debt forgiveness.

From 1 April 2008, as part of the rewrite of the income tax legislation, the language of section LD 3 was modified but at no time has there been an intention to change the effect of the provision.

This amendment to section LD 3 replaces the words "monetary gift of $5 or more" with the original wording "gift of money of $5 or more" and aligns the donation tax credit provision with the policy intent.

The application date is 1 April 2008. However, there is a savings provision for taxpayers who have already taken a position in reliance on the previous wording, provided that they filed a return or a donation tax credit claim before 16 January 2019 (the date on which the Finance and Expenditure Committee reported to the House of Representatives on the Bill).

Deregistered charities in group structures

Large charities will often operate as part of a group, with charitable entities holding equity investments in other registered charities. If a parent entity and its subsidiaries are deregistered under the Charities Act 2005, then the deregistration rules apply to each of those entities and each entity must pay tax based on the value of its net assets. The value of the underlying assets could therefore be taxed more than once.

This is an over-reach of the policy intent of the deregistration tax rules, and it is appropriate to allow the deregistered charitable parent entity to make an adjustment in its net asset calculation.

This amendment to section HR 12(3)(d) ensures that if a parent entity and one or more members of a charitable group deregister at the same time, the value of the parent's shares in the subsidiary is ignored for the purposes of calculating the parent's income under the deregistration tax rules.

The application date is 1 April 2019.

Disposal of assets by a charitable group for market value

Charities that wholly-own an investment company will typically register that company as a charity in its own right. If the charity later sells its shares in the investment company, then that subsidiary may be required to deregister and be taxed on the value of its net assets.

However, if the subsidiary is sold at arm's length for market value, no value leaves the charitable group and it is an overreach to impose the deregistration tax on the subsidiary.

It is not appropriate to apply the deregistration tax in these circumstances, because the charitable group has simply replaced a certain amount of value in shares with the same amount in cash. In addition, the deregistration tax liability is likely to be reflected in the sale price of the shares, which would mean that the charitable group bears the economic burden of the tax liability.

This amendment to Section HR 12(2) ensures that if a charity sells an interest in a subsidiary at arm's length for market value, the deregistration tax does not apply to that subsidiary if it is deregistered as a result of the sale.

The application date is 1 April 2019.

Carve-out for marae assets

Generally, a deregistered charity can reduce the amount of tax payable under the deregistration rules by disposing of, or transferring their assets within one year of, the day they were deregistered. However, "reservation" land upon which marae are built cannot be disposed of or transferred to pay the resulting tax bill because of restrictions on alienation of reservation land under the Te Ture Whenua Māori Act 1993. This means that marae that are registered as charities have been unable to reduce their deregistration tax liabilities, unlike other deregistered charities.

This amendment to section HR 12(3)(d) ensures that for marae built on reservation land established under the Te Ture Whenua Māori Act 1993, the value of the land and improvements on the land will be excluded from the net asset calculation.

The application date is 14 April 2014 (the date the deregistration tax rules took effect).

Valuation of assets and liabilities

Before this amendment, the legislation referred to a deregistered charity being taxed on its "net assets". However, there was no indication in the Income Tax Act 2007 as to what valuation method should be used to measure the entity's net assets. Providing a valuation method in the legislation helps provide more certainty for taxpayers.

Using the historical cost of the asset does not provide the desired deterrent effect against deregistration, as sometimes what is today a very valuable asset could be recorded at a much lower historical cost value. This is inconsistent with the policy intent of the deregistration tax rules, which is to provide an incentive for charitable assets to remain in the charitable sector.

This amendment in section HR 12(7) specifies that assets and liabilities should be valued at their market value. Market value refers in general terms to the price an asset would be sold for in an arm's length transaction. This is usually determined from market-based evidence by appraisal.

There are two situations when valuing assets and liabilities at market value is not required:

i. Certain assets (premises, plant, equipment and trading stock) already have a prescribed valuation method in the deregistration rules. That value should be used for the purposes of the "net assets" calculation.

ii. If the deregistered charity has assets and liabilities not subject to the prescribed valuation method, and it valued these assets and liabilities at fair value to comply with the Public Benefit Entity International Not-for-Profit Accounting Standard 17, the fair value should be used for the purposes of the "net assets" calculation.

The application date is 1 April 2019.

Gifts of money made within one year of deregistration

Before this amendment, a deregistered charity that was a company or Māori authority could make a gift of money to another charity within 12 months of deregistration and this donation would both reduce its deregistration tax liability and be eligible for a gift deduction under the charitable giving rules.

Example

A deregistered charity holds $1 million worth of funds in its bank account at the date of deregistration. It donates half of that amount to another charity within 12 months of deregistration.

This has the effect of excluding $500,000 from tax under the deregistration tax rules. However, as the deregistered charity is now subject to normal income tax rules, it can also receive a $500,000 income tax deduction for the gift of money.

The one donation of $500,000 is therefore eligible for two tax concessions, despite not adding any new funds to the charitable sector.

This double benefit was inconsistent with the policy intent, as the assets are effectively already in the charitable sector.

These amendments to the charitable giving rules in sections DB 41 and DV 12 clarify that gifts of money transferred to another charity in accordance with the deregistration rules do not also qualify for a gift deduction.

The application date is 14 April 2014 (the date the deregistration tax rules took effect).

De minimis threshold for small-scale deregistered charities

Small-scale deregistered charities with limited resources can find it difficult to value assets for the purposes of the deregistration tax. It is inefficient for Inland Revenue to dedicate compliance resources to these small-scale charities as the potential tax liability would be very low.

A de minimis threshold of $10,000 in net assets has been introduced in section HR 12(2)(c) to exclude small-scale charities from the deregistration tax rules.

Inland Revenue estimates that a $10,000 net asset threshold will remove about 60 per cent of all deregistered charities from the deregistration rules, based on recent data published by Charities Services.

The application date is 1 April 2019.

EXTENSION OF THE CANTERBURY EARTHQUAKES ROLL-OVER RELIEF

Sections CZ 25, DZ 20, EZ 23B, EZ 23BB, EZ 70, EZ 71, EZ 72, EZ 73, EZ 74 of the Income Tax Act 2007

Sections EZ 23B and EZ 23BB have been amended to allow depreciation roll-over relief for properties affected by the Canterbury earthquakes in 2010 and 2011. A prerequisite for a person to receive the depreciation relief is that the person obtains replacement property in Canterbury. The amendments extend the deadline for obtaining the replacement property from the end of the 2018–19 income year to the end of the 2023–24 income year. This is because a number of affected taxpayers were unable to meet the previous deadline (the end of 2018–19 income year) for reasons outside their control.

Sections CZ 25, DZ 20, EZ 70, EZ 71, EZ 72, EZ 73 and EZ 74 have also been amended so that their end-dates are aligned with the changes to sections EZ 23B and EZ 23BB. This is because these sections are essential to the proper functioning of the rollover relief provisions, and some formed a complimentary part of the original set of Canterbury earthquakes tax concessions.

Application dates

The amendments to sections CZ 25, EZ 23B and EZ 23BB apply from 4 September 2010, and the amendments to sections DZ 20, EZ 70, EZ 71, EZ 72, EZ 73 and EZ 74 apply from 1 April 2016.

HURUNUI/KAIKOURA EARTHQUAKE – ROLL-OVER RELIEF FOR OWNERS OF REVENUE ACCOUNT PROPERTY

Section CZ 25B of the Income Tax Act 2007

The new section CZ 25B allows the owners of revenue account property that is land and buildings affected by the Hurunui/Kaikoura earthquake in November 2016 the similar rollover treatment as for the owners of property affected by the Canterbury earthquakes in 2010–2011. Such roll-over relief ensures that property owners can defer (or roll-over) income tax liabilities arising from the receipt of insurance payments for irreparably damaged or abandoned buildings.

For consistency with the amendments to the Canterbury earthquakes roll-over relief provisions, this amendment applies for income years before the 2024–25 income year.

Application date

The amendment applies for the 2015–16 and later income years.

PAYMENTS TO FIRE AND EMERGENCY VOLUNTEERS

Section RD 5 of the Income Tax Act 2007

Section RD 5 of the Income Tax Act 2007 has been amended so that honoraria received by fire and emergency volunteers from the Fire and Emergency New Zealand are now treated as "salary and wages" and subject to PAYE rules. This amendment ensures that such volunteers are no longer required to file separate income tax returns for taxable honoraria they receive (and to separately account for the ACC levies).

Application date

The amendment applies from 1 April 2019.

ASSOCIATED PERSONS ANTI-AVOIDANCE RULE FOR LAND SALES

Section CB 15(1) of the Income Tax Act 2007

Background

This amendment corrects an unintended error arising in the rewrite of section CD 1(11) of the Income Tax Act 1994 into section CB 13(1) of the Income Tax Act 2004 (re-enacted as section CB 15(1) of the Income Tax Act 2007).

Key features

The provision is an anti-avoidance rule to ensure that land held on revenue account is treated as continuing to be on revenue account for a subsequent disposal of that land when it is transferred to an associated person.

The amendment clarifies that consideration derived from the transfer of land between associated persons is income of the vendor under section CB 15(1) only if the transfer is not taxable under one of the main land sales rules (sections CB 6 to CB 14).

In addition, the amendments also clarify that the exclusions (residential exclusion, investment exclusion, and the farmland exclusion) generally do not apply to that subsequent disposal if section CB 15(1) applies to a transfer of land between associated persons.

Application date(s)

The amendment applies from the beginning of the 2008–09 income year. However, a savings provision applies to protect tax positions taken based on the law, as it was, prior to 28 June 2018 (the date of introduction of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill).

Detailed analysis

The amendment clarifies that the section is intended to apply to a vendor of land disposing of land to a third party if:

- the vendor had acquired the land from an associated person; and
- the associated person would have been taxed on the disposal of land to the third party, had they kept the land and disposed of it themselves to the third party (hypothetical transaction).

In addition, the amendment ensures the vendor of the land is not entitled to the benefit of the exclusions from the land sales rules (residential exclusion, investment exclusion, and the farmland exclusion).

Example

An example of a disposal of land to which section CB 15(1) applies is as follows.

Land was acquired by Peter, a property developer, for his development business. The land was later transferred by Peter to his spouse, Janie. The following year, Janie builds a home on the land and lives in it. Eight years later, Janie on-sells the land to a third party (a family trust) and leases back the home.

As the property was acquired for the property development business, the land was held by Peter on revenue account under section CB 7(1)(b). The transfer of the land from Peter to Janie was included in calculating Peter's taxable income for the year in which the transfer occurred.

When Janie sells the land to the family trust, she is liable for tax on that sale if:

- she had acquired the land from an associated person; and
- Peter would have been taxed on the disposal of land to the family trust if he had instead kept the land and disposed of it himself to the trust in a hypothetical transaction.

Peter would have been taxed on the hypothetical transaction because the disposal of land by a property developer is always on revenue account if the land was acquired for the property development business. In addition, none of the exclusions apply to Janie because they are not available for disposals to which section CB 15(1) applies.

Therefore, Janie is taxed on the disposal of land to the family trust under section CB 15(1). Despite Janie living in a home she has built on the property the residential exclusion does not apply. This is consistent with the original policy intent.

ASSOCIATED PERSONS AND 10-YEAR RELIEF RULE FOR LAND SALES

Section CB 15(2) of the Income Tax Act 2007

Background

The amendment corrects an unintended legislative error arising in the rewrite of section GD 9(1) of the Income Tax Act 1994 into section CB 13(2) of the Income Tax Act 2004 (re-enacted as section CB 15(2) of the Income Tax Act 2007).

Key features

The 10-year relief rule applies to a vendor of land if the vendor was associated with a land dealer, land developer or a builder at a certain point of time within the 10 years prior to the sale.

Section CB 15(2) allows the vendor to aggregate their period of ownership of the land being sold with the immediate prior period of ownership if the land was acquired from an associated person.

Application date(s)

The amendment applies from the beginning of the 2008–09 income year. However, a savings provision applies to protect tax positions taken based on the law, as it was, prior to 28 June 2018 (the date of introduction of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill).

Detailed analysis

When the relief rule applies

Section CB 15(2) allows the vendor to aggregate their period of ownership with the ownership period of the person they acquired the land from, if that other person was an associated person at the time the vendor acquired of the land. If this association requirement is satisfied, section CB 15(2) applies to grant relief from tax for the vendor who disposes of land within 10 years from the time:

- the vendor acquired the land, if at that time the vendor was also an associated person of either a land dealer or a land developer. The associated person from whom the vendor acquired the land is not required to be either that land dealer or land developer;
- the vendor has commenced improvements on the land, if at that time, the vendor was also an associated person of a builder. Again, the associated person from whom the vendor acquired the land is not required to be that builder;

- the vendor acquired the land if since acquisition, if the value of the land since acquisition has increased because of zoning changes; or
- a scheme of development or subdivision has begun to be carried out on that land.

Relief is determined solely by the aggregate period of ownership of the vendor and the immediately preceding owner (provided the vendor and that other person were associated persons when the vendor acquired the land).

Relationship between section CB 15(1), (2)

The amendment to section CB 15(2) also clarifies that for a person who acquired land from an associated person (the vendor) and later sells it to a third person:

- the 10-year relief rule applies only if the vendor's sale of land is taxable under any of sections CB 6 to CB 12 or CB 14. It is not necessary for the earlier transfer of the land to the vendor to be a taxable transaction; and
- the 10-year relief rule also applies in determining whether the associated person would have been taxable on the hypothetical transaction referred to in section CB 15(1)(d).

Example Investment Co acquires bare land for investment purposes. Investment Co is wholly owned by Paul who is an associated person of Investment Co.

Five years later, Paul acquires that bare land from Investment Co. At this time, Paul has a 30% shareholding in Develop Co, a land development company. This makes Paul an associated person of Develop Co.

Four years later, Paul sells the land to Kim, his spouse. Paul and Kim are associated persons (spouses are associated persons) and Kim is also an associated person of both Investment Co and Develop Co.

Five years later Kim sells that land to a third party.

In this example, Kim would be taxed on the disposal of land to the third party because of her association with the land developer at the time she acquired the land. The 10-year relief rule is not available to Kim because she:

- acquired the land from an associated person (Paul);
- at the time of acquiring the land from Paul, she was an associated person of Develop Co, a land developer; and
- the total combined period of ownership of Kim and Paul is nine years.

In this example, the associated person relief rule is intended to apply only to those periods of time in which both Paul and Kim held the land. It is not intended that the relief rule should count periods when the same land was held continuously within the circle of association prior to Paul's acquisition of the land. Therefore, the relief rule is not intended to count the period when the land was held by Investment Co in determining the 10-year period. As the aggregate period of ownership in which Paul and Kim hold the land is nine years, the relief rule does not apply.

EXTRA PAY

Section RD 17 of the Income Tax Act 2007

Background

This amendment corrects an unintended legislative change in section RD 17 of the Income Tax Act 2007 arising in the rewrite of this provision. This could have resulted in too much PAYE being withheld from an extra pay.

Key features

The rewrite of this provision into the Income Tax Act inadvertently included all previous amounts of extra pay within that four-week period when calculating the annualised amount. This inadvertent drafting change could result in too much PAYE being withheld.

The amendment restores the intended effect and confirms current practice.

Application date(s)

The amendment applies from the beginning of the 2008–09 income year. However, a savings provision applies to protect tax positions taken that result in an incorrect amount of PAYE on an extra pay – the savings provision ensures that the employer is not exposed to penalties for the incorrect withholding.

Detailed analysis

The amendment corrects an unintended change arising during the rewrite of the provision into section RD 17 of the Income Tax Act. The amount of PAYE to be withheld from an extra pay (for example, a performance bonus) is determined by calculating an average rate of tax on an annualised amount of PAYE income payments based on:

- the amount of the extra pay; and
- all regular wages and salaries paid in the four weeks prior to the date of the extra pay.

This annualised calculation is not intended to include any other amounts of extra pay that may have been made in that four-week period.

The amendment reflects policy and practice relating to the calculation of PAYE on an extra pay by employers.

A concern raised in submissions was whether the retrospective nature of the amendment could result in an employer being exposed to penalties if the employer had applied the rewritten law correctly and withheld an incorrect amount of PAYE.

The combined effect of the retrospective amendment and its savings provision ensure that since the enactment of the Income Tax Act:

- taxpayers who have withheld PAYE from an extra pay consistent with the policy intent will be treated as always complying with the retrospective law; and
- taxpayers who have withheld PAYE from an extra pay consistent with the wording of the wording in the law prior to this amendment will not be exposed to penalties.

PRE-CONSOLIDATION IMPUTATION CREDITS

Section OP 22(1)(d), (1B) of the Income Tax Act 2007

Section 244(3), (4) of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019

Background

This savings provision relates to amendments made to section OP 22 (use of pre-consolidation imputation credits) by the Taxation (Annual Rates 2017–18, Employment and Investment Information and Remedial Matters) Act 2019 (the "EII Act") (retrospective to the beginning of the 2008–09 income year), which:

- confirm the Commissioner's application of section OP 22;
- correct a minor unintended legislative change arising in the rewrite of the provision; and
- ensure the law works as intended.

A pre-consolidation imputation credit is a credit balance of an imputation credit account (ICA) of a company that existed immediately prior to the company becoming part of a consolidated imputation group.

The policy intent for the use of pre-consolidation imputation credits is that a consolidated imputation group may transfer a pre-consolidation imputation credit from the ICA of a member company of the group, only if:

- a debit entry is made to the group ICA;
- the group ICA would have a debit balance immediately after the debit entry;
- the transferred pre-consolidation credit does not exceed that debit balance in the group ICA; and
- shareholder continuity is satisfied for the pre-consolidation imputation credit.

Submissions received after enactment of the EII Act raised a question about the appropriateness of the policy in section OP 22 for a consolidation imputation group wishing to use pre-consolidation imputation credits. The savings provision allows these submissions to be appropriately considered in the future, within the tax policy work programme.

Key features

The amendments replace sections OP 22(1)(d) and (1B) with effect from 29 March 2018 to facilitate a savings and a transitional provision for tax positions relating to:

- the transfer of a pre-consolidation imputation credit from an individual company's imputation credit account (ICA) to the ICA of a consolidated imputation group; and
- the law as it was prior to amendments made to section OP 22 (use of pre-consolidation imputation credits) of the Income Tax Act 2007 by the EII Act.

The savings and transitional provisions apply for a tax position adopted by a consolidated imputation group for a transfer of a pre-consolidated imputation credit that:

- offsets a debit balance in the group's ICA arising from a debit entry to the ICA; and
- exceeds that debit balance.

The savings provision allows a transfer of a pre-consolidation credit to the extent that the amount transferred does not exceed the debit entry to the group ICA (the entry that gave rise to the debit balance in the group ICA).

The transitional provision is intended to apply if the amount of a pre-consolidation credit transferred to the group ICA during the transitional period is more than the amount allowed to be transferred under the savings provision.

Application dates

The savings provision and its corresponding transitional provision apply to a tax position taken under section OP 22 of the Income Tax Act 2007 for the transfer of pre-consolidation imputation credits for tax years beginning before 1 April 2021 (the 2020–21 or earlier tax years).

Detailed analysis

Section 244 of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 (the "ARMTARM Act") provides a savings provision for amendments to section OP 22 relating to the use of pre-consolidation imputation credits. The amendments in section 244 of the ARMTARM Act:

- replace the amendments to section OP 22 enacted in sections 176 of the EII Act 2018 on 29 March 2018;
- facilitate the implementation of a savings provision for section OP 22, for tax positions taken based on the application of section OP 22, as it was prior to 29 March 2018; and
- implement a transitional provision that applies to tax positions taken that are inconsistent with the requirements of the savings provision.

Replacement of amendments to section OP 22

The EII Act retrospectively amended section OP 22, by replacing section OP 22(1)((d) and inserting section OP 22(1B), with a commencement date of 1 April 2008. These amendments ensured the law is consistent with the policy intent for the use of pre-consolidated imputation credits, as follows. A consolidated imputation group may transfer a pre-consolidation imputation credit from the ICA of a member company of the group, only if:

- a debit entry is made to the group ICA;
- the group ICA would have a debit balance immediately after the debit entry;
- the transferred pre-consolidation credit does not exceed that debit balance in the group ICA; and
- shareholder continuity is satisfied for the pre-consolidation imputation credit.

The amendments in section 244(1), (2) of the ARMTARM Act replace the amendments made to section OP 22 of the 2007 Act, commencing from 29 March 2019. These replacement amendments have the same effect as those made in the EII Act and are made to facilitate the implementation of savings and transitional provisions.

Savings provision

The savings provision is to allow a consolidated imputation group and its member companies to transfer pre-consolidation imputation credits (until 31 March 2021) in a manner consistent with some policy observations set out in a 1992 background paper.

Under the savings provision, a member company of a consolidated imputation group may transfer a pre-consolidation credit from its ICA account to the group ICA, if all the following are satisfied:

- The group ICA has a debit entry in a tax year which would not be fully offset by an earlier credit entry to the Group ICA.
- Immediately prior to that debit entry being made to the group ICA, an individual member company of the consolidated imputation group has credit balance in its ICA account (this can only be a pre-consolidation credit balance).
- The amount of the pre-consolidation imputation credit transferred from the member company's ICA to the group ICA does not exceed the amount of that debit entry to the group ICA.
- Shareholding continuity is satisfied for the pre-consolidation imputation credits transferred up to the time of the transfer.

Example 1 sets out how section OP 22 applies, without considering the savings provision.

Example 1

Company A in a consolidated group pays a dividend on 30 September 2016 with $60,000 imputation credits attached. Prior to paying the dividend, the consolidated group's ICA credit balance was $1,000. Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance of $100,000. No other transactions occur in the group ICA during the year to 31 March 2017.

The outcome given by section OP 22 (consistent with the policy intent) is as follows:

Date	Group ICA	Company B ICA
1 April 2016	1,000	100,000
30 September 2016 (dividend paid by Coy A)	(60,000)	
30 September 2016 (transfer from Coy B)	59,000	(59,000)
31 March 2017 (balance)	0	41,000

Example 2 illustrates the effect of the savings provision for Example 1 (section 244(3) of the ARMTARM Act). Example 2 illustrates that the amount of the pre-consolidation credit:

- may exceed the debit balance that would have arisen in the group ICA; but
- may not exceed the amount of the debit entry to the group ICA that would result in a debit balance in that account.

Example 2

The savings provision confirms a tax position taken for tax years beginning prior to 1 April 2021 for transferring a pre-consolidated imputation credit if:

- the amount transferred exceeds the debit balance arising in a group ICA after a debit entry; and
- the amount transferred is less than or equal to the debit entry in the Group ICA.

This is illustrated here:

Date	Group ICA	Company B ICA
1 April 2016	1,000	100,000
30 September 2016 (dividend paid by Coy A)	(60,000)	
30 September 2016 (transfer from Coy B)	60,000	(60,000)
31 March 2017 (balance)	1,000	40,000

Transitional provision

This provision applies for a tax positions taken for the transfer of a pre-consolidation imputation credit to the ICA of a consolidated imputation group if the following are satisfied:

- A debit entry is made to the group ICA.
- That debit entry would result in the group ICA having a debit balance.
- The amount of that transferred credit is greater than the amount of the debit entry to the group ICA.
- Shareholder continuity is satisfied for the transferred imputation credit.

Neither section OP 22 as enacted (nor as amended by the EII Act) nor section 244(3) permit the amount of a pre-consolidation credit transferred to a consolidated group's ICA to exceed the amount of the relevant debit entry in the group ICA. The transitional provision ensures that the transfers of pre-consolidation credits made in the 2018–19 tax year or any earlier tax year do not exceed the amount allowed under the savings provision in section 244(3)(d) of the ARMTARM Act.

However, a legislative error in the transitional provision relates to the tax years to which the provision applies. This error is proposed to be corrected to have the effect described below.

The transitional provision is intended to apply for any tax year ending prior to the 2019–20 tax year, to give the following outcomes (see Example 3):

- A transfer of an excess amount of pre-consolidation credit in any year is to be reduced to the maximum amount allowed to be transferred under the savings provision.
- The closing balance of the ICA for each of those earlier tax years is to be recalculated.
- If that adjusted closing balance is a debit balance or an increase in the debit balance, the amount of the balance (or the increased amount) is a further income tax liability for that year, but there is no need to file an amended ICA return for any tax year ending before the 2018–19 tax year nor pay further income tax under this rule for any of those earlier tax years.
- Instead, the aggregate effect of those adjustments for pre-consolidation credits will be carried forward to the 2018–19 tax year in the adjusted opening balance for the 2018–19 tax year.
- After making these adjustments, if the adjusted closing ICA balance at 31 March 2019 differs from that already filed and is either a debit balance or an increase in the debit balance, the amount of the debit balance (or the increased amount) is a further income tax liability for that year in addition to any other further income tax liability.
- The aggregate amount of further income tax liability is to be paid within the 2019–20 tax year by the due date in the transitional provision (which is proposed to be extended to later in the 2019–20 tax years).
- No imputation penalty or additional imputation tax is payable in relation to this further income tax liability.

In addition, taking a tax position that transfers an excess amount of an imputation credit to the ICA of a consolidated group during the 2019–20 and 2020–21 tax years is not possible under the savings provision.

The combined effect of the savings and transitional provisions in section 244 of the ARMTARM Act are illustrated in example ZC.

Example 3 – adjustment for transfer of excess pre-consolidation imputation credit

This example is based on the following assumed facts:

- Company A in a consolidated group pays a dividend on 30 September 2016 with $60,000 imputation credits attached.
- Prior to paying the dividend, the consolidated group's ICA credit balance was $1,000.
- Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance of $100,000.
- No other transactions occur in the group ICA during the year to 31 March 2017.
- The group transfers the entire amount of the pre-consolidation credit to the Group ICA on the payment of the dividend.

Assume the group also pays:

- $50,000 of income tax in April 2017;
- a dividend with $90,000 imputation credits attached in September 2017;
- $60,000 of income tax in April 2018; and
- A dividend with $75,000 imputation credits attached in September 2018
- $60,000 of income tax in April 2018; and
- A dividend with $58,000 imputation credits attached in September 2018.

Date	Group ICA As returned	Group ICA adjusted	Company B ICA As returned	Company B ICA adjusted
1 April 2016	1,000	1,000	100,000	100,000
30 September 2016 (dividend paid by Coy A)	(60,000)	(60,000)		
30 September 2016 (transfer from Coy B)	100,000	100,000	(100,000)	
30 September 2016 retrospective adjustment		(40,000)		40,000
31 March 2017 /1 April 2017 (balance)	41,000	1,000	0	40,000
Adjustment debit balance (further income tax liability)		*0*		
7 April 2017 tax paid	50,000	50,000		
30 September 2017 dividend paid by group company	(90,000)	(90,000)		
31 March 2018/1 April 2018	1,000	(39,000)		40,000
Adjustment debit balance (further income tax liability)		*39,000*		
7 April 2018 tax paid	60,000	60,000		
30 September 2018 dividend paid by group company	(58,000)	(58,000)		
31 March 2019 / 1 April 2019	3,000	(37,000)		40,000
Further income tax liability		*0*		
Resulting debit balance at 31 March 2019		*37,000*		

Example 3 illustrates that the consolidated group has overdistributed $79,000 of imputation credits during the two years to 31 March 2018. Shareholders will have received credit for this overdistributed amount in aggregate over the same years.

Therefore, the consolidated group is required to pay further income tax of $79,000.

No imputation penalty tax or imputation additional tax is payable on this aggregate amount of further income tax.

The pre-consolidation credits can be used in future periods provided the transfer is consistent with section OP 22, or until the 2020–21 tax year consistent with section 244(3) of the ARMTARM Act.

DEFINITIONS OF SETTLOR AND SETTLEMENT

Section HC 27(2)(ab) of the Income Tax Act 2007

Background

The amendments to section HC 27(2)(ab):

- correct an unintended legislative change arising in the rewrite of the trust rules relating to services provided to the trust for less than market value; and
- clarify that incidental services provided by a trustee (such as bookkeeping and trustee services) for less than market value are not a transfer of value, which aligns the general meaning of settlement with current practice.

Application date

The amendment for the unintended legislative change in section HC 27(2)(ab) applies from the beginning of the 2008–09 income year and confirms existing practice.

The amendment to the meaning of settlement and transfer of value for incidental services in the new paragraph provided for less than market value (section HC 27(2)(ab) applies from the date of enactment.

Detailed analysis

Rewrite amendment

The rewrite of the trust rules rationalised several provisions relating to definitions of "settlor" and "settlement", into the definition of "transfer of value". A transfer of value, in relation to a settlement on a trust, is defined generally as a transfer of money (or money's worth) to or for the benefit of a trust, without adequate consideration being given in return from the trust.

In addition, other transactions are specifically included in the definition of settlor and settlement as they do not represent a transfer of value under ordinary principles. For example, a person who provides an "on demand" loan to a trust is treated as a settlor if the right to demand payment is either deferred, or not exercised.

However, under ordinary principles, a transfer of value-for-money's worth normally requires the amount transferred to the trust to be convertible into money. For example, the gifting of property to a trust is a transfer of value to the trust because, under ordinary principles, the property is readily convertible into money.

However, the provision of services to, or for the benefit of, a trust for less than market value is not an amount that is readily convertible into money. Therefore, services provided at less than market value do not come within the definition of transfer of value and would not be a settlement under the Income Tax Act.

In contrast, the value of these services for less than market value was specifically treated as a settlement in the Income Tax Act 2004. The amendment which inserts section HC 27(2)(ab) restores the effect given by the Income Tax Act 2004 into the rewritten provisions in the Income Tax Act 2007.

Incidental services provided to a trust

The minor beneficiary rules, which apply to tax trustees at 33% on income distributed to minor beneficiaries, recognise that incidental services such as bookkeeping and trustee services provided to the trust should not be counted as settlements. The purpose of that exclusion is to simplify compliance.

However, because of the insertion of section HC 27(2)(ab), such incidental services will be counted as settlements under the more general meaning of settlement. On analysis this results in different rules relating to a settlement on a trust applying depending on whether the trust has minor beneficiaries. Aligning the two rules is more consistent with current practice.

The amendment to section HC 27(2)(ab) ensures that, from 18 March 2019, incidental services provided to trusts (such as bookkeeping and trustee services) will not be treated as a transfer of value on a prospective basis.

MAINTENANCE AMENDMENTS

Sections as per the table

The following amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

Minor maintenance items

The following amendments relate to minor maintenance items to correct:

- 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 inconsistent use of terminology and definitions.

Maintenance amendments: schedule of clause numbers and changes to text

Section of principal Act	Enactment	Amendment	Commencement date
CB 11(2)	Income Tax Act 2007	Improve drafting consistency	1 April 2008
CD 3	Income Tax Act 2007	Correction to cross-reference	1 July 2009
CD 5(2)(a)	Income Tax Act 2007	Correction to cross reference	1 April 2008
CD 6(4)	Income Tax Act 2007	Correction to cross-reference	1 April 2008
CW 9(2)(a)(vi)	Income Tax Act 2007	Repeal redundant provision	Enactment date
CW 19	Income Tax Act 2007	Improve drafting consistency	30 March 2017
DV 19(2)(a)	Income Tax Act 2007	Correction to grammar	1 April 2008
EW 46C(4),(5)	Income Tax Act 2007	Improve drafting consistency	2008–09 income year
HE 3(1)(a)	Income Tax Act 2007	Correction to grammar	Enactment date
HM 2(3)	Income Tax Act 2007	Correction to cross-reference	Enactment date
RD 2(1)(e)	Income Tax Act 2007	Correction to cross-reference	1 April 2019
RD 22(1)	Income Tax Act 2007	Correction to cross-reference	1 April 2019
RF 2B	Income Tax Act 2007	Omit redundant terms	Enactment date
RF 2C	Income Tax Act 2007	Omit redundant term	Enactment date
YA 1 "employer monthly schedule"	Income Tax Act 2007	Correction of terminology	Enactment date
YA 1 "financial institution"	Income Tax Act 2007	Correction of terminology	Enactment date
YA 1 "large budget film grant"	Income Tax Act 2007	Improve drafting for clarity	Enactment date
YA 1 "multi-rate PIE"	Income Tax Act 2007	Correction to grammar	Enactment date
YA 1 "overtime"	Income Tax Act 2007	Correction to cross-reference	Enactment date
3 "person incorrectly assumed to be a provisional taxpayer"	Tax Administration Act 1994	Omit redundant terms	1 October 2007
23C(1)	Tax Administration Act 1994	Correction to cross-references	1 April 2019
23D(4)	Tax Administration Act 1994	Correction to cross-reference	1 April 2019
31C(5)	Tax Administration Act 1994	Correction to cross-reference	Enactment date
36BD(5)	Tax Administration Act 1994	Correction of terminology	1 April 2008
47(2)	Tax Administration Act 1994	Correction to cross-reference	Enactment date
Schedule 4, "earner levy"	Tax Administration Act 2004	Correction of terminology	1 April 2019
163(1)(b)	Child Support Act 1991	Correction to cross-reference	1 April 2019
Schedule 2	Student Loan Scheme Act 2011	Correction to cross-reference	9 December 2009

ORDER IN COUNCIL

MINIMUM FAMILY TAX CREDIT THRESHOLD RISES FOR THE 2019–20 TAX YEAR

The household income threshold for the minimum family tax credit ("MFTC"), which guarantees eligible low-income families a minimum level of after-tax income, rises from $26,156 to $26,572 per year, on 1 April 2019.

The new threshold was approved by the Income Tax (Minimum Family Tax Credit) Order 2018 on 26 November 2018. The new regulation also revokes the Income Tax (Minimum Family Tax Credit) Order 2015 (LI 2015/294) and Income Tax (Minimum Family Tax Credit) Order 2016 (LI 2016/282) as they are now obsolete.

The MFTC provides a top-up to after-tax income for eligible working families and ensures families do not face a reduction in after-tax income when they move off a benefit and into paid employment.

The increase applies for the 2019–20 and later tax years.

Income Tax (Minimum Family Tax Credit) Order 2018 (LI 2018/239)

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 19/01: What are the requirements for claiming tax deductions for payments to family members for services?

This Question We've Been Asked (QWBA) is about claiming tax deductions for payments to family members for services. It will be of interest to those paying family members for services from a business or other income earning activity.

Question

What are the requirements for claiming tax deductions for payments to family members for services?

Answer

To claim a tax deduction for payments to family members for services:

- the family member must provide services to your business;
- the amount paid must not be excessive; and
- if the family member is your spouse or partner, you must have the Commissioner's prior approval for a deduction unless you run your business through a company.

Key Terms

Your business means any business or other income earning activity carried on by you on your own account, in partnership, or through a company.

Close company means a company controlled by five or fewer natural persons.

Partner means civil union partner or a de factor partner

Spouse means a married partner

Explanation

1. You cannot split the income you earn between your family members for income tax purposes. To claim a tax deduction for payments to a family member for services, the family member must provide services to your business and the amount paid must not be excessive. You must not pay the family member more than what you would pay a non-family member for the same services. In addition, if the family member is your spouse or partner, you must have the Commissioner's prior approval for a deduction unless you run your business through a company.
2. This QWBA replaces three items:
   - "Wages paid to spouse who cooks for permanent employees—deductibility" *Tax Information Bulletin* Vol 6, No 1 (July 1994): 5;
   - "Details to be supplied to Inland Revenue when seeking a deduction for payments to spouse" *Tax Information Bulletin* Vol 6, No 7 (December 1994): 2-3; and
   - "Reasonable wages—payments to spouse" *Tax Information Bulletin* Vol 7, No 7 (January 1996), 28.

Family members

3. Family members are:
   - your spouse or partner;
   - your parents, children, sisters, brothers, grandchildren, and grandparents and the spouses and partners of those persons;
   - your spouse or partner's parents, sisters, brothers, grandchildren, and grandparents;
   - yours and your spouse or partner's adoptive parents, adopted siblings, children, and grandchildren;
   - the trustee of a trust that any of these people has or can benefit under.

Family member must provide services to your business

4. You must be able to show that the family member provided services to your business. This is even if you have the Commissioner's prior approval to deduct the payment (see [9]-[17]). Depending on the circumstances, the types of evidence that might be relevant include:
   - a wage book or diary (manual or electronic) recording the dates, hours worked, and nature of the services provided by the family member;
   - a vehicle log book recording the dates and nature of business travel undertaken by the family member and other documentation supporting the purpose of the travel such as invoices for parking and other services or goods acquired or provided on the dates travelled;
   - copies of any PAYE payment information;
   - an employment contract or contract for services;
   - if the family member is an independent contractor or otherwise in business on their own account, invoices detailing the nature and extent of the services provided;
   - bank statements or other documents showing the amounts you paid to the family member for the services provided.

Payments must not be excessive

5. The amount paid must not be excessive for the services the family member provides. This includes where you have the Commissioner's prior approval for a deduction and subsequently the amount you pay your spouse or partner, or the hours they work, or the nature of the services they provide changes (see [9]-[17]). If the amount paid is excessive, the Commissioner may reallocate the income of the business based on what is considered reasonable and, in the case of a company, treat the excess as a dividend derived by the family member (ss DC 5(3), GB 23, GB 24, and GB 25).
6. The Commissioner considers payments to family members for services to be excessive when the amount paid is more than a reasonable amount for the services provided. This is explained in "QB 14/09: Income tax – meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors" *Tax Information Bulletin* Vol 26, No 9 (October 2014): 22.
7. Exemptions may apply in the case of:
   - contracts of employment, engagement, or partnership meeting certain requirements (s GB 24);
   - an adult employed substantially full-time in the business of a close company and who manages or administers the company, provided the amount they are paid is not influenced by their relationship with a shareholder or director (s GB 25(3)).
8. The exemptions are explained in QB 14/09 at [20] and [52].

Commissioner's prior approval

9. If the family member is your spouse or partner, you must have the Commissioner's prior approval for a deduction, unless you run your business though a company (s DC 5–see [11]). Approval is required whether you pay your spouse or partner a salary or wages, a commission, or another amount for services.
10. Approval may be granted only if:
    - the Commissioner considers the payment is for services rendered;
    - the services are not domestic services or otherwise services connected with the home, although, if you are a farmer, the Commissioner may approve a deduction for amounts you pay your spouse or partner to cook for farm employees;
    - the services are provided in earning income from your business;
    - a deduction for the payment has not been claimed.
11. Section DC 5 provides:

    DC 5 Payments to spouses, civil union partners, or de facto partners: services

    No deduction without approval

    (1) A person is denied a deduction for a payment to their spouse, civil union partner, or de facto partner for services without the Commissioner's approval.

    When Commissioner can give consent

    (2) The Commissioner may approve the deduction only if—

    (a) the Commissioner considers that the payment is for services rendered; and

    (b) the services are not domestic services or otherwise services connected with the home; and

(c) the payment is incurred by the person exclusively in deriving their assessable income; and

(d) the approval is granted before the deduction is claimed.

Relationship with section GB 23

(3) This section is overridden by section GB 23 (Excessive remuneration to relatives).

Link with subpart DA

(4) This section overrides the general permission.

12. You may apply for approval to deduct payments you have already made during an income year. You have up until the time you file your tax return to get approval. However, it may be a good idea to apply before you start paying your spouse or partner. The Commissioner cannot backdate approval after a deduction has been claimed in your tax return. Even if the amount paid is not excessive, a deduction claimed without prior approval is denied and your spouse or partner will still need to treat the payment as income.

13. You must make a new application for approval if you increase the amount you pay your spouse or partner. Otherwise, you do not have to make a new application for approval every year.

14. To apply for approval, you need to send the Commissioner details of:
   - the nature of your business;
   - full details of the services your spouse or partner provides;
   - the average number of hours your spouse or partner works each week and the number of weeks worked each year;
   - if others provide the same services to your business as your spouse or partner, details of the services the others provide and the payments you make for them; and
   - the amount you pay your spouse or partner and how the amount is paid (for example, at regular intervals or periodically or by crediting an account).

15. Whether your spouse or partner provides services as an employee or independent contractor, similar details are required. Send the details to Inland Revenue using your preferred method of contact (see Inland Revenue's website for contact details: **www.ird.govt.nz**).

16. The Commissioner will grant approval if satisfied the payments are for services rendered and if the other requirements of s DC 5 are met (see [10]).

17. If you run your business through a company, prior approval is not required to deduct payments to your spouse or partner for services. However, services must be provided and the amount paid must not be excessive.

Examples

18. The following four examples explain how the law applies.

Example 1 – Payments made to spouse or partner for services

Year 1

Jan carries on a business as a florist. Jan employs spouse Sam to help with deliveries during weekends. Jan keeps a diary and records the hours Sam works and the deliveries Sam performs and pays Sam a market wage. Jan deducts PAYE and ACC premiums and pays the net amount to Sam electronically at the end of each month.

At the end of the income year, before filing an income tax return, Jan applies to Inland Revenue for approval to deduct the payments made to Sam. Inland Revenue grants approval for Jan to deduct the wage paid to Sam because:

- Jan supplies the required details about Sam's employment to Inland Revenue;
- the services Sam provides are not domestic services and Jan incurs the payment exclusively in deriving assessable income;
- the payments are not excessive compared with the amount of wages paid to delivery drivers performing similar kinds of deliveries.

Jan files an income tax return claiming a deduction for the payments.

Year 2

In the next income year, Sam agrees to do bookwork for Jan's business as well as helping with deliveries. Jan increases Sam's wages for the additional hours and services Sam provides. Jan does not get Inland Revenue's approval to deduct the increased payment before filing an income tax return claiming a deduction.

A new application for approval is required because the increase in Sam's wages is due to additional hours and services Sam provides. A deduction for the increased payment is not allowed because Jan did not receive Inland Revenue's prior approval. Sam must still treat the increased payment as income.

Example 2 – Amounts paid to children

Talla and Filo operate a dairy farm in partnership. They employ their 13-year old son to help on the farm and pay him monthly. Talla and Filo advise their son helps with milking, weed control, calf rearing, bringing in cows for milking, and farm maintenance about 10 hours per week.

Talla and Filo keep a wage book for other employees. However, it does not contain any record of work done by their son. Without wage book entries or other evidence to support the work done by their son, Talla and Filo have not shown they are entitled to deduct the amounts they pay him. Their son must still treat the amounts Talla and Filo pay him as income.

Example 3 – Amount paid by company to director and shareholder's partner

Jed carries on a printing business through his company Zeb Ltd. Jed works full time in the business. His civil union partner Soul is primarily responsible for their four children. Zeb Ltd employs Soul and pays him fortnightly. Zeb Ltd files its tax return claiming a deduction for the amount paid to Soul. Soul files his tax return including the amounts received from Zeb Ltd as income.

During an audit, Inland Revenue asks what services Soul provided to the business. Jed responds with a list of tasks, including preparing GST returns, banking, issuing invoices, taking phone inquiries and following up debtors. Jed has kept a diary of the hours Soul spent preparing Zeb Ltd's GST returns. However, neither the diary nor any other available evidence shows Soul having undertaken any of the other tasks.

Zeb Ltd is allowed a deduction for a reasonable portion of the amount paid to Soul, based on the nature and value of services Soul has provided. The excess will be treated as a dividend derived by Soul as he is related to Zeb Ltd's director and shareholder Jed.

Example 4 – Amount paid by real estate agent to spouse

Ashley is a licensed real estate agent. Ashley employs de facto partner Mel, a licensed salesperson. Mel assists Ashley with open homes, phone inquiries, cold calling and other real estate agency work. Ashley does not pay Mel a regular wage but shares real estate commissions from property sales with Mel.

Ashley and Mel file income tax returns for the year:

- Ashley returns real estate commissions received as income and claims a deduction for the amount paid to Mel.
- Mel returns the amount received from Ashley as income.

Ashley has not obtained Inland Revenue's prior approval to deduct the amount paid to Mel. Therefore, Ashley cannot deduct the share of commission paid to Mel.

References

Subject references

Deductions

Income tax

Payments for services

Relatives

Legislative references

Income Tax Act 2007: ss DC 5, GB 23, GB 24, GB 25

Other references

"Details to be supplied to Inland Revenue when seeking a deduction for payments to spouse" *Tax Information Bulletin* Vol 6, No 7 (December 1994): 3.

"QB 14/09: Income tax—meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors" *Tax Information Bulletin* Vol 26, No 9 (October 2014): 22.

"Reasonable wages—payments to spouse" *Tax Information Bulletin* Vol 7, No 7 (January 1996), 28.

"Wages paid to spouse who cooks for permanent employees—deductibility" *Tax Information Bulletin* Vol 6, No 1 (July 1994): 5.

QB 19/02: Depreciation – change of use event

We have been asked to clarify whether a change of use event occurs for depreciation purposes when a business becomes a charity but continues to apply its assets in the same way it did before becoming a charity. The question has been raised because the change of use event could give rise to depreciation recovery income.

Question

Could depreciation recovery income arise when a business becomes a charity?

Answer

Yes. Depreciation recovery income may arise where a change of use of depreciable property results in depreciation deductions no longer being available. For these purposes, a change of use refers to the use of property in deriving assessable income. Because a charity's income is exempt, the property will no longer be available for use in deriving assessable income, so will no longer qualify as being "depreciable property". This change of use results in depreciation deductions being denied. The recent introduction of s EE 47(2B) means that the change of use (and any depreciation recovery income) will occur immediately before the income exemption applies.

Key Terms

Depreciable property - property expected to decline in value while used or available for use in deriving assessable income.

Explanation

1. We have been asked to clarify whether a change of use of depreciable property occurs where a business becomes a charity and derives exempt income. This issue is relevant as a change of use could give rise to depreciation recovery income.
2. All legislative references are to the Income Tax Act 2007, unless otherwise stated.

Depreciation recovery income

3. Under s EE 1 a person has depreciation recovery income for an income year if:
   - they own an item of depreciable property;
   - the property is disposed of or a relevant event occurs; and
   - an amount of depreciation recovery income is calculated under a relevant provision, including s EE 48 (effectively where the consideration exceeds the adjusted tax value of the property).
4. The provisions relating to the calculation of depreciation recovery income in ss EE 44 to EE 48 apply where either a disposal or another relevant event occurs. One such event is a change of use of the property, as a result of which a person is denied a depreciation deduction for the next income year. Sections EE 47(1) and (2) provide:

   EE 47 Events for purposes of section EE 44

   Events to which sections EE 48 to EE 52 apply

   (1) For the purposes of section EE 44, this section describes the events to which sections EE 48 to EE 52 apply.

   Change of use or location of use

   (2) The first event is the change of use, or change of location of use, of an item of property, as a result of which a person is denied a deduction for an amount of depreciation loss for the item for the next income year. The event is treated as occurring on the first day of the next income year, and includes a change in use of an item for the purposes of the definition of commercial fit-out and a change in the status of a building related to an item for the purposes of that definition.
5. Where s EE 47(2) applies, the consideration for the property is treated as being the market value of the property at the time the change of use occurs (s EE 45). If the market value of the property exceeds the property's adjusted tax value on the date that the change of use event occurs (or is treated as occurring), the difference in these amounts is the depreciation recovery income that arises (although this income is capped at the total amount of depreciation loss claimed). Similarly, if the market value of property is less than its adjusted tax value on that date, the difference in those amounts may give rise to an amount of depreciation loss under s EE 48(2) (excluding buildings under s EE 48(3)) which may be deductible in accordance with ss DA 1(1) and DA 1(4).

6. A new provision, s EE 47(2B), provides for the timing of the change of use event in certain circumstances as follows:

   Event timing for person's becoming tax exempt

   (2B) Despite subsection (2), if the event is connected to a person's income becoming exempt income, the event is treated as occurring immediately before the person's income becomes exempt.

What is a "change of use"?

7. Where a business becomes a charity but continues to be carried on in the same way, it has been suggested that there is no change of use as the property is still being applied in the same way as before the exemption.
8. The word "use" has various meanings. The *Concise Oxford English Dictionary* (11th ed, 2012) defines the term "use" as:

   Take, hold or deploy as a means of achieving something.... Treat in a particular way. ...

9. In *Thornton Estates Ltd v CIR* (1998) 18 NZTC 13,577 Richardson P commented:

   As any dictionary will show, "use" and "used" have a wide range of meanings. Thus in relation to property, the Oxford English Dictionary (2ed) defines "use" as: "8. a. To employ or make use of (an article, etc), esp. for a profitable end or purpose; to utilize, turn to account"; and also "12. To expend or consume (a commodity, etc) by use; 13. to use up: a. To consume (a commodity or stock) by use." In turn, "used" means "1. b. That is or has been made use of; utilized" and also "II. Used up ..." and "7. Reduced, exhausted, or consumed by using". Similarly, the Tasman Dictionary defines "use" as "1. To employ for some purpose" and "3. To expend or consume in use". Which meaning is intended must be taken from the context.

10. Accordingly, the relevant event could relate to a change of the holding, deployment or treatment of an asset in a particular way. Relevantly, it could mean to employ or make use of for a particular purpose or aim, or it could mean to consume. The first of these potential meanings supports a view that a "change of use" refers to the purpose for which property is employed. The second potential meaning of "use", being to "consume", supports a narrower meaning relating to the application of the property in a particular way (for example, its physical use).
11. Assistance in determining which is the correct interpretation can be taken from the wider context of the depreciation regime.
12. "Depreciable property" is defined in s EE 6 as property that might be expected to decline in value while used or available for use in either deriving assessable income or carrying on a business for the purpose of deriving assessable income.
13. If an item is used or available for use in deriving exempt income, or for a private use, the property is not depreciable. Specific rules apply to property that is partly used for deriving assessable income and partly used for other (non-taxable) purposes at the same time (see ss EE 49 and EE 50).
14. Accordingly, it can be seen from these provisions that the use (or availability) of the property in deriving assessable income or for carrying on a business for the purpose of deriving assessable income (and not for deriving exempt income nor private use) is the important background context for depreciation purposes.
15. In summary, depreciation recovery income may arise where a change of use of depreciable property results in depreciation deductions no longer being available. For these purposes, a change of use refers to the use of property in deriving assessable income.

When will depreciation deductions be denied?

16. Relevantly, s EE 47(2) requires that the change of use has a result that the person is denied a depreciation deduction for the next income year. A person will be denied a depreciation deduction where property is not used or available for use in deriving assessable income. This indicates that the relevant change of use must be one that relates to a change in the depreciable status of the property. This supports the wider meaning of "use" referred to above, as being one for a relevant purpose (that is, a purpose of deriving assessable income), rather than just its application in the business.
17. A person is allowed a deduction for depreciation loss where property is "depreciable property" and the general permission in s DA 1 is satisfied. That is, a depreciation deduction is available to the extent it is incurred in deriving assessable income or excluded income or is otherwise incurred in the course of carrying on a business for the purposes of deriving such income. Under s DA 2, a deduction is not available to the extent that expenditure or loss is incurred in deriving exempt income or for private use (amongst other things).
18. Section BD 1(2) provides that an amount of income is "exempt income" if it is a person's exempt income under subpart CW. In the context of charities, ss CW 41 and CW 42 exempt all income derived by a charity or a charitable business. Accordingly, where s CW 42 applies to a previously taxable business (for example, because its shares were acquired by a charity, or it becomes a charity itself), the business is no longer deriving "assessable income" but is deriving exempt income.

19. Accordingly, as a charity's income is exempt, its property will not be available for use in deriving assessable income, and so will not qualify as being "depreciable property". This change of use results in depreciation deductions being denied.

Will ss EE 47(2) and EE 47(2B) apply?

20. A change of use under s EE 47(2) is not limited to referring to a change in the application of an asset but refers to a change in its use for a particular purpose, being the derivation of assessable income. This could still involve a change in the application of the item (such as property being taken out of a business and used for private use) but also extends to an item being applied in the same way in a business, but for a purpose of deriving exempt income. This conclusion is consistent with the purpose of depreciation recovery income, which is to recover excess deductions for depreciation that was not actually experienced on the property, at the time the property is no longer available for use in deriving assessable income.
21. Accordingly, the context and purpose of the depreciation regime supports the view that when a business becomes a charity (or any other entity deriving exempt income) there will be a change of use event under ss EE 47(2) and EE 47(2B). This is because the property is no longer used in a business for the purpose of deriving assessable income, but instead is used for the purpose of deriving exempt income. A result of this change is that depreciation deductions are no longer available.
22. The recent enactment of s EE 47(2B) changes the timing of the change of use (and therefore the derivation of any depreciation recovery income or loss on disposal). The change of use will occur, and any depreciation recovery income will be derived (or loss incurred) immediately before the entity's income becomes exempt. For completeness, depreciation deductions will be denied from the beginning of the income year in which the change of use is treated as occurring under s EE 47(2B).

Conclusion

23. Section EE 47(2) will apply where a business becomes a charity and begins to derive exempt income, even though assets are still being applied in the business in the same way. This change of use of depreciable property is treated as if there were a disposal of the depreciable property for market value. A consequence of this conclusion is that the business may have a depreciation gain (or loss) on disposal. The recent enactment of s EE 47(2B) provides that the change of use occurs immediately before the entity's income becomes exempt (and therefore any depreciation gain or loss also arises immediately before the entity's income becomes exempt).
24. As an aside, the same conclusion would also be reached for any business which begins to derive exempt income under subpart CW. Also, the same conclusion about a change of use occurring would also apply to any other change in the use of an item that was used or available for use in deriving assessable income (for example, where an item is no longer used for deriving assessable income and instead is used for private use).
25. Examples 1 and 2 illustrate the application of this approach.

Examples

Example 1 - Business acquired by a charity

Warm Feelings Ltd is in the business of manufacturing and selling sustainably sourced woollen blankets. The shares in Warm Feelings Ltd are acquired by a registered charity, with the intention that Warm Feelings Ltd would continue to operate in the same way, although all profits would be used for charitable purposes (and its constitution amended accordingly). Once Warm Feelings Ltd satisfies the requirements in s CW 42, it will begin to derive exempt income.

Warm Feelings Ltd had been depreciating various items of equipment used in manufacturing the blankets. After satisfying the requirements in s CW 42, those items are no longer available for use in deriving assessable income. Accordingly, there will be a change of use of the items under ss EE 47(2) and EE 47(2B) that results in deductions for depreciation loss being disallowed.

Warm Feelings Ltd may be liable for depreciation recovery income if the market value of its depreciable property exceeds the adjusted tax value of that property on the relevant date under s EE 47(2B). Similarly, it may have a depreciation loss on disposal if the market value of depreciable property is less than the adjusted tax value of that property. The change of use (and any depreciation recovery income or loss) is treated as occurring immediately before its income became exempt. Any other depreciation loss is denied in that income year.

Example 2 – Calculation and timing

The shareholders of Warm Feelings Ltd register as a charity (and satisfy s CW 42) with effect from 1 April 2019. Warm Feelings Ltd has a standard balance date. As with example 1, at the time Warm Feelings Ltd ceases to derive assessable income, there is a change of use event and ss EE 47(2) and EE 47(2B) apply.

Section EE 47(2B) treats the change of use as occurring immediately before the income becomes exempt, on 31 March 2019. As with example 1, Warm Feelings Ltd may be liable for depreciation recovery income if the market value of its depreciable property exceeds the adjusted tax value of that property on that date.

On 31 March 2019, an amount of depreciation recovery income or loss will need to be calculated and will be taxable or potentially deductible in that income year. No other amount of depreciation loss will be deductible for that year.

Warm Feelings Ltd had acquired its manufacturing equipment on 1 April 2013 for $10,000. Using the DV depreciation rate of 13%, it had claimed depreciation loss deductions for the last five years. The adjusted tax value of the equipment as at 31 March 2019 was $6,098. However, at that date the market value of the equipment was valued at $6,500. Accordingly, Warm Feelings Ltd will derive an amount of depreciation recovery income of $402 in the income year ended 31 March 2019.

References

Subject references

Income Tax

Depreciation

Legislative references

Income Tax Act 2007 ss BD 1(2), DA 1, DA 2, EE 1, EE 6, EE 44, EE 45, EE 47, EE 48

Case references

Thornton Estates Ltd v CIR (1998) 18 NZTC 13,577

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 19/02: Voluntary disclosures

Introduction

Standard practice statements describe how the Commissioner of Inland Revenue (the Commissioner) will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement sets out the factors that the Commissioner will consider when forming an opinion as to whether a taxpayer has made a full voluntary disclosure to the Commissioner of all the details of a tax shortfall.

Unless specified otherwise, all legislative references in this Statement are to the Tax Administration Act 1994 (the TAA).

Application

This Statement applies from 27 March 2019 and replaces SPS 09/02: Voluntary disclosures published in *Tax Information Bulletin* Vol 21, No 5 (July 2009).

Standard practice

Summary

1. An important feature of the shortfall penalties regime is that shortfall penalties are reduced in certain specific circumstances. Section 141G(1) allows a shortfall penalty to be *reduced if, in the Commissioner's opinion, the taxpayer makes a full voluntary disclosure to the Commissioner of all the details of the tax shortfall*.
2. Voluntary disclosures may be made by a taxpayer in person, by telephone or in writing, including by modifying their existing tax return by using myIR.
3. Making a "full" voluntary disclosure involves the taxpayer disclosing the following information to the Commissioner in relation to each tax shortfall (as a minimum):
   - sufficient details for the Commissioner to satisfactorily identify the taxpayer (name, trade name, IRD number) and confirm the taxpayer's contact details (postal address, contact telephone number(s), email address); and
   - the tax periods and tax types involved; and
   - an explanation as to why the tax shortfall occurred; and
   - sufficient detail of the tax shortfall including its amount, and full details of the facts and circumstances leading to the tax shortfall to enable the Commissioner to make a correct assessment of the tax shortfall; and
   - any further information that is necessary for the Commissioner to make a correct assessment.
4. The wording of s 141G(1) discloses four essential elements to a voluntary disclosure. A voluntary disclosure:
   - must disclose a tax shortfall; and
   - must disclose all the details of the tax shortfall; and
   - must disclose something to the Commissioner; and
   - must be made voluntarily.
5. All these elements must be present before the Commissioner will form an opinion that what has been disclosed by a taxpayer amounts to a full voluntary disclosure.
6. Many disclosures made to the Commissioner are unprompted. That is, they are not made as a consequence of the Commissioner first contacting the taxpayer. They will often arise when the taxpayer notices an error or omission in a tax return that has been filed and proactively contacts the department. If the disclosure is clearly unprompted, then as long as the taxpayer provides all the details of the tax shortfall, the disclosure made by the taxpayer will be treated by the Commissioner as a full voluntary disclosure; it is the disclosure of a tax shortfall that has been made voluntarily. Because of this, a taxpayer in this position will not have to consider further the detailed discussion of the four essential elements to a voluntary disclosure (stated at [4] above) that follows.

A voluntary disclosure must disclose a tax shortfall

7. A tax shortfall is defined by s 3(1) as being the difference between the tax effect of the tax position taken by a taxpayer and the correct tax position, where that difference results in an increase in the tax payable by the taxpayer (or results in a decrease in a tax benefit). In making a voluntary disclosure, a taxpayer is disclosing to the Commissioner what the taxpayer now believes is an incorrect tax position that they have taken and requesting that the Commissioner make an assessment that they believe is based on a correct tax position.
8. A taxpayer is not able to make a voluntary disclosure on a matter that they wish to dispute. Nor will the Commissioner accept as voluntary disclosures, disclosures that are conditional on a particular outcome, or on the Commissioner doing (or not doing) something. This is because, given the definition of "tax shortfall" discussed above, a voluntary disclosure can only disclose a tax position that the taxpayer believes to be the correct tax position.
9. A taxpayer may make a voluntary disclosure and subsequently have a change of view as to whether the tax position disclosed is correct. This may occur, for instance, if further facts become available to the taxpayer, judicial authority is released, or the Commissioner changes her view in a public statement or ruling.

A voluntary disclosure must disclose all the details of a tax shortfall

10. For the purposes of the voluntary disclosure regime, disclosing all the details of a tax shortfall is known as "making a full voluntary disclosure". A "full" voluntary disclosure under s 141G requires a clear statement by the taxpayer of all the details of the difference between the tax effect of the tax position taken by the taxpayer, and the correct tax position.
11. All the details of a tax shortfall, including the monetary difference between the original tax position taken by the taxpayer and the correct tax position, should be disclosed by the taxpayer, as well as details of how this monetary difference was arrived at.
12. Although this does not necessarily require quantification of the tax shortfall to the last dollar in every circumstance, if the taxpayer makes little or no attempt to quantify the tax shortfall, or deliberately understates the tax shortfall, the voluntary disclosure cannot be a full voluntary disclosure. If the taxpayer is unable to quantify the exact amount of the tax shortfall, in order to allow the disclosure to be treated as a full voluntary disclosure, there is an expectation that the taxpayer will co-operate with the Commissioner to arrive at the amount of the tax shortfall.
13. A taxpayer's tax return is made up of a number of tax positions and an error in any of them may lead to a tax shortfall for that tax position. A taxpayer's tax return that contains a number of incorrect tax positions means that there will be a number of tax shortfalls that may have a shortfall penalty imposed on each of them separately. Where a taxpayer has multiple tax shortfalls they may make full voluntary disclosures for any of these tax shortfalls separately.
14. In some circumstances the Commissioner is required to amalgamate a number of tax shortfalls and create an aggregated tax shortfall for which only one shortfall penalty is imposed. This occurs because of s 141(10). As a voluntary disclosure must contain all the details of a tax shortfall, if a number of tax shortfalls have been aggregated by the Commissioner, any voluntary disclosure made by a taxpayer will need to disclose all the details of all the individual incorrect tax positions taken for the aggregated tax shortfall in order to be treated as a full voluntary disclosure.

A voluntary disclosure must disclose something to the Commissioner

15. For the purposes of the voluntary disclosure regime a "disclosure" is made if the taxpayer reasonably believes that the tax shortfall being disclosed is not known to the Commissioner. This is an objective test; whether the taxpayer's belief that the Commissioner was unaware of the details of the tax shortfall at the time that it was disclosed was reasonable in the circumstances.
16. It is the Commissioner's view that if a voluntary disclosure of a tax shortfall is made by a taxpayer and the Commissioner is already aware of that tax shortfall, this will generally still amount to a "disclosure" by the taxpayer. It will not amount to a disclosure if:
    - the Commissioner has expressly advised the taxpayer of an incorrect tax position and a tax shortfall; or
    - the facts and circumstances of the interactions between the taxpayer and the Commissioner clearly indicate that it was reasonable for the taxpayer to infer that the Commissioner already knew of a tax shortfall. Any decision to not accept a voluntary disclosure on this basis will be made by a senior officer.

A voluntary disclosure must be made voluntarily

17. A disclosure will always be made voluntarily unless a taxpayer, in making the disclosure, was acting under an obligation to do so, such that the making of the disclosure was not as a result of "acting on one's own free will". Meeting an obligation

to provide information to the Commissioner does not necessarily mean that a voluntary disclosure cannot be made separately. A general invitation/suggestion by the Commissioner for a taxpayer (or group of taxpayers) to consider making a voluntary disclosure cannot amount to an "obligation" being imposed on those taxpayers.

Voluntary disclosures and subsequent prosecution action

18. If a taxpayer makes a full voluntary disclosure before they are first notified of a pending investigation, the Commissioner's usual practice is not to prosecute those taxpayers. In circumstances where the Commissioner forms the view that a taxpayer's actions or omissions is such that non-prosecution could lead to voluntary compliance more generally being undermined, the Commissioner may still proceed with that subsequent prosecution action. A decision to prosecute in these circumstances will be an exceptionally rare occurrence, limited to serious offences, and will require the approval of a very senior officer.

Detailed discussion

19. An important feature of the shortfall penalties regime is that shortfall penalties are reduced in certain specific circumstances. The reduction of a shortfall penalty occurs[1]:
    - to take into account a taxpayer's previous good behaviour (s 141FB);
    - to acknowledge the adequate disclosure of a taxpayer's tax position (s 141H); and
    - to account for a tax shortfall that is temporary (s 141I).
20. Additionally, s 141G(1) allows that a shortfall penalty may be reduced if, in the *Commissioner's opinion, the taxpayer makes a full voluntary disclosure to the Commissioner of all the details of the tax shortfall*.
21. The purpose of imposing shortfall penalties is to encourage voluntary compliance, and to address non-compliance in a way that is consistent, impartial and proportionate to the seriousness of that breach. The main forms of civil penalty are those listed at ss 141A to 141EB. These sections impose a shortfall penalty for taking an incorrect tax position or for doing or failing to do anything described in one of these shortfall penalty provisions. Shortfall penalties are imposed on a graduating scale from 20% to 150% of the difference between the tax effect of a taxpayer's tax position and the correct tax position; the "tax shortfall"[2].
22. The purpose of allowing a reduction to a shortfall penalty when a taxpayer makes a full voluntary disclosure is two-fold. It provides an incentive to taxpayers to determine their correct tax liability and aids voluntary compliance. It also provides cost savings in investigation time for Inland Revenue and other benefits that result from taxpayer co-operation.
23. If the Commissioner forms the opinion that a taxpayer has made a full voluntary disclosure before the taxpayer is first notified of a pending audit or investigation (investigation[3]), this is known as a *pre-notification disclosure*. In this circumstance the shortfall penalty will be reduced by 100% if that shortfall penalty was initially imposed for not taking reasonable care, taking an unacceptable tax position, or for an unacceptable interpretation. All other shortfall penalties will be reduced by 75%.
24. Full voluntary disclosures made after a taxpayer is first notified of an investigation, but before that investigation commences, are known as *post-notification disclosures*. In this circumstance the shortfall penalty will be reduced by 40%. Pre- and post-notification voluntary disclosures are further discussed at [79] and [85] below. No reduction in the quantum of a shortfall penalty is available where a disclosure is made after an investigation has commenced.

Voluntary disclosures and section 113

25. A voluntary disclosure provided by a taxpayer that discloses a tax shortfall is both a request that the Commissioner form an opinion that the disclosure amounts to a full voluntary disclosure, and a request that the Commissioner exercise the discretion contained in s 113 to amend the relevant assessment.
26. If a taxpayer makes a full voluntary disclosure to the Commissioner, s 113 provides the legislative authority for effecting the reassessment (but see discussion below regarding *proposed tax positions* (at [43]) and *conditional disclosures* (at [44] – [47]).
27. The discretion contained in s 113 is a broad one allowing the Commissioner to amend assessments to ensure their correctness. The Commissioner will generally agree to amend assessments that are requested if making the requested adjustment will result in a correct assessment being issued.

[1] Note that a shortfall penalty may also be increased to address a taxpayer's obstruction of the Commissioner (s 141K)

[2] Section 3(1)

[3] For the purposes of this Statement, the term audit or investigation will be referred to as an *investigation*

28. A full discussion on how the Commissioner will use the s 113 discretion can be found in SPS 16/01: *Requests to amend assessments*, published in *Tax Information Bulletin* Vol 28 No 4, May 2016 and at **www.ird.govt.nz**[4].

How to make a voluntary disclosure

29. Voluntary disclosures may be made by a taxpayer in person, by telephone or in writing[5 6].
30. If a voluntary disclosure is made in person to an officer of Inland Revenue, the officer will either
    - record the disclosure in writing and ask the taxpayer to sign that document as being a correct record of the voluntary disclosure; or
    - ask the taxpayer to make the disclosure in writing, including by email, completing the *Voluntary disclosure (IR281)* form[7] or letter, as is most convenient for the taxpayer.
31. To ensure there is a clear record of all the details of the voluntary disclosure, the ability to accept a voluntary disclosure by telephone is limited to calls that are received by Inland Revenue at a site that has call recording. For practical purposes, this means that a taxpayer will need to call using one of Inland Revenue's 0800 numbers. If a call is received by a site that does not have call recording, the taxpayer will be asked to put their voluntary disclosure in writing and/or complete either an IR281 or IR281P form as appropriate.
32. Whether the voluntary disclosure is made in person, by telephone or in writing, in order for a "full" voluntary disclosure to be made requires the disclosure of all relevant details of the tax shortfall. This is so the Commissioner can make a correct assessment in terms of s 113 with little requirement for further resources and time to be spent on the matter. The taxpayer must disclose all the details of the difference between the tax effect of the tax position(s) originally taken by the taxpayer, and the correct tax position(s). Note that full voluntary disclosures may be made for a number of different tax positions. This is discussed further at [54] – [59] below.
33. Making a "full" voluntary disclosure involves the taxpayer disclosing the following information to the Commissioner in relation to each tax shortfall (as a minimum):
    - sufficient details for the Commissioner to satisfactorily identify the taxpayer (name, trade name, IRD number) and confirm the taxpayer's contact details (postal address, contact telephone number(s), email address); and
    - the tax periods and tax types involved; and
    - an explanation as to why the tax shortfall occurred; and
    - sufficient detail of the tax shortfall including its amount (but see further discussion at [35] and [52] – [53] below), and full details of the facts and circumstances leading to the tax shortfall so as to enable the Commissioner to make a correct assessment of the tax shortfall; and
    - any further information that is necessary for the Commissioner to make a correct assessment.
34. Where a voluntary disclosure is made by a taxpayer using myIR to modify an existing tax return, much of the above information will be supplied while undertaking that modification. Despite this it will still be necessary for a taxpayer to provide an explanation as to why the tax shortfall occurred as well as full details of the facts and circumstances leading to the tax shortfall. When modifying a tax return this information can be provided in the space provided for the "description" of the "amendment information".
35. When a taxpayer makes a voluntary disclosure in writing, the Commissioner will acknowledge its receipt and advise the taxpayer whether the disclosure meets all of the requirements of a full voluntary disclosure. Irrespective of how a taxpayer makes a voluntary disclosure (by person, by telephone or in writing) if, in examining the voluntary disclosure, the Commissioner requires additional information, the taxpayer will be contacted and allowed a reasonable period of time to provide that information. The time period for providing the information will be negotiated between the taxpayer and the Inland Revenue officer. So long as the additional information is supplied within the agreed period (or such other period as is subsequently negotiated), the failure to supply that information in the first instance will not prevent the taxpayer's initial voluntary disclosure from being treated as a full voluntary disclosure, on the date that the initial disclosure was made.

[4] Search term: 16/01

[5] "in writing" includes by electronic means, including using myIR to modify a tax return

[6] For a GST return, taxpayers may also use the "make an amendment" option in myIR

[7] Or our *Voluntary disclosure (IR281P)* form if a taxpayer wishes to disclose the sale of a property

Unprompted disclosures

36. The wording of s 141G(1) discloses four essential elements to a full voluntary disclosure. A full voluntary disclosure:
    - must disclose a tax shortfall; and
    - must disclose all the details of the tax shortfall; and
    - must disclose something to the Commissioner; and
    - must be made voluntarily.

    All these elements must be present before the Commissioner will form an opinion that what has been disclosed by a taxpayer amounts to a full voluntary disclosure.

37. Many disclosures made to the Commissioner are unprompted. That is, they are not made as a consequence of the Commissioner first contacting the taxpayer; often they arise because the taxpayer notices an error or omission in a tax return that has been filed and proactively contacts Inland Revenue (often by telephoning one of the department's contact centres) to have it corrected[8].

When an unprompted disclosure is made, then as long as the taxpayer provides all the details of the tax shortfall (per [32] and [33] above), the Commissioner accepts that all the essential elements of a voluntary disclosure will have been met; that is, the disclosure has been made "voluntarily" and "discloses" a tax shortfall that the taxpayer believes that the Commissioner is not aware of. As long as all the details of the tax shortfall are provided, the Commissioner accepts that a full voluntary disclosure has been made by the taxpayer.

38. Some of these unprompted disclosures will not be liable to a shortfall penalty. In this circumstance, the fact that the disclosure is accepted as being a full voluntary disclosure is moot as there will be no reduction in the amount of a shortfall penalty that needs to be considered.

Where the disclosure is treated as a full voluntary disclosure, then if the unprompted disclosure attracts the imposition of a shortfall penalty, because there has been no relevant prior contact by the Commissioner the voluntary disclosure will be treated as a pre-notification disclosure and the appropriate voluntary disclosure reduction applied.

The detailed discussion that now follows considers in some depth the above four essential elements of a disclosure that are stated at [36] above. Given the statements at [37] and [38] regarding unprompted disclosures, this discussion is only relevant if a shortfall penalty is imposed, the disclosure is not clearly an unprompted voluntary disclosure, and/or the voluntary disclosure has not disclosed all the details of the tax shortfall (per [32] and [33] above).

A voluntary disclosure must disclose a tax shortfall

39. A shortfall penalty is applied to a "tax shortfall". A tax shortfall is defined by s 3(1) as being the difference between the tax effect of the tax position taken by a taxpayer and the correct tax position, where that difference results in an increase in the tax payable by the taxpayer (or a decrease in a tax benefit).

40. In making a voluntary disclosure, a taxpayer is disclosing to the Commissioner a tax position that the taxpayer now believes to be incorrect and requesting that the Commissioner make an assessment that they believe is based on the correct tax position. Any discussion regarding a taxpayer's culpability for a shortfall penalty (including any matter pertaining to a taxpayer's perceived guilt or wrongdoing) is a matter for separate discussion between the CIR and the taxpayer.

41. For a voluntary disclosure to be effective and reduce the amount of a shortfall penalty, the Commissioner must first impose a shortfall penalty. If the Commissioner does not impose a shortfall penalty, then the fact that the disclosure of the tax shortfall has been made voluntarily can have no effect (in this regard see also [38] above). Where this occurs, the voluntary disclosure will simply be treated as a request to amend the relevant assessment in terms of s 113.

42. If a taxpayer purports to make a voluntary disclosure that discloses a tax position that is merely proposed or is conditional, the Commissioner will not accept that the taxpayer has made a full voluntary disclosure. A full voluntary disclosure will also not be accepted where the taxpayer supplies false or misleading information in support of the proposed tax position.

Proposed tax positions

43. Given that in making a full voluntary disclosure, a taxpayer is disclosing to the Commissioner both a previously incorrect tax position and what they now believe to be the correct tax position, there are two matters that need to be noted. Firstly, a voluntary disclosure cannot be made for a tax position that is yet to be taken. A taxpayer could not make what purports to be a voluntary disclosure, as a means of having the Commissioner give a view on a tax position that was merely being considered.

[8] Note that s 113A also allows taxpayers to self-correct some low value errors

Conditional disclosures

44. Secondly, it is the Commissioner's view that a taxpayer is not able to make a voluntary disclosure on a matter that they wish to dispute. Nor will the Commissioner accept as a voluntary disclosure, a disclosure that is conditional on a particular outcome, or on the Commissioner doing (or not doing) something. This is because, given the definition of "tax shortfall" discussed above, a voluntary disclosure can only disclose a tax position that the taxpayer believes to be the correct tax position. For instance, the Commissioner would not accept as a voluntary disclosure the disclosure of a purported tax shortfall when it was the taxpayer's intention to engage in the disputes process with the Commissioner once the relevant assessment had been made on the basis that the new tax position was incorrect.

45. It is implicit in the scheme of s 141G that the taxpayer is committed to the disclosed tax position being the correct tax position. The disclosure of a tax shortfall is not a negotiation between the taxpayer and the Commissioner where the correctness of the tax position being disclosed is arguable by the taxpayer. Nor is it an opportunity for a taxpayer to make partial disclosures of the tax shortfall (for instance, making only a partial disclosure of their understated sales). Section 141G is a voluntary, "all cards on the table" approach for a taxpayer to disclose how their original tax position differs from what they now believe to be the correct tax position. Non-committal to, or non-acceptance of this correct tax position is inconsistent with the purpose of s 141G.

46. A taxpayer may make a voluntary disclosure and subsequently have a change of view as to whether the tax position disclosed is correct. This may occur, for instance, if further facts become available to the taxpayer, judicial authority is released, or the Commissioner changes her view in a public statement or ruling. If this occurs before the Commissioner makes the relevant assessment, a taxpayer can:
    - resile from the tax position that they took in their initial voluntary disclosure and provide a new voluntary disclosure to the Commissioner providing the full details of what they now consider to be the correct tax position (but see [59] below regarding the timing of any new voluntary disclosure). Where this new tax position does not disclose a tax shortfall the disclosure will be treated as a request to amend an assessment in terms of s 113.
    - resile from the tax position that they took in their full voluntary disclosure and revert to their original tax position. Where the Commissioner agrees with this outcome, nothing further will occur. However, if the Commissioner believes that the tax position disclosed in the voluntary disclosure is correct then the taxpayer is free to dispute any adjustment (including the imposition of a shortfall penalty) that the Commissioner subsequently makes. In this circumstance a voluntary disclosure reduction of the shortfall penalty will still be available to the taxpayer. This is based on the fact that the Commissioner accepts that the tax position disclosed in the voluntary disclosure is the correct tax position and despite resiling from it, the taxpayer did initially make a full voluntary disclosure of that tax position.
    - resile from the tax position that they took in their initial voluntary disclosure, but only to the extent of the quantum of the tax shortfall. This may occur, for instance, where the taxpayer and the Commissioner are unable to agree on the correct quantum of the tax shortfall. For further discussion on this matter see [43] – [45] above and [52] – [53] below.

47. Once an assessment has been made and the applicable response period for the taxpayer to issue a Notice of Proposed Adjustment has passed, a taxpayer is not able to enter into a dispute with the Commissioner[9].

A voluntary disclosure must disclose all the details of a tax shortfall

48. Disclosing all the details of a tax shortfall is known as making a full voluntary disclosure. A "full" voluntary disclosure under s 141G requires a clear statement by the taxpayer of all the details of the difference between the tax effect of the tax position taken by the taxpayer, and the correct tax position.

49. The voluntary disclosure regime is predicated on the fact that under a self-assessment regime, the taxpayer has the best knowledge of their tax affairs. In order for a voluntary disclosure to be said to be a full voluntary disclosure, there is the expectation that all the details of a tax shortfall, including the monetary difference between the original tax position taken by the taxpayer and the correct tax position, should be disclosed, as well as details of how this monetary difference (the tax shortfall) was arrived at (but see [52] – [53] below).

50. Making a full voluntary disclosure will generally involve the taxpayer disclosing the following information to the Commissioner in relation to each tax shortfall (as a minimum):
    - sufficient details for the Commissioner to satisfactorily identify the taxpayer (name, trade name, IRD number) and confirm the taxpayer's contact details (postal address, contact telephone number(s) and email address); and
    - the tax periods and tax types involved; and
    - an explanation as to why the tax shortfall occurred; and

[9] Sections 89C(c), 89D(1),

- sufficient detail of the tax shortfall including its amount (but see [35] above and[52] – [53] below for further discussion on this matter), and full details of the facts and circumstances leading to the tax shortfall so as to enable the Commissioner to make a correct assessment of the tax shortfall; and
- any further information that is necessary for the Commissioner to make a correct assessment.

Sufficient detail of the tax shortfall

51. To make a correct assessment, the Commissioner requires details of the amount of the tax shortfall and how this has been calculated.

52. This does not necessarily require quantification of the tax shortfall to the last dollar in every circumstance. What is required is that the taxpayer attempts to quantify the amount of the tax shortfall to the best of their ability, given their knowledge and expertise. If the taxpayer makes little or no attempt to quantify the tax shortfall, or deliberately understates the tax shortfall, the voluntary disclosure cannot be a full voluntary disclosure. If the taxpayer is unable to quantify the exact amount of the tax shortfall, then in order to allow the disclosure to be treated as a full voluntary disclosure, there is an expectation that the taxpayer will co-operate with the Commissioner to arrive at the correct calculation of the tax shortfall within an agreed timeframe (see [35] for further discussion on this matter). This co-operation will also fulfil the final requirement of what constitutes a full voluntary disclosure (per [50] above), *any further information that is necessary for the Commissioner to make a correct assessment*.

53. This does not obligate the taxpayer to agree with the Commissioner in all circumstances (but see further discussion at [43] – [45] above). Where, despite the honest endeavours of both parties, agreement is unable to be reached on the exact quantum of the tax shortfall, the taxpayer is able to dispute any adjustment that the Commissioner subsequently makes, and their disclosure will be treated as a full voluntary disclosure.

Example 1: Treatment of unprompted voluntary disclosure of a partial tax shortfall

Peter is the owner of a popular restaurant. Peter is aware that a number of local restaurants have recently been subject to investigation by Inland Revenue. He decides that he should disclose to the Commissioner that he has not been declaring all the cash sales that are made by the restaurant.

Peter will often remove amounts of cash from the till for his personal use but has not kept any record of how much has been taken over the years. He makes a voluntary disclosure to the Commissioner disclosing the nature of the understated sales, providing a rough estimate of how much he believes he has taken (and how he has calculated these takings) and makes an offer to assist the Commissioner to arrive at a more accurate figure if required.

Peter is true to his word and after the Commissioner and Peter have undertaken a thorough analysis of the restaurant's sales data, Peter and the Commissioner come to an agreement as to the likely amount of the omitted sales. On this basis the Commissioner accepted that Peter voluntarily disclosed a tax shortfall. Because Peter initially quantified the tax shortfall to the best of his ability and then assisted the Commissioner to arrive at the correct tax shortfall, his voluntary disclosure amounted to a full voluntary disclosure. As the disclosure was unprompted it was treated as a pre-notification disclosure (per box at [37] above).

The 2nd bullet point of [46], and [53] above provides discussion of the potential outcome should Peter and the Commissioner not be able to agree on the quantum of the tax shortfall.

Because he made an unprompted voluntary disclosure, Peter received a 75% reduction on the evasion shortfall penalty that was imposed. This can be compared to the 40% reduction that would have applied if Peter had waited until he was notified of a pending investigation before making a voluntary disclosure.

The relationship between a tax shortfall and a taxpayer's tax position

54. As already discussed (at [39] above), a "tax shortfall" is the difference between the tax effect of the tax position taken by a taxpayer and the correct tax position.

55. A taxpayer's tax return is made up of a number of tax positions and an error in any one of them may lead to a tax shortfall for *that* tax position. A taxpayer's tax return that contains a number of incorrect tax positions means that there may be a number of tax shortfalls that may have a shortfall penalty imposed on each of them separately. In these circumstances, a taxpayer may make a full voluntary disclosure in respect of each separate tax shortfall. If full voluntary disclosures are made in respect of some incorrect tax positions and not others, a voluntary disclosure reduction in the quantum of any shortfall penalty subsequently imposed will only be available in respect of those tax positions (and tax shortfalls) that were the subject of a full voluntary disclosure.

56. This same rationale applies to voluntary disclosures made in respect of some tax types (and not others) and/or some tax periods (and not others). If full voluntary disclosures are made in respect of some separate tax types and/or periods and not others, a voluntary disclosure reduction will only be available in respect of the tax positions (and tax shortfalls) that were the subject of a full voluntary disclosure.

57. Sometimes making a full voluntary disclosure in relation to a tax position will result in a consequential adjustment being required to another tax type. For instance, an income tax adjustment may have a consequential impact for GST purposes. In addition, a full voluntary disclosure made in relation to a tax position in one tax period may result in the same or similar adjustments being required in other tax periods. Despite the statements made at [55] above, where a taxpayer initially (and inadvertently) omits to include these additional tax types/periods in their voluntary disclosures and this fact is obvious to the Commissioner, the Commissioner will advise the taxpayer of the apparent omission(s) and allow the taxpayer to include these additional facts. If this consequential alteration is made in a timely manner after the inadvertent omission is brought to the taxpayer's attention (per [35] above), the initial full voluntary disclosure will continue to be treated as a full voluntary disclosure in relation to these additional facts.

Example 2: Voluntary disclosures only disclose some of the tax shortfalls discovered during an investigation

Carol operates a café and has been notified by the Commissioner that the department intends to carry out an investigation of her tax affairs for the 2016 income year.

Before this investigation commences, Carol and her agent take the opportunity to review the café's 2016 income tax return and discover that some private expenditure has been claimed in error as business purchases. The over-claimed expenditure is for the purchase of private food items. Carol makes a post-notification voluntary disclosure of all the details of this over-claimed expenditure.

During the subsequent investigation other errors are located in the 2016 income tax return. These additional errors relate to an incorrect trading stock calculation and the use of incorrect depreciation rates for some asset types.

The tax positions taken for purchases, trading stock and depreciation are all separate tax positions that result in separate tax shortfalls. The fact that a voluntary disclosure was made by Carol only for the tax position taken for purchases does not mean that this voluntary disclosure is not a full voluntary disclosure specifically for this tax position.

Carol's full voluntary disclosure in relation to business purchases initially related to income tax only. When the Commissioner pointed out to Carol that this would have a consequential effect on her GST return Carol immediately amended her initial voluntary disclosure to include this fact. This amendment was accepted by the Commissioner as part of the initial full voluntary disclosure, as it was made in a timely manner after she was advised of the consequential adjustment that was required.

In this case Carol received a reduction in the shortfall penalty imposed for the over-claimed purchases (for both income tax and GST). Because they were not included in Carol's full voluntary disclosure, no voluntary disclosure reduction was available for the shortfall penalties imposed for the other incorrect tax positions taken.

58. As can be seen from the above discussion and example, the term "tax position" is able to be viewed quite narrowly and, in these circumstances, a failure to disclose every incorrect tax position will not necessarily invalidate full voluntary disclosures that have been made for one or more of these incorrect tax positions.

59. Because separate full voluntary disclosures may be made for each of the various tax positions taken by a taxpayer in their tax returns, the timing of the making of each full voluntary disclosure may impact the level of shortfall penalty reduction available for each shortfall. For instance, a full voluntary disclosure made for a tax position before the taxpayer receives a notification of a pending investigation will attract a reduction of either 100% or 75% (depending on the type of shortfall penalty imposed). If that same taxpayer were to make a separate full voluntary disclosure in respect of a different tax position they have taken (or make a new voluntary disclosure in respect of the same tax position), and not make that disclosure until after being notified of the pending investigation (but before the investigation had commenced), then the shortfall penalty reduction for that separate tax position and tax shortfall would be only 40%. No reduction would be available if the disclosure was made after the investigation had commenced.

Treatment of multiple, similar tax positions

60. In some circumstances the Commissioner is required to amalgamate a number of tax shortfalls and create one aggregated tax shortfall for which only one shortfall penalty will be imposed. This occurs because of s 141(10). This section states that if a taxpayer takes various tax positions in the same return period, that are a "similar or identical taxpayer's tax position", any tax shortfalls resulting from these tax positions must be aggregated and are treated as one tax shortfall.

61. Because a voluntary disclosure must contain all the details of a tax shortfall, if a number of tax shortfalls have been aggregated by the Commissioner in terms of s 141(10), then to be effective any voluntary disclosure made by a taxpayer will need to disclose all the details of all the individual incorrect tax positions taken for the aggregated tax shortfall.

A voluntary disclosure must disclose something to the Commissioner

62. As stated at [36] above, another essential voluntary disclosure element is that a taxpayer must "disclose" something to the Commissioner. While this term is not defined in any of the revenue Acts, the Concise Oxford English dictionary defines "disclose" in the following terms:

    Disclose *v 1. Make (secret or new information) known…*

63. The ordinary meaning of a "disclosure" emphasises that the information being imparted is "new". It is the Commissioner's view that, for the purpose of the voluntary disclosure regime, whether information that is being disclosed is new is judged from the taxpayer's perspective. That is, a "disclosure" is made if the taxpayer reasonably believes that the information being disclosed is not known to the Commissioner. This is an objective test; whether the taxpayer's belief that the Commissioner was unaware of the details of the tax shortfall at the time that it was disclosed was reasonable in all the circumstances. The Commissioner's actual knowledge is not relevant in this context.

64. Although s 141G contemplates that it is the Commissioner's opinion that is relevant as to whether a taxpayer has made a full voluntary disclosure, this does not mean that whether a "disclosure" has been made is tested from the Commissioner's perspective. It simply means that it is for the Commissioner to form an opinion as to whether a disclosure of information is a "full voluntary disclosure".

Disclosures made when the Commissioner is already aware of the tax shortfall

65. For the purposes of the voluntary disclosure regime, it is the taxpayer's knowledge when making a disclosure that requires consideration. Taxpayers should not be put into a position of having to second guess the Commissioner's knowledge regarding a tax shortfall to gain a full voluntary disclosure reduction.

66. It is the Commissioner's view that, if a voluntary disclosure is made by a taxpayer of a tax shortfall and the Commissioner is already aware of that tax shortfall, this will generally still amount to a "disclosure" by the taxpayer. It will not amount to a disclosure when the taxpayer, viewed objectively, was "clearly aware" that the Commissioner already knew of a tax shortfall.

67. Generally, a taxpayer will be said to be clearly aware of the Commissioner's knowledge of a tax shortfall if:
    - the Commissioner has expressly advised the taxpayer of an incorrect tax position and a tax shortfall; or
    - the facts and circumstances of the interactions between the taxpayer and the Commissioner clearly indicate that it was reasonable for the taxpayer to infer that the Commissioner already knew of a tax shortfall.

    For the purposes of this paragraph, it is not necessary for the Commissioner to advise the taxpayer of "the" tax shortfall; that is, the exact amount of the tax shortfall. It will be sufficient for the taxpayer to be advised that the Commissioner is aware that the tax position that they have taken is incorrect and there is "a" tax shortfall.

68. This inference (that the Commissioner was aware of the tax shortfall, per [67] above) may include situations where there has been so much interaction between the Commissioner and the taxpayer narrowing down the tax shortfall through, for instance, repeated correspondence, interviews and information requests, that it would be reasonable for a taxpayer to infer that the Commissioner knew that there was an incorrect tax position and a tax shortfall. This represents a high bar and instances of this occurring will be highly fact specific. It is the Commissioner's view that it will only be in rare instances that the level of interaction will be such that it would be reasonable for a taxpayer to infer that the Commissioner already knew of the incorrect tax position and a tax shortfall. Any decision to not accept a voluntary disclosure on this basis will be made by a senior officer.

Example 3: Making a voluntary disclosure when Commissioner is aware of a likely tax shortfall

The Commissioner has received information from Land Information New Zealand (LINZ) regarding sales of residential properties by taxpayers in the 2017 income year. The Commissioner commences a project to contact all taxpayers who have acquired and on-sold properties within a two-year timeframe. The first step in that project is to contact affected taxpayers and gain a greater understanding of the individual circumstances of each transaction. Note that this contact would not constitute a notification of a pending investigation (for further discussion on notifications see [81] – [85] and [88] – [90] below).

One of the affected taxpayers is Sally. The LINZ information available to the Commissioner shows that she has sold a residential property 10 months after it was acquired, and that the property's land transfer tax statement did not show it as being used as Sally's family home. Sally is contacted by letter and asked to confirm the sale details and provide her explanation of the circumstances of this transaction. Also included in this letter are details of the brightline test and the exemptions available from it. Although the Commissioner believes that it is likely that this transaction may be liable to income tax, until this further information is received that is by no means certain (it could be for instance, that the properties land transfer tax statement did not correctly claim the property as a family home, or one of the other brightline exemptions applies).

Sally responds by confirming the details of the transaction and notifies the Commissioner of the tax shortfall from the sale of the property. Sally's notification of a tax shortfall is a "disclosure" under s 141G because, although Sally is aware that the Commissioner knows of the transaction, the Commissioner has not advised her of a tax shortfall (and as a matter of fact, at this early stage the Commissioner would not be certain that a tax shortfall existed) nor does the limited interaction between Sally and Commissioner reasonably indicate to Sally that the Commissioner was aware of the tax shortfall.

This can be contrasted with the example of Sally being in the business of property development. In this scenario the Commissioner may be in a position to advise Sally from the outset that the Commissioner believes that there was a tax shortfall (irrespective of the brightline test. If the Commissioner were to advise Sally of the tax shortfall in this circumstance Sally would not be in a position to make a full voluntary "disclosure", as she would be aware that she was not disclosing anything new to the Commissioner; she would merely be confirming a tax shortfall that she knew the Commissioner was already aware of.

A voluntary disclosure must be made voluntarily

69. The final essential element of the voluntary disclosure regime (per [36] above) is that the disclosure must be "voluntary". This term is not defined in any of the revenue Acts, so will take its ordinary meaning.

70. The Concise Oxford English dictionary[10] defines "voluntary" as:

    Voluntary *adj 1 done, given, or acting of one's own free will…*

    This definition has been affirmed by case law. For instance, in *AG v Ellis*[11] the meaning of "voluntarily" (in the context of the Customs and Inland Revenue Act 1881) was held to mean:

    "Voluntarily" is not used in the sense of "without consideration", but in its ordinary sense of "freely", "without compulsion", and "not under any obligation".[12]

71. Bearing this definition in mind, it is the Commissioners view that a disclosure will always be made voluntarily unless a taxpayer, in making the disclosure, was acting under an obligation to do so, such that the making of the disclosure was not as a result of "acting on one's own free will". The Concise Oxford English dictionary defines "obligation" in the following terms:

    Obligation *n 1. An act or course of action to which a person is morally or legally bound; the condition of being so bound…*

72. Sections 17 – 17M impose legal requirements for taxpayers to disclose information to the Commissioner on request, and ss 15B(e) and (f) impose less formal obligations on taxpayers to disclose information and co-operate with the Commissioner. If the Commissioner makes either formal or informal requests for documents or information, it could be argued that any information subsequently disclosed cannot be said to have been disclosed voluntarily by the taxpayer; in the circumstances they were under an obligation to make a disclosure.

73. Merely meeting the Commissioner's request for information does not necessarily mean that the taxpayer could not subsequently (or additionally) "voluntarily" make a disclosure of a tax shortfall. These two acts can be mutually exclusive. Section 141G is clear that the voluntary disclosure must be of a tax shortfall. In the context of a Commissioner's request for information, this would require the specific disclosure of a tax shortfall and not just a provision of documents and/or information more generally. For a disclosure not to have been made voluntarily in these circumstances would require

[10] Concise Oxford English dictionary (12th Ed.)

[11] [1895] 2 QB 466

[12] See also *Re Wilkinson, Page v Public Trustee* [1926] Ch 842, 850

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the information provided to the Commissioner to clearly show a tax shortfall, without the need for the Commissioner to undertake "further investigatory work". In this context "further investigatory work" is limited to any further investigatory work required in order for the Commissioner to be satisfied that a correct assessment is able to be issued in respect of the tax position disclosed by the information provided.

74. Whether further investigatory work would be necessary, such that the disclosure may not be a full voluntary disclosure, will be determined on a case by case basis. It is the Commissioner's view that this will be a high threshold and the information requested and provided would need to clearly show a tax shortfall.

75. For instance, if a taxpayer was under an obligation to supply personal bank statements and those statements showed a number of deposits, the Commissioner would not be able to state that those deposits were assessable income (and therefore disclosed a tax shortfall) without having to undertake further investigatory work. They could, for instance, be capital or private in nature. In this circumstance, any disclosure made by the taxpayer relating to these deposits would be treated as having been made voluntarily. It needs to be noted that, in order to be eligible for a voluntary disclosure reduction of any subsequent shortfall penalty that was applied, the taxpayer would need to make a "full" voluntary disclosure of all of the tax shortfall in relation to the tax position in question; in the example given, the taxpayer would need to disclose all of the assessable income and not just that shown on the bank statements (see also discussion at [49] and [52] above).

76. This can be contrasted with the scenario of bank statements that showed the receipt of amounts of "interest". In the situation where that interest had not been returned, the taxpayer could not argue that the provision of these statements amounted to a voluntary disclosure. The taxpayer was under an obligation to provide the bank statements and the statements clearly show a tax shortfall with no further investigatory work required of the Commissioner.

77. A general invitation/suggestion by the Commissioner for a taxpayer (or group of taxpayers) to consider making a voluntary disclosure cannot amount to an "obligation" being imposed on those taxpayers. Section 141G does not impose any legal obligation on taxpayers to make voluntary disclosures and so, in these circumstances the Commissioner is merely pointing out the existence and purpose of the voluntary disclosure regime. If this type of suggestion is made to a taxpayer and that taxpayer subsequently makes a full voluntary disclosure, that disclosure will be treated as having been made voluntarily.

Example 4: Whether a disclosure is being made "voluntarily"

George owns a dairy and has been notified by the Commissioner that the department intends to carry out an investigation of his tax affairs for the 2016 income year. The notification includes a request for business records.

Before sending his business records to the Commissioner, George and his accountant review these records and his tax returns for the 2016 year. This review reveals that George has failed to make an allowance for groceries that he and his family have taken for their personal use. This has resulted in purchases being overstated in his income tax return, as well as errors being made in his GST returns.

George then provides the business records to the Commissioner and discloses the relevant tax shortfalls.

While George is involuntarily discharging an obligation to provide information to the Commissioner (his business records), the disclosure of the tax shortfalls has been made separately and voluntarily. This is because the business records, by themselves, are not capable of disclosing a tax shortfall without further investigatory work by the Commissioner.

In this case George received a post-notification shortfall penalty reduction.

78. The filing of tax returns is not a voluntary act, but rather a legislative requirement imposed on taxpayers generally. Neither could the contents of these returns usually amount to a voluntary disclosure. This is because the tax return merely records the various tax positions taken by a taxpayer and therefore cannot disclose a tax shortfall as is required by s 141G. If a taxpayer wished to make a voluntary disclosure in respect of a period for which they had not filed the required return, the Commissioner would expect that return to be filed before or at the time that the voluntary disclosure was made.

Related matters

Reductions in shortfall penalties

79. As stated at [21] above, ss 141A to 141EB impose a shortfall penalty for taking an incorrect tax position or for doing or failing to do anything described in one of these shortfall penalty provisions. Shortfall penalties are imposed on a graduating scale from 20% to 150% of the difference between the tax effect of a taxpayer's original tax position and the correct tax position; the "tax shortfall". An important feature of the shortfall penalties and voluntary disclosure regimes is that, once imposed on a taxpayer, shortfall penalties are reduced if the Commissioner forms the opinion that the taxpayer has made *a full voluntary disclosure to the Commissioner of all the details of the tax shortfall*[13].

[13] See [19] for details of other circumstances that may give rise to a reduction in the level of shortfall penalty imposed by the Commissioner

80. The reductions available to taxpayers that make a full voluntary disclosure are:

- If the full voluntary disclosure is made before the taxpayer is first notified of a pending investigation (pre-notification disclosure), the shortfall penalty will be reduced by 100% if that shortfall penalty was initially imposed for not taking reasonable care, taking an unacceptable tax position, or for an unacceptable interpretation. All other shortfall penalties will be reduced by 75%[14].
- If the full voluntary disclosure is made after a taxpayer is first notified of an investigation, but before that investigation commences (post-notification disclosure), the shortfall penalty will be reduced by 40%[15].
- The above reductions also apply if the shortfall penalty is for a temporary tax shortfall[16].
- The amount of shortfall penalty payable by a taxpayer for not taking reasonable care, or for taking an unacceptable tax position, must not exceed $50,000 if the tax shortfall was voluntarily disclosed by the taxpayer within a specified timeframe[17]. It should be noted that this is a monetary cap rather than a reduction and that the cap only applies after all other reductions in the amount of the shortfall penalty have been taken[18].

Notification and commencement of an investigation

81. As stated above, crucial to deciding the level of reduction that is available to a taxpayer that makes a voluntary disclosure to the Commissioner is whether that voluntary disclosure qualifies as a pre- or post-notification disclosure. In turn, this is dependent on the taxpayer being "notified" that an investigation is either pending or has commenced.

82. Inland Revenue will *notify* a taxpayer when they are about to be investigated and/or advise them when an investigation has commenced[19]. This notification will specifically use the word "audit" or "investigation".

83. This notification will be in writing and communicated by post, fax, personal delivery or by electronic means. The notice will inform the taxpayer of the tax periods and tax types that are being investigated. If the scope of an investigation widens during that investigation and other tax types or periods are to be reviewed, the taxpayer will be promptly notified in writing of this change. Each party to an investigation will be separately notified.

84. An investigation *commences* at the earlier of:

- the end of the first interview; and
- the time when an officer inspects information and the taxpayer is notified in writing of the inspection[20]. Until the notification of inspection is given or the first interview has ended, a taxpayer will still qualify for a post-notification voluntary disclosure reduction.

85. Further information regarding these matters may be found in Standard Practice Statement *SPS 16/03 Notification of a pending audit or investigation*[21].

When does a taxpayer make a full voluntary disclosure?

86. For a disclosure to be "full", all information relating to the tax shortfall must be provided. The timing of when a disclosure can be accepted as being "full" is when all the details relating to that tax shortfall have been received by the Commissioner. For instance, if the initial details of a tax shortfall are disclosed before the taxpayer receives the notification of a pending investigation, but the final details of that tax shortfall are not supplied to the Commissioner until after the taxpayer receives that notification, the "full" disclosure has occurred after the notification of the pending investigation and would only qualify for a post-notification disclosure reduction.

87. Exceptions arise where, per [35] and [52] above, the taxpayer is assisting the Commissioner to make a final quantification of the tax shortfall, or per [56] above, when the taxpayer is in the process of confirming a consequential alteration to their initial voluntary disclosure. Where these occur, and the agreed timeframes are adhered to, the Commissioner will accept that the full voluntary disclosure was made on the date of the initial voluntary disclosure.

[14] Section 141G(3)

[15] Section 141G(3)(b)

[16] Section 141J

[17] Section 141JAA

[18] Interpretation Statement IS0053 Shortfall penalty for not taking reasonable care and Interpretation Statement IS0055 *Shortfall penalty – unacceptable interpretation and unacceptable tax position*. Included in *Tax Information Bulletin* Vol 17 No 9 (November 2005). See **www.ird.govt.nz** (search term: IS0053)

[19] Section 141G(4) sets out who the Commissioner may notify of a pending audit or investigation. See Appendix attached to this SPS.

[20] Section 141G(5)

[21] This may be found at **www.ird.govt.nz** (search term: 16/03)

Disclosures for another tax type, another tax period or another entity

88. As stated at [83] above, the notification of a pending investigation will advise the taxpayer of the tax periods and tax types that are to be investigated. If a taxpayer subsequently makes a full voluntary disclosure that is for a tax shortfall in a tax period or to a tax type that is not covered by this notification, that full voluntary disclosure will qualify as a pre-notification voluntary disclosure.

89. Similarly, if a full voluntary disclosure is made on behalf of an entity not subject to a notice of pending investigation (for instance, another company in a group of companies), that full voluntary disclosure will be treated as a pre-notification voluntary disclosure. Note however that when a company has a branch, the branch and company are considered to have been notified of a pending investigation at the same time. This is because the branch is not a separate entity to the company.

90. It is not uncommon for an investigation to be extended beyond the scope of that stated in the original notification of a pending investigation to include, for instance, additional revenue types, tax periods or entities. As stated at [83] above, if this occurs, the Commissioner will promptly notify the taxpayer in writing of the intention to extend the investigation and the scope of this extension. For the purposes of the voluntary disclosure regime this additional notification will be treated as the first notification of a pending investigation for, as appropriate, the additional revenue(s), tax period(s) or entities stated in the notification.

Voluntary disclosures and subsequent prosecution action

91. If a taxpayer makes a full voluntary disclosure before they are first notified of a pending investigation, the Commissioner's usual practice is not to prosecute those taxpayers. The decision not to prosecute in such cases is an exercise of the prosecutorial discretion on the basis that any subsequent prosecution action in this circumstance would not aid voluntary compliance. While it may be the Commissioner's usual practice not to prosecute in such circumstances, the Commissioner may not abdicate the exercise of the prosecutorial discretion by a pre-emptive blanket policy of not prosecuting in every case of a pre-notification voluntary disclosure[22]. However, the Commissioner may, where there are proper authorised alternatives to prosecution, decide that prosecution is not justified in the public interest[23]. This is likely to be the case where an appropriate shortfall penalty will ensure that the integrity of the tax system is not undermined.

92. In circumstances where the Commissioner forms the view that a taxpayer's actions or omissions are such that non-prosecution could lead to voluntary compliance more generally being undermined, the Commissioner may still proceed with that subsequent prosecution action. For instance, this may occur when the taxpayer has a history of serious non-compliance such that a decision not to prosecute would suggest that the integrity of the tax system in general, and voluntary compliance in particular, would be undermined; for example, where a taxpayer has been guilty of serious tax evasion in the past and, despite shortfall penalties being imposed at that time, further instances of evasion had been identified. Simply because a full voluntary disclosure had been received should not stand in the way of the Commissioner prosecuting when the previous imposition of other penalties have had little or no effect on the taxpayer's subsequent compliance behaviour. A decision to prosecute in these circumstances will be an exceptionally rare occurrence, limited to serious offences, and will require the approval of a very senior officer.

93. Prosecution action may be considered by the Commissioner when a taxpayer does not make a full voluntary disclosure of a tax shortfall (see [50] – [57] for further discussion) before they are first notified of a pending investigation or when a taxpayer makes a full voluntary disclosure after they have been notified of a pending investigation.

Challenge rights

94. After receiving and fully considering a disclosure received from a taxpayer, the Commissioner may form the opinion that the taxpayer has not provided a "full voluntary disclosure" as required by s 141G(1), or that a disclosure was not made before either the taxpayer was first notified of a pending investigation (s 141G(1)(a)) or before the investigation commenced (s 141G(1)(b)). If such an opinion is formed, the Commissioner may not provide the taxpayer with the level of reduction in a shortfall penalty to which the taxpayer believes they are entitled.

95. In these circumstances the taxpayer can challenge the amount of the shortfall penalty, including the fact that they may disagree with the level of reduction provided by the Commissioner.

[22] See *Polynesian Spa Ltd v Osborne* [2005] NZAR 408 (HC) at [69], approved in *Osborne v Worksafe* [2017] NZCA 11 at [35]

[23] Solicitor-General's Prosecution Guidelines, **http://www.crownlaw.govt.nz/publications/prosecution-guidelines/** at 5.9.13

Reconsideration and complaint rights

96. If a taxpayer is concerned that their circumstances have not been given proper consideration, they should raise their concern with the staff member that considered their disclosure and ask for the decision to be reviewed by a more senior officer.

97. If a taxpayer is still not satisfied with the level of service they receive, they can obtain more information about the Inland Revenue Complaints Management Service at **www.ird.govt.nz** (search keywords: complaints and disputes) or phone 0800 274 138 (Monday to Friday between 8am and 5pm).

This Standard Practice Statement is signed on 27th March 2019

Rob Wells
Manager, Technical Standards, OCTC

Appendix

Legislation and published statements

Of relevance to the Commissioner when considering voluntary disclosures are the following sections of the TAA:

3 Interpretation

3(1) [Definitions] In this Act, unless the context otherwise requires, -

…

…

shortfall penalty means a penalty imposed under any of sections 141AA to 141K for taking an incorrect tax position or for doing or failing to do anything specified or described in those sections.

…

…

tax shortfall, for a return period, means the difference between the tax effect of—

(a) a taxpayer's tax position for the return period; and

(b) the correct tax position for that period,—

when the taxpayer's tax position results in too little tax paid or payable by the taxpayer or another person or overstates a tax benefit, credit, or advantage of any type or description whatever by or benefiting (as the case may be) the taxpayer or another person

139 Purposes of this Part

The purposes of this Part are—

(a) to encourage taxpayers to comply voluntarily with their tax obligations and to co-operate with the department; and

(b) to ensure that penalties for breaches of tax obligations are imposed impartially and consistently; and

(c) to sanction non-compliance with tax obligations effectively and at a level that is proportionate to the seriousness of the breach.

141 Tax shortfalls

…

…

141(10) If—

(a) in a return period, a taxpayer takes a taxpayer's tax position—

(i) in respect of, or as a consequence of entering into, an arrangement; or

(ii) in respect of an article, item, or matter; and

(b) in the same return period, the taxpayer takes a similar or identical taxpayer's tax position—

(i) in respect of, or as a consequence of entering into, a similar or identical arrangement; or

(ii) in respect of a similar or identical article, item, or matter—

the tax shortfalls arising from the taxpayer's tax positions are to be aggregated and deemed to be 1 tax shortfall.

141G Reduction in penalty for voluntary disclosure of tax shortfall

141G(1) A shortfall penalty payable by a taxpayer under any of sections 141A to 141EB may be reduced if, in the Commissioner's opinion, the taxpayer makes a full voluntary disclosure to the Commissioner of all the details of the tax shortfall, either—

(a) before the taxpayer is first notified of a pending tax audit or investigation (referred to in this section as **pre-notification disclosure**); or

(b) after the taxpayer is notified of a pending tax audit or investigation, but before the Commissioner starts the audit or investigation (referred to in this section as **post-notification disclosure**).

141G(2) The Commissioner may from time to time—

(a) specify the information required for a full voluntary disclosure; and

(b) the form in which it must be provided.

141G(3) The level by which the shortfall penalty is reduced—

(a) for pre-notification disclosure is—

(i) 100%, if the shortfall penalty is for not taking reasonable care, for taking an unacceptable tax position, or for an unacceptable interpretation; or

(ii) 75%, if subparagraph (i) does not apply:

(b) for post-notification disclosure is 40%.

141G(4) A taxpayer is deemed to have been notified of a pending tax audit or investigation, or that the tax audit or investigation has started, if—

(a) the taxpayer; or

(b) an officer of the taxpayer; or

(c) a shareholder of the taxpayer, if the taxpayer is a close company; or

(d) a tax adviser acting for the taxpayer; or

(e) a partner in partnership with the taxpayer; or

(f) a person acting for or on behalf of or as a fiduciary of the taxpayer,—

is notified of the pending tax audit or investigation, or that the tax audit or investigation has started.

141G(5) An audit or investigation starts at the earlier of—

(a) the end of the first interview an officer of the department has with the taxpayer or the taxpayer's representative after the taxpayer receives the notice referred to in subsection (4); and

(b) the time when—

(i) an officer of the department inspects information (including books or records) of the taxpayer after the taxpayer receives the notice referred to in subsection (4); and

(ii) the taxpayer is notified of the inspection.

141J Limitation on reduction of shortfall penalty

(1) This section applies to a shortfall penalty payable by a taxpayer if—

(a) the taxpayer makes a voluntary disclosure; and

(b) the shortfall penalty is payable in respect of a temporary tax shortfall; and

(c) the shortfall penalty would be reduced under section 141G or 141H in the absence of this section.

(2) The shortfall penalty is reduced by—

(a) 100%, if—

(i) the shortfall penalty is for not taking reasonable care, for taking an unacceptable tax position, or for taking a tax position involving an unacceptable interpretation of a tax law; and

(ii) the tax shortfall is voluntarily disclosed under section 141G before notification of a pending tax audit or investigation; or

(b) 75%, if paragraph (a) does not apply.

141JAA Shortfall penalty for not taking reasonable care or for taking unacceptable tax position may not be more than $50,000

(1) Despite section 141J, a shortfall penalty payable by a taxpayer for not taking reasonable care, or for taking an unacceptable tax position, may not be more than $50,000 if the taxpayer voluntarily discloses the shortfall under section 141G, or the Commissioner determines the shortfall, no later than the date that is the later of—

(a) the date that is 3 months after the due date of the return to which the shortfall relates; and

(b) the date that follows the due date of the return to which the shortfall relates by the lesser of—

(i) 1 return period; and

(ii) 6 months.

(2) This section does not apply if section 141K applies.

Other relevant legislative provisions are:

Sections 15B(e) and (f), 17, 113, 141A – EB, 141FB, 141H, 141I and 141K of the TAA

Published statements

This SPS should be read in conjunction with the following statements published by the Commissioner and any issued in replacement:

Standard Practice Statement 16/01: Requests to amend assessments[24]

Standard Practice Statement 16/03: Notification of pending audit or investigation[25]

[24] Published in *Tax Information Bulletin* Vol 28 No 4 (May 2016)

[25] Published in *Tax Information Bulletin* Vol 28 No 7 (August 2016)

OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject

OS 19/02: Persons who are permitted to confirm an income statement of a deceased person or provide information to the Commissioner to finalise the tax account of a deceased person

Introduction

This operational statement lists the persons who are able to confirm an income statement of a deceased person under s RZ 15 of the Income Tax Act 2007 (ITA 2007) and who can provide information to the Commissioner to finalise a deceased person's tax account under s 22F of the Tax Administration Act 1994 (TAA 94) where the deceased does not have a will and no executor or administrator has been appointed.

Application

This operational statement applies from the date that it is signed.

Summary

The following persons may confirm an income statement issued in respect of the income years from 1 April 2008 to 31 March 2019 where the income statement was issued in respect of a deceased person who died without a will and an executor or administrator has not been appointed:

- The widow or widower of the deceased person
- A person who is the surviving civil union/de-facto partner of the deceased person
- A child of the deceased person
- A person who is entitled to administer the estate
- A person related by blood or marriage and be maintaining the deceased person's child/children
- A person who has the custody and control of the deceased person's child/children

The following persons may supply information to finalise income years from 1 April 2019 of a deceased person who died without a will and an executor or administrator has not been appointed:

- The widow or widower of the deceased person
- A person who is the surviving civil union/de-facto partner of the deceased person
- A child of the deceased person
- A person who is entitled to administer the estate
- A person related by blood or marriage and be maintaining the deceased person's child/children
- A person who has the custody and control of the deceased person's child/children

Discussion

1. Under s RM 5 (repealed from 1 April 2019) of the ITA 2007, a person who receives an income statement that results in a refund of more than $600 must confirm that the income statement is correct before the refund can be issued.
2. Where the person has died, the executor or administrator of the person's estate will be able to confirm an income statement by virtue of s 43 of the TAA 1994. However, where the person has died without making a will and no executor or administrator has been appointed, it was unclear as to whether relatives of the deceased person would be able to confirm the income statement and receive the refund.
3. Therefore, s RZ 15 of the ITA 2007 has been introduced to allow certain classes of persons to confirm the income statement of a person who has died and for whom no executor or administrator has been appointed where the amount of the refund does not exceed $15,000. Section RZ 15 applies to income statements issued in respect of the 2008/2009 income year and succeeding income years up to the 2018/2019 income year.

4. The Commissioner must publish a list of the classes of persons who are considered likely to have had a relationship with the deceased person such that they are likely to be best placed to confirm an income statement of the person.
5. In compiling the classes of persons, the Commissioner has made reference to section 65 of the Administration Act 1969 which prescribes the persons that may be paid any monies that are owing to a deceased person and there is no executor or administrator having been appointed.
6. Going forward from 1 April 2019, income statements are to be replaced with a new regime in which Inland Revenue will calculate the tax liability or refund for a person who is in receipt of "reportable income" which includes a PAYE income payment and a payment of resident passive income. Under s 22F of the TAA 1994, if the person earns income other than reportable income, they will be required to advise Inland Revenue of this so a correct assessment of the tax to pay or refund due can be issued.
7. Where the person is deceased, the executor or administrator of the estate will be able to supply information of income and expenses on behalf of the deceased. However, like the situation with the confirmation of an income statement, where a person has died without a will and no executor or administrator has been appointed, it would be questionable whether relatives are permitted to supply the information to finalise the tax account of the deceased.
8. To avoid doubt, ss 22F(5) and (6) of the TAA 1994 provide that the Commissioner must publish a list of the classes of persons who are considered likely to have a relationship with the deceased person such that they are likely to be best placed to provide income information on behalf of a deceased person.
9. As with s RZ 15 of the ITA 2007, the classes of persons that are able to provide income information on behalf of a deceased person are based on those prescribed in section 65 of the Administration Act 1969.

Operational practice

10. A person who wishes to confirm an income statement of a deceased person or wants to provide information to the Commissioner to finalise the tax account of a deceased person must complete the form IR 625, available on the Inland Revenue website.

This Operational Statement is signed on 4 April 2019

Manager, Technical Standards, OCTC

Legislation

RZ 15 Treatment of certain refunds made on income statements: 1 April 2008 to 31 March 2019

When this section applies

(1) This section applies for the period that starts on 1 April 2008 and ends on 31 March 2019 when—
  - (a) an income statement has been provided to a person for a tax year and the result is that an amount of tax must be refunded to the person; and
  - (b) the person is a deceased person for whom no executor or administrator has been appointed; and
  - (c) the amount is—
    - (i) more than the confirmation threshold applying for the person at the time the income statement was provided; and
    - (ii) not more than $15,000.

Persons confirming correctness of statements

(2) The Commissioner may allow a person appearing on the list described in subsection (3) to confirm, to the best of their knowledge, the correctness of the income statement on behalf of the person.

List of classes of persons

(3) The Commissioner must publish a list of the classes of persons who are considered likely to have a relationship with a deceased person and that the Commissioner considers may be best placed to confirm an income statement of a deceased person.

22F Information requirements

Obligations for information on other income

(1) Subject to section 22K(1), an individual must provide information to the Commissioner for a tax year on the total amount of assessable income that they derive for the corresponding income year to the extent to which the amount is not reportable income, see schedule 8, part A, table 1.

Obligations for reportable income information

(2) No obligation to provide information for a tax year arises in relation to an amount of reportable income that is not included in an individual's pre-populated account for the tax year unless the individual knows, or might reasonably be expected to have known, that the amount should properly be included in their final account for the tax year.

Additional amounts

(3) An individual may provide information for a tax year on an amount set out in schedule 8, part A, table 2.

Benefits under employee share schemes

(4) Subsection (1) does not apply to an amount of income that is a benefit that a person receives under an employee share scheme to the extent to which their employer has included information relating to the benefit in their employment income information under section 23K and schedule 4, table 1, rows 4 and 7.

Information provided on behalf of deceased individuals

(5) In order to finalise the account of a deceased individual under section 22H, the Commissioner may allow a person appearing on the list described in subsection (6) to provide, to the best of their knowledge, income information on behalf of the deceased individual.

List of classes of persons

(6) The Commissioner must publish a list of the classes of persons who are considered likely to have a relationship with a deceased individual and that the Commissioner considers may be the sort of person who is best placed to provide income information on behalf of adeceased individual.

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.

Commissioner wins liquidation rehearing

Case	*The Commissioner of Inland Revenue v Chesterfields Preschools Limited & Therese Anne Sisson* [2019] NZHC 272
Decision date	26 February 2019
Act(s)	S 241 Companies Act 1993
Keywords	"liquidation"

Summary

This was a liquidation rehearing. The Court found that the Commissioner of Inland Revenue ("the Commissioner") had established the grounds for making an order of liquidation and accordingly placed Chesterfields Preschools Limited ("CPL") into liquidation.

Facts

The Commissioner commenced this liquidation proceeding against CPL in 2015. The Commissioner relied upon the statutory presumption of CPL's insolvency arising through CPL not having satisfied the requirements of a statutory demand. On 6 October 2015 the High Court, following a defended hearing, made an order putting CPL into liquidation (*Commissioner of Inland Revenue v Chesterfields Preschools Ltd* [2015] NZHC 2440, (2015) 27 NZTC 22-029).

Ms Sisson was subsequently joined as a second defendant in this proceeding to enable her to pursue an appeal. Her appeal was partially successful (*Sisson v Commissioner of Inland Revenue* [2017] NZCA 326, (2017) 28 NZTC 23-023). The Court of Appeal found the High Court had not made a determination as to the precise level of CPL's tax liability and accordingly sent the matter back to the High Court so that CPL could test the accuracy and methodology of the Commissioner's calculation.

In the meantime, interim liquidators were appointed to CPL by this Court on 15 December 2017 (*Commissioner of Inland Revenue v Chesterfields Preschools Ltd* [2017] NZHC 3172, (2017) 28 NZTC 23-046).

Decision

Is the Commissioner a creditor of CPL?

Ms Sisson denied that CPL owes any debt to the Commissioner, her evidence (focused on core tax) was CPL owed $6,898.22 (without consideration of penalties and interest).

However, the Court noted that the Commissioner is a judgment creditor (in relation to costs judgments) in the sum of $32,105 (together with accruing interest).

Accordingly, the Court held that the Commissioner is a creditor of CPL.

Is CPL unable to pay its debts?

The statutory demand issued by the Commissioner was not complied with by CPL. There arose the rebuttable presumption that CPL is unable to pay its debts.

It was accordingly for CPL (or Ms Sisson) to establish in this proceeding that CPL is able to pay its debts.

CPL's tax debt to the Commissioner

The Court found that the logical starting point for consideration of CPL's debt were the detailed tables prepared by the Commissioner's officers in relation to each tax type on a strictly chronological basis. Ms Sisson also complied her own table extracted her starting figures and dates from the Commissioner's schedules.

The Commissioner's tables showed that the tax debt of CPL was $1,088,461.15.

The Court was satisfied on the evidence with the Commissioner's calculation and methodology of CPL's debt.

Other indebtedness claimed by the Commissioner

The Court was satisfied that CPL owed $307,389.01 in prospective or contingent debt (made up of unpaid GST and the associated UOMI (use-of-money interest) on the sale of a property and on insurance proceeds).

The Court also stated that the $280,000 the Commissioner had lent to the interim liquidators of CPL was to be taken into account as an established debt of CPL.

Resulting debt figures

For the purposes of assessing CPL's solvency or insolvency the Court recognised the established debt figure of $1,400,566.15 and that the Court could take into account the figure of $307,389.01 for contingent or prospective debts.

Solvency

The Commissioner relied upon the presumption of insolvency under s 287 of the Companies Act 1993 as CPL had failed to comply with the statutory demand.

The Court noted that it is established that the s 241(4)(a) test of ability to pay debts involves primarily a "cashflow" test of solvency to be contrasted with the "balance sheet" test of solvency. Ms Sisson pleaded that CPL is balance sheet solvent.

The Court found that asset realisation in due course might achieve funds of $1,109,314.77 for CPL. However, this fell short of the established debt of CPL to the Commissioner, being $1,400,566.15. It was still further short of the figure including contingent and perspective indebtedness of $1,707,955.16, which includes $307,389.01 which the Court may take into account in assessing CPL's insolvency.

The Court held the CPL clearly is not balance sheet solvent. Even were there to be made available to CPL further time to realise its two remaining assets, the realisations would not enable CPL to clear its indebtedness. This is not a case where there has been a temporary lack of liquidity. The lack of liquidity has been longstanding and cannot be resolved through realisation of assets. Ms Sisson was unable to rebut the presumption the CPL is unable to pay its debts

The Court's discretion

The Court could not determine any basis upon which the Court might now appropriately refuse to make an order liquidating this company which for a long period has not been trading and is substantially insolvent. Accordingly, it ordered the liquidation of CPL.

Commissioner wins tax avoidance case against Cullen Group Limited in the amount of $51.5m plus interest and penalties

Case	*Cullen Group Limited v The Commissioner of Inland Revenue* [2019] NZHC 404
Decision date	12 March 2019.
Act(s)	Income Tax Act 2004, ss BG 1, GB 1, NG 1, NG 5, NG 6, OB 1 & OD 7. Tax Administration Act 1994, s 108. Stamp and Cheque Duties Act 1971, ss 86G, 86H, 86I and 86J.
Keywords	"tax avoidance", "arrangement", "interest deductions", "AIL", "NRWT", "reconstruction", "time bar".

Summary

This matter concerned Cullen Group Limited's ("CGL") challenge to the Commissioner of Inland Revenue's ("the Commissioner") assessment that CGL avoided $59.5 million of non-resident withholding tax ("NRWT"). CGL had paid $8 million in approved issuer levy ("AIL"), leaving a shortfall of $51.5 million. CGL argued that the arrangement involved the restructuring of Mr Eric Watson's affairs in order to achieve certainty about his change of tax residency from New Zealand to the United Kingdom

and to plan for application of the United Kingdom's laws governing remittance of foreign-sourced income. In finding for the Commissioner, the Court did not consider the arrangement was within the contemplation and purpose of Parliament in enacting the AIL regime. It had a more than merely incidental purpose or effect of altering the incidence of tax and was a tax avoidance arrangement which was void against the Commissioner.

Impact

This decision reaffirms the law on tax avoidance as set out in the Supreme Court's decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*"). It further reconciles the minority and majority decisions in *Ben Nevis* regarding the interplay between the use of specific tax provisions and, for the general anti-avoidance rule in s BG 1 of the Income Tax Act 2007 ("the ITA"), Parliament's contemplation of how those provisions should be used.

Facts

Mr Watson moved from New Zealand to the United Kingdom in 2002. He was concerned to ensure his "permanent place of abode" for tax purposes changed from New Zealand to the United Kingdom.

On 13 November 2002, Mr Watson restructured his ownership of Cullen Investments Ltd ("CIL"). The key steps were:

- Mr Watson sold his shares in CIL to CGL, at a rounded value of $193m, being $291m less his previous shareholder advances of $98m. The purchase price of $291m was accepted as at market value.
- CGL's purchase of the shares was funded by a vendor loan from Mr Watson of $193m (Loan A). Mr Watson also lent CGL $98m (Loan B) which CGL on-lent to CIL so that CIL could repay Mr Watson's shareholder advances.
- Mr Watson assigned Loans A and B to two conduit companies in the Cayman Islands, Modena Holdings Ltd (Modena) and Mayfair Equity Ltd (Mayfair) with back to back loans of $193m (Modena Loan) and $98m (Mayfair Loan) to Modena and Mayfair.

The effect of all of this was that CGL owned CIL, CGL owed $193m to Modena and $98m to Mayfair, Modena owed $193m to Mr Watson and Mayfair owed $98m to Mr Watson. Effectively, instead of owning shares in CIL, Mr Watson held loans for the same value to CGL through Modena and Mayfair; he had exchanged equity for debt.

The terms of Loans A and B from Mr Watson to the CGL (which he assigned to Modena and Mayfair) included:

- Modena and Mayfair could only request repayment a loan, or part thereof, from CGL if Mr Watson had demanded repayment of the corresponding Modena or Mayfair loan. Modena or Mayfair's demand to CGL was to be contemporaneous with, and not exceed the amount specified, in Mr Watson's demand to Modena or Mayfair.
- Interest was payable at 16% per annum. The Court accepted this reflected an arms' length arrangement.
- CGL could not assign or transfer its rights or obligations under the loans. Mr Watson, as lender could assign his rights but any other lender, including Modena and Mayfair, could only assign them back to Mr Watson or with his agreement.
- CGL was to register each loan with the Commissioner as a registered security for AIL purposes and make payment of AIL to the Commissioner.

Modena and Mayfair entered into a memorandum of understanding with CIL in December 2002 under which their directors delegated to CIL employees the power to effect transfers of funds from Modena's and Mayfair's BNZ accounts to Mr Watson's BNZ accounts. Further, when CIL sought the consent of third party financiers, CIL stated "[t]he change is an internal reorganisation and has no practical effect on the control of Cullen and its group companies".

When the arrangement was unwound, Mr Watson demanded repayment from Modena (then owing $587.5m) and Mayfair (then owning $140.9m) and Modena and Mayfair assigned Loans A ($587.5m) and Loan B ($140.9m) to Mr Watson. Mr Watson made demand on CGL for repayment of Loans A and B. CGL entered a deed setting off the loans in return for issuing non-voting redeemable preference shares, redeemable at the holder's option and with no dividend payable. Mr Watson transferred the preference shares to Novatrust Ltd, a professional trustee company in Jersey, as trustee for the Summit Trust, funded by loan agreements with Mr Watson for $728.4m ($587.5m + $140.9m) with the shares in CGL used as security.

CGL applied for approved issuer status and registered Loans A and B as registered securities. From March 2003 to November 2008, CGL paid AIL of 2% on the $397m interest it paid, or credited in account, to Modena and Mayfair, amounting to just over $8m.

In 2010, the Commissioner assessed CGL for NRWT at 15% on the $397m interest, amounting to around $59.5m. Offsetting the $8m of AIL already paid, the resulting tax liability was around $51.5m and CGL challenged the NRWT assessments in the High Court.

Decision

As a preliminary point, the High Court ruled that evidence from CGL's experts responding to positions of the Commissioner earlier in the dispute process (rather than the Commissioner's expert briefs exchanged in the challenge) and proposed evidence about the legal effect of a Double Tax Agreement (DTA) on the New Zealand withholding tax rate, being legal submissions, were inadmissible.

The Court noted that the general approach to construing specific tax provisions and the general anti-avoidance provision in New Zealand tax law is now well-settled. The leading authority is *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 389. Relevant to this case, and bearing in mind that the burden of proof is on the taxpayer, the three requirements for tax avoidance are:

- The arrangement uses, and falls within, specific tax provisions.
- Viewed in light of the arrangement as a whole, the taxpayer has used the specific provisions in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision.
- The arrangement has a purpose or effect, that is more than merely incidental, of altering the incidence of tax.

The Court set out the arrangement at paragraph [39] and the parties agreed that the arrangement fell within the specific provisions of the ITA and the Stamp and Cheque Duties Act 1971 ("SCD") in relation to NRWT and AIL. The Court set out the law on NRWT, AIL and s OD 7 of the ITA 1994 (the relevant associated person section at the time of the arrangement). The Court queried whether CGL and Modena or Mayfair may be associated under the "control by any other means" subsection, which potentially encompasses control in terms of economic substance, but accepted that the Commissioner was bound by her pleadings that CGL was not, legally, an associated person of Modena or Mayfair.

The Court then considered whether the specific tax provisions were used in a way which cannot have been within Parliament's contemplation. This case raised directly the question of the difference between a purposive interpretation of specific tax provisions and Parliament's contemplation of how those provisions should be used. For there to be tax avoidance, the arrangement must fall within the meaning of the provisions, construed in light of their purpose, but outside the way in which Parliament contemplated they be used.

Judicial understanding of Parliament's purpose in enacting the legislation informs but does not substitute for judicial interpretation of the words Parliament enacted. The "parliamentary contemplation" stage of the s BG 1 tax avoidance inquiry is wider than simply a purposive interpretation of the text of specific provisions. It is important that it is the "use" of specific provisions and this is an "intensely factual" exercise, focusing on how the arrangement has used, or deployed, the specific provisions. Viewed objectively, in a commercially and economically realistic way, is that use consistent with Parliament's purpose or contemplation? Artificial and contrived structuring of an arrangement is a "classic indicator" that the use is not consistent with Parliament's contemplation.

The Court found that there was no doubt the arrangement here involved highly complex and contrived ownership structures that would not be found in arms' length relationships. Neither the lender nor the borrower was independent here. Mr Watson exchanged equity in CIL for debt owed by CGL back to him ultimately. The level of control that Mr Watson had was usually an incident of ownership of equity, not debt. The ownership and debt relationships were structured in such a way as to allow Mr Watson, through CGL, to pay AIL at 2% rather than NRWT at 15%.

After traversing the background of the AIL regime, introduced in the 1991 Budget Night amendments, the Court agreed with the Court of Appeal, High Court and TRA in *Vinelight Nominees Ltd v Commissioner of Inland Revenue* that the objective of the AIL regime is to encourage investment in New Zealand by reducing the cost of New Zealand residents borrowing from non-residents. The Court accepted the expert evidence that no new funds were introduced into New Zealand by the arrangement and, objectively, viewed in light of the arrangement as a whole, CGL used the specific provisions in a way that cannot have been within the contemplation and purpose of Parliament when it enacted the provisions.

The Court concluded that payment of AIL was a key element of Loans A and B and altering the incidence of $51.5m of tax was not merely incidental. Here, the Commissioner was entitled to make her assessment on the basis that CGL was liable to pay NRWT and did not need to exercise her reconstruction discretion under s GB 1 of the ITA.

The Court also found that the NRWT rate should not be 10% (the NRWT rate under the New Zealand / UK DTA) nor were the assessments timebarred.

Accordingly, the Court dismissed CGL's challenge and upheld the NRWT assessments for $51,496,127.38 plus use of money interest and penalties.

Supreme Court dismisses application for leave to appeal

Case	*Gerardus Peter van Uden v Commissioner of Inland Revenue* [2019] NZSC 29
Decision date	19 March 2019
Act(s)	Income Tax Act 1994, Income Tax Act 2004, Tax Administration Act 1994
Keywords	"general or public importance", "commercial importance", "miscarriage of justice", "permanent place of abode"

Summary

This was an application for leave to appeal to the Supreme Court on the basis the Court of Appeal did not apply the principles set out in *Commissioner of Inland Revenue v Diamond* [2015] NZCA 613 ("*Diamond*") to Mr van Uden's case. In addition, Mr van Uden challenged decisions about taxation of his employer's superannuation fund; whether the reassessment was properly made given the position of the officer who made it; and, as to the penalties imposed. The Supreme Court dismissed the application as there was no matter of general or public importance or general commercial significance or miscarriage of justice.

Impact

The decision confirms that the Supreme Court will not give leave to appeal unless it is satisfied it is necessary in the interests of justice to hear and determine the appeal.

Facts

Mr van Uden is a sea captain employed by a foreign shipping company. He has worked at sea for over 40 years. The Commissioner of Inland Revenue ("the Commissioner") assessed Mr van Uden as liable for New Zealand Income tax for the 2005 to 2009 tax years on the basis Mr van Uden had a permanent place of abode in New Zealand for those tax years and was liable to pay tax in New Zealand on his worldwide income. In addition, a 10 percent penalty was imposed because Mr van Uden, in not returning his income on that basis, had taken an unacceptable tax position.

In upholding the decisions of the High Court and the Taxation Review Authority ("the TRA") on the question of Mr van Uden's permanent place of abode, the Court of Appeal concluded that Mr van Uden had made the relevant property his home. The Court considered the "individual factors listed in *Diamond* support this conclusion". These included matters such as household expenditure.

The Court of Appeal then dealt with whether Mr van Uden's interest in his employer's non-contributory superannuation fund ("the Provident Fund") would constitute an interest in a foreign investment fund ("FIF") which was accordingly taxable on the basis of the accrual rules. The Court rejected the argument made on behalf of Mr van Uden that because the contributions to the Provident Fund were paid by his employer there was no "cost or expenditure incurred by or on behalf of Mr van Uden" as regards that Fund. The Court of Appeal concluded the employer was acting on Mr van Uden's behalf in making the contributions.

The Court of Appeal also rejected the challenge made to the process followed by the Commissioner in removing the time bar that applied to the assessment for the 2005 to 2008 tax years. The issue was whether the relevant officer acting under delegated power had made the necessary factual reassessment. The Court of Appeal upheld the finding of the High Court that the delegate had expressly exercised the delegated power.

Finally, the Court of Appeal rejected Mr van Uden's submission he should not have been liable for shortfall penalties under s 141B of the Tax Administration Act 1994.

Decision

The Supreme Court found that at some point the Court may wish to revisit the *Diamond* test, but the present case, where no issues as to that test arise, does not provide an appropriate opportunity for that. The proposed ground of appeal raises no point of general or public importance, nor any matter of general commercial significance. Nor is there an appearance of a miscarriage of justice. Rather, Mr van Uden in this respect would seek to revisit concurrent findings in the TRA, the High Court and the Court of Appeal. Further, the *Diamond* factors were seen as simply supporting the Court of Appeal's conclusion, not determining it.

The Court found that the other three proposed grounds raise no questions of general or public importance or of general commercial importance. The outcome on these matters rested on the particular factual circumstances.

Taking first the proposed ground relating to the FIF rules, the Court found that the applicant's concern arises from the Court's assessment of the particular facts in light of the direction in s CG 15(2)(d) of the Income Tax Act 1994 ("ITA 1994") that the cost be incurred "by or on behalf of the person". The second question, whether the person with the delegated powers undertook the reassessment so that the time bar was lifted is similarly fact- specific. Finally, the Court of Appeal in concluding shortfall penalties were payable applied the relevant principles from this Court's decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 2289 at [181]-[203].

The Court found no appearance of a miscarriage of justice arising from the Court of Appeal's approach to these matters. In terms of the first proposed ground of appeal, s CG 15(2)(d) of the ITA 1994 provides that expenditure incurred by "or on behalf of" the person is covered. Nothing raised by the applicant in relation to the proposed second ground calls into question the approach taken in the Courts below. On the last of the proposed grounds, nothing raised by Mr van Uden indicates there is a risk of a miscarriage of justice arising from the application of the principles in *Ben Nevis*.

In relation to Mr van Uden's submission that he has not had access to justice, the Court found the matters he wishes to raise have all been considered by the Courts below. The Court concluded it is not necessary in the interests of justice to hear and determine the proposed appeal.

High Court clarifies when Commissioner's Notice of Response is due following s 89K decision

Case	*Peter William Mawhinney as Trustee of the Doug Vesey Trust v Commissioner of Inland Revenue* [2019] NZHC 553
Decision date	25 March 2019
Act(s)	Goods and Services Tax Act 1985 Tax Administration Act 1994 – ss 89AB, 89AC, 89D(5), 89H(2), 89K, 138P Taxation Review Authorities Act 1994 – s 26A Interpretation Act 1999 – ss 7, 18
Keywords	"deemed acceptance", "response period"

Summary

The Commissioner of Inland Revenue's ("the Commissioner") Notice of Response ("NOR") was filed within two months of the decision by the Taxation Review Authority ("the TRA") that the Commissioner should have accepted the Doug Vesey Trust's ("the Trust") Notice of Proposed Adjustment ("NOPA") out of time pursuant to s 89K of the Tax Administration Act 1994 ("the TAA"). In her judgment, Peters J upheld the finding of the TAA that the Commissioner's NOR was filed in time and there was no deemed acceptance of the Trust's NOPA.

Impact

The judgment makes it clear that both prior to and subsequent to the amendments to ss 89AB and 89AC of the TAA, the Commissioner's NOR is not required until two months after the conclusion of s 89K challenge proceedings. There is no valid NOPA until the hearing authority determines that the Commissioner should have accepted a taxpayer's NOPA out of time. The Commissioner is not required to issue a "protective" NOR in these circumstances.

The judgment also clarifies that, pursuant to s 138P(2), where the disputable decision is not an assessment, the hearing authority's powers are limited to directing the Commissioner to alter her decision, i.e. in this case to issue a s 89K(1) notice.

Facts

A GST return was filed by the Trust on 5 November 2008 for the period ended 31 October 2008, claiming a refund of $625,000.

On 16 April 2013, the Commissioner issued a Notice of Assessment ("NOA") in respect of that return. She assessed the refund due for the period as "nil".

In order to be within the four month response period the Trust was required to issue a NOPA in response by 16 August 2013. A NOPA was not issued until 30 March 2015 but was accompanied with a request under s 89K that the Commissioner accept the NOPA out of time.

By letter dated 29 April 2015, the Commissioner notified the Trust that she refused to accept the NOPA and that, as a consequence, the Trust was deemed to have accepted the Commissioner's NOA.

In May 2016 the TRA held that the Commissioner ought to have not refused the Trust's late NOPA and set aside the Commissioner's refusal. The Commissioner then issued a NOR within two months of the TRA's decision.

This led to the second hearing before the TRA, and ultimately to this appeal. The Trust contended that the Commissioner's NOR was out of time and, by s 89H(2), the Commissioner was deemed to have accepted the Trust's NOPA and must refund the GST claimed.

Amendments to ss 89AB and 89AC of the TAA came into force on 24 February 2016 ("the amendments"). In the decision under appeal the TRA held the amendments applied and were determinative of the issues. The appellant contends they did not apply.

Decision

Response Period

The appellant's NOPA was of no effect when it was issued on 30 March 2015 (s 89D(5), TAA).

Section 138P(2) permits the TRA, if it upholds a challenge, to direct the Commissioner to alter her decision – for example to direct the Commissioner to issue a s 89K(1) notice – and the Commissioner must do so. Accordingly, even on a successful challenge under s 89K(6), the most the TRA may do is direct the Commissioner to issue a s 89K(1) notice. Her Honour held that the notice will be in the same terms and the same effect as one given by the Commissioner of her own volition. That is, it is that notice which renders the late-filed document effective and it does not matter that the notice may be issued under a direction from the TRA or the High Court. Therefore, a late filed document becomes effective when the 89K(1) notice is issued and that the time starts to run against the Commissioner from then and not before.

Her Honour held that there is no relevant statutory provision which suggests that the

Commissioner should issue a NOR "just in case" a taxpayer brings a successful challenge to her refusal. She added that there is no good reason to require the Commissioner to devote resources to issuing a NOR that might not be required and that there was no prejudice to a disputant in allowing the challenge procedure to run its course before requiring the Commissioner to take a further step.

The applicable response period for the Commissioner's NOR did not start to run prior to the TAA's decision in May 2016, and was issued in time.

Did the amendments apply?

The Judge held that although the words of s 89AC(b) do not reflect the procedure in s 138P(2),the meaning is clear enough. Time starts to run from the date the TRA upholds the challenge or the Commissioner concedes.

The Judge did not accept the appellant's arguments that as the Trust's dispute commenced before the amendments were passed, that they did not apply. She held that the commencement section of the legislation and the commencement provisions for other amendments to Part 4A of the TAA, make it clear that the amendments were to be applied to all, as yet, undetermined disputes.

Taxation Review Authority clarifies the meaning of "stop" in s EC20

Case	*TRA 004/18 and TRA 005/18* [2019] NZTRA 2
Decision date	29 March 2019
Act(s)	Income Tax Act 2007, s EC 20
Keywords	"stop" "specified livestock"

Summary

The Tax Review Authority ("the TRA") concluded that the use of the phrase "stops deriving income from the sale of specified livestock" in s EC 20 of Income Tax Act 2007 ("the ITA") is to be read as requiring a permanent stop. A "stop" for one income year is not sufficient to be able to use the livestock valuation provisions in s EC 20.

Impact

This decision clarifies the position that a taxpayer must stop deriving income from the disposal of specified livestock permanently to use the process for valuing herd livestock in s EC 20 of the ITA.

Facts

The taxpayers are trusts that operated in a partnership. The trustees were "Mr and Mrs Smith" and their accountant, "Mr Brown". The taxpayers owned a herd of dairy cows which they milked on the "XY Trust No 2" farm. They also owned 4 hectares of land on which they raised jersey bull calves. The dairy herd was sold on 1 June 2012 and the jersey calves in September and October 2012 (i.e. in the 2013 tax year) and as at 1 November 2012, the taxpayers did not own any specified livestock. Mr and Mrs Smith personally purchased 18 jersey bull calves on 11 December 2012, which were kept on the 4 hectares of land owned by the taxpayers.

On 29 November 2012 the accountants for the taxpayers wrote to the Commissioner advising that the partnership had ceased farming and that they elected to use the 2012 National Average Market Values ("NAMVs") under s EC 20 of the ITA to calculate their 2013 livestock income.

In the 2014 and 2015 tax years, the taxpayers purchased further jersey bull calves, keeping and raising them on their 4 hectare property.

It was accepted that between 1 November 2012 and 31 May 2013, the taxpayers (the trusts) did not own any livestock so had stopped deriving income from the disposal of specified livestock in the 2013 tax year (only). It was also accepted that that the taxpayers derived income from the disposal of specified livestock in the income years subsequent to the 2013 tax year.

On 5 September 2013, the taxpayers filed their 2013 income tax returns using the 2012 NAMVs. The 2013 NAMVs were lower than the 2012 NAMVs and the effect of using the 2012 NAMVs was a deduction for opening stock of $1,160,612 rather than $993,490 if the 2013 NAMVs were used.

The challenge concerned the ability for the taxpayers to use the 2012 NAMVs to value their livestock in the 2013 tax year under section EC 20 of the ITA.

Decision

A person is allowed a deduction for the property on hand at the start of an income year under s DB 49 of the ITA and the value of the property at the end of income year is income under s CH 1. Subpart EC of the ITA sets out the valuation of livestock that is deducted under s DB 49 and is the relevant subpart to this challenge. The usual rule, under s EC 2, is that opening value of stock is the closing value from the previous year.

The herd scheme is a valuation method that values each type of livestock on the basis of the NAMVs. The scheme treats livestock as a capital asset, despite its similarity to trading stock. The taxpayers used the herd scheme valuation method.

Section EC 16 of the ITA provides the method for valuing livestock under the herd scheme. It modifies the effect of s EC 2 so that rather than the opening value of the stock in a given year being the same as the closing value from previous year, the opening value equates to the closing value in the same year. The effect of this is that, under the herd scheme, any movements in herd values over the year are not subject to income tax and no deductions arise.

However, the situation changes again if s EC 20 applies. In that case, there is no revaluation of the opening value under s EC 16(3) (revaluating it to the closing value for the same year). Instead, if s EC 20 applies, the opening value of the livestock is the closing value from the previous year.

The taxpayers submitted that the interpretation of s EC 20 was a matter of first principles and the purpose of the provision was to enable farmers to obtain certainty as to their income tax requirements.

The Commissioner submitted that whilst the dictionary definition of "stop" indicates that deriving income from the disposal of specified livestock has come to an end or been discontinued, there remains an ambiguity as to whether the disposal of livestock has come to an end in a single year or permanently. Having regard to the immediate and general legislative context, the social, commercial or other objectives of the enactment and the legislative history, parliamentary debates, and reports, the Commissioner submitted that a taxpayer must stop deriving income from the disposal of specified livestock permanently in order to satisfy the requirements of s EC 20.

The TRA adopted the comprehensive analysis of the legislative history of s EC 20 provided by the Commissioner, including extrinsic material (such as Officials Issues Papers) and set this out.

The TRA did not accept that the meaning of the section was plain on its face, and agreed with the Commissioner that the meaning of "stops" was not clear whether it meant comes to an end in a single year or permanently. Where the plain and ordinary meaning of the text is not clear, it is necessary to determine the meaning most consistent with the context and purpose

of the provision. It is apparent from a review of the legislative history and extrinsic material that the purpose of s EC 20 was "to help remove delays on windup" for farmers who "cease farming" and allow them to use the previous year's herd values in their accounts, rather than being "forced to wait until the market values are released for that year before commencing wind up".

There was no change in meaning with the introduction of the word "stops" instead of "ceases" in s EC 20 in the Income Tax Act 2004 and that the section does not include the word "permanently" is not determinative. In the TRA's view, the context and purpose of s EC 20 clearly supports the interpretation that the farming activity is to be stopped permanently.

Contrary to the taxpayers' submission that a farmer could not predict whether the NAMVs would advantage or disadvantage the famer, the TRA agreed that the issue was identified as a problem in the extrinsic material and, here, the taxpayers "had a fair idea" what the 2013 NAMVs were likely to be. The position taken by the taxpayers was tantamount to "cherry picking" which NAMVs to apply and was completely in contradiction to the measures taken by Parliament to eradicate "flexibility of the rules being inappropriately used".

The TRA was satisfied that s EC 20 is to be read as meaning that for the section to apply, the taxpayer must stop deriving income from the disposal of specified livestock permanently. Here, as the taxpayers did not permanently stop deriving income from the disposal of livestock, they were not able to use the 2012 NAMVs under s EC 20. The TRA dismissed the challenge and upheld the Commissioner's assessments using the 2013 NAMVs.

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