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# 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.taxtechnical.ird.govt.nz** (search keywords: public consultation).

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

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

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

| Ref | Draft type | Title | Comment deadline |
|---|---|---|---|
| ED0231 | Operational statement | Excusing estates from filing income tax returns | 7 July 2021 |
| PUB00390 | Interpretation statement | GST – definition of a resident | 9 July 2021 |

# IN SUMMARY


## New legislation

**Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021** 3

The new legislation includes measures to:

- allow businesses to claim greater deductions for feasibility expenditure
- loosen the loss continuity rules
- extend the bright-line test, and
- require consistent allocation of the purchase price of property in an asset sale.

**Order in Council – LI 2021124** 132

**Tax Administration (Direct Credit of Problem Gambling Levy Refunds) Order 2021**

An Order in Council was made to include refunds of the problem gambling levy as a tax type refundable by direct credit under section 184A of the Tax Administration Act 1994.

## Ruling

**BR Prd 21/03: Zap NZ Limited** 133

This ruling concerns the application of the GST voucher rules to the Zap NZ Limited digital gift card and loyalty scheme. Under the scheme, customers purchase Zap, which Zap holders can redeem for goods or services supplied by participating retailers.

## Question we've been asked

**QB 21/04: When an employer is party to an employee share scheme, when does an employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arise?** 136

This question we've been asked is relevant to any employer who is party to an employee share scheme where the employee receives a benefit under the scheme within 20 days of: the end of the employer's income year; or a breach of shareholder continuity in the employer (for example, due to an employee share scheme winding up as a result of an acquisition).

## Interpretation statement

**IS 21/03: GST – Registration of non-residents under section 54B** 140

Section 54B of the Goods and Services Tax Act 1985 allows non-resident businesses that do not make supplies to end consumers in NZ to register for GST and recover GST input tax on goods and services acquired in NZ. Since it was introduced, there have been legislative changes that treat certain supplies by non-residents as being made in NZ, including the supply of remote services and low value goods. This means a greater number of non-residents must register under the standard registration provision and fewer non-residents are eligible to register under s 54B. This item provides guidance on whether a non-resident is eligible to register under s 54B.

## Operational statements

**OS 21/01: Income tax treatment of accommodation provided to employees** 162

This statement is intended to clarify and simplify the tax rules around employer-provided accommodation.

**2021 CPI adjustment to Operational Statement OS 19/03: Square metre rate for the dual use of premises** 175

This update to OS 19/03 shows the annual adjustment to the square metre rate for the dual use of premises.

**Kilometre rates for the business use of vehicles for the 2021 income year** 175

The table of rates for the 2020/2021 income year for motor vehicle expenditure claims.

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## Determinations

**National Average Market Values of Specified Livestock Determination 2021** 176

This determination establishes the national average market value (NAMV) of specified livestock for 2021.

**Determination FDR 2021/02: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method** 179

Any investment by a New Zealand resident investor in the NZD Hedged Accumulation Class Z-Shares of the Colchester Global Bond Enhanced Currency Fund is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest.

# 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 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021

On 30 March, the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 was granted Royal assent and passed into law.

The new legislation includes measures to:

- allow businesses to claim greater deductions for feasibility expenditure
- loosen the loss continuity rules
- extend the bright-line test, and
- require consistent allocation of the purchase price of property in an asset sale.

### Feasibility expenditure

*(Sections CH 13, DB 66 and DB 67 of the Income Tax Act 2007)*

The Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 contains changes codifying when businesses can deduct expenditure over five years related to completing, creating or acquiring property (business assets) that is later abandoned. Immediate deductions are also available for such expenditure that in total is $10,000 or less in an income year. Together, the changes are intended to set out the circumstances when expenditure can be deducted for property that but for abandonment would have been depreciable property or revenue account property.

The rules complement the current tax depreciation rules in situations when property is abandoned and not completed.

Deductions for expenditure in relation to abandoned property are clawed back as taxable income if the property is subsequently completed, created or acquired. This effectively puts a taxpayer in the position that they would have been in if they had never abandoned the property.

Taxpayers may be able to obtain certainty on the tax treatment of feasibility expenditure (including for abandoned and completed property) incurred in particular arrangements by applying for a ruling from Inland Revenue's Tax Counsel Office.

#### Background

From a policy perspective, the economic value of business expenditure that is expected to decline in value should be either immediately deductible or, when it provides an enduring benefit, deductible over time if that benefit declines over time. When the tax system does not provide for that treatment, an economic distortion is created.

An example of this distortion arises with feasibility expenditure incurred by taxpayers to determine the practicability of a proposal to acquire or create property that will decline in value over time. The Income Tax Act 2007 generally denies immediate deductions for expenditure when it has a connection with property that has the potential to yield future economic benefits beyond the current income year. If the expenditure is required to be capitalised and the property is not completed, the expenditure is not recognised for tax depreciation purposes and is unable to be deducted for tax purposes, resulting in what is referred to as "black hole" expenditure. This creates an incentive for businesses to complete capital projects that would otherwise be abandoned.

The non-deductibility of this expenditure effectively raises the cost of risky investments in new property (where the chance of a viable outcome is uncertain) and therefore can act as a barrier to businesses committing resources to developing new property – which is important to innovation and driving productivity improvements.

The new rules are intended to sit alongside the Income Tax Act's rules for tax depreciation and Inland Revenue's interpretation statement IS 17/01[1] for businesses that regularly incur feasibility expenditure.

[1] Interpretation statement IS17/01: Deductibility of feasibility expenditure. Tax Information Bulletin Vol 29, No 3 (April 2017) available at **www.taxtechnical.ird.govt.nz/tib/volume-29---2017/download-tib-vol29-no3**

The amendments respond to private sector concerns following the 2016 decision by the Supreme Court in *Trustpower Limited v Commissioner of Inland Revenue*,[2] which limited the deductibility of expenditure incurred on property that is subsequently abandoned. The rules reduce tax barriers for businesses seeking to invest in new property, by providing greater deductibility of expenditure where it relates to property that is abandoned.

The amendments do not give tax deductions for expenditure related to property that is not expected to decline in value, such as land, goodwill and shares. While property that is not expected to decline in value sometimes does, it would only be appropriate to provide deductions for this expenditure if the tax system taxed gains in property that appreciated.

The amendments do not alter the rules that exist for:

- tax depreciation (although the rules do allow immediate deductions in some circumstances if the expenditure is less than $10,000 – this is explained in more detail below)
- company administration costs
- costs incurred in the course of abandoning property
- research and development
- resource consents
- unsuccessful software projects
- patents
- plant variety rights.

The amendments also do not affect the application and effect of the general permission test relating to deductions. This is explained in more detail below under "Detailed analysis".

### Key features

Section DB 66 allows taxpayers to deduct expenditure incurred in relation to making progress towards completing, creating or acquiring property if:

- the property would be:
  - depreciable property, including depreciable intangible property, or
  - revenue account property
- progress on the property is abandoned with the outcome that the property is not completed, created or acquired, and
- no deduction for the expenditure is allowed under any other provision in the Act.

The deduction does not apply to expenditure on certain items, such as land, shares and goodwill.

Deductions meeting the conditions above can be spread in equal proportions over a five-year period starting in the income year the property was abandoned (section DB 66(2)). However, there is no entitlement to any remaining portions of the deduction if the abandoned property is completed, created or acquired within the five-year spreading period.

Section DB 67 allows an immediate deduction in the income year for expenditure incurred in relation to making progress towards completing, creating or acquiring property if the total expenditure incurred in an income year that could be subject to this provision is $10,000 or less and:

- the expenditure is related to depreciable property or revenue account property, and
- no deduction for the expenditure is allowed under any other provision in the Act.

As is the case with section DB 66, new section DB 67 does not allow a deduction for certain items, such as land, shares or goodwill.

Given that section DB 67 allows immediate deductions if the expenditure is less than $10,000 (even if the property has not been abandoned), this rule will in some circumstances override the general depreciation rules. This is explained in more detail below under "Detailed analysis".

The expenditure under both sections must be incurred in relation to making progress towards completing, creating or acquiring the property.

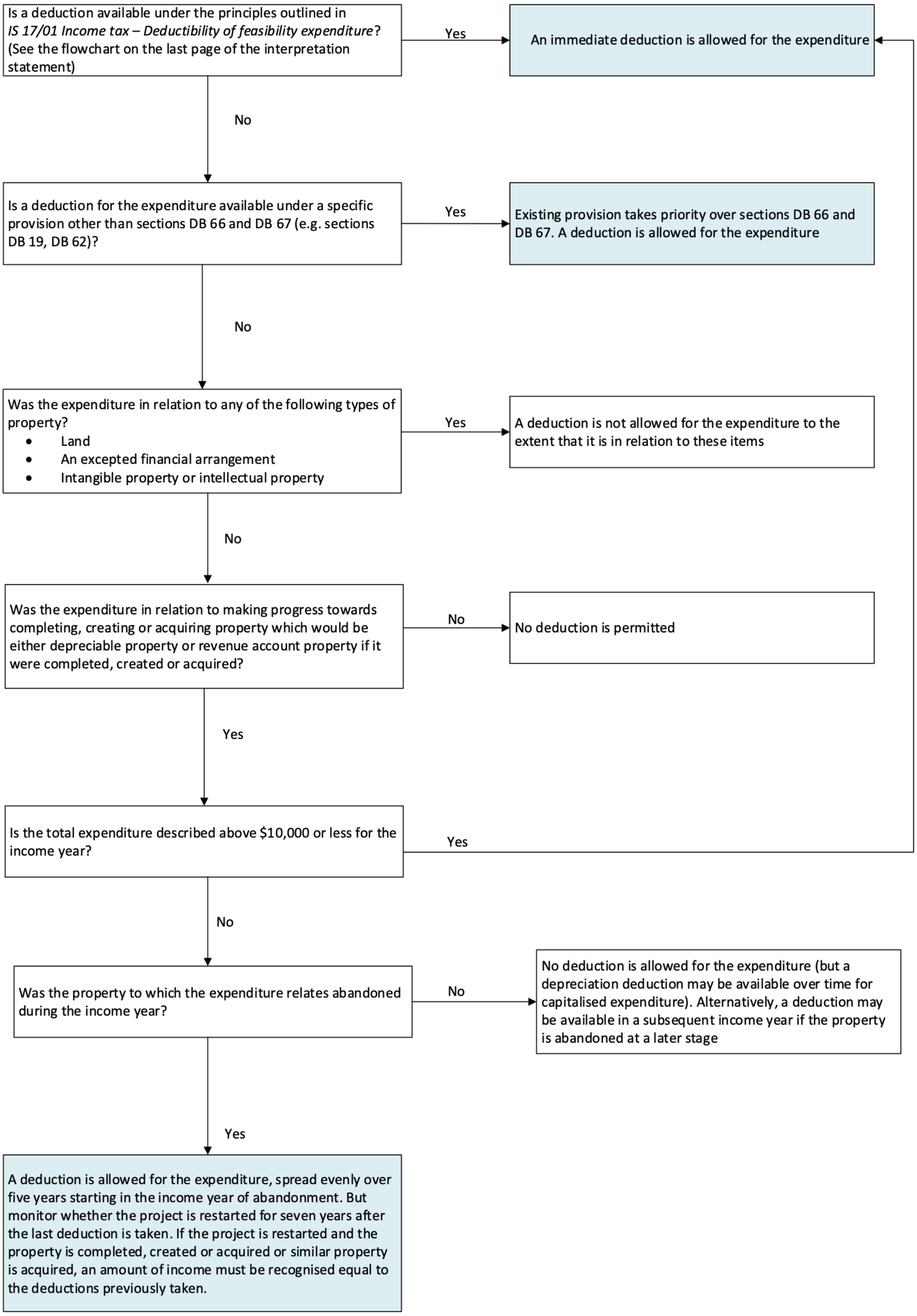
The amount of the available deduction is equal to the expenditure the taxpayer incurs related to making progress towards completing, creating, or acquiring property.

[2] SC 74/2015 [2016] NZSC 91.

For abandoned property that is later completed, created or acquired, new section CH 13 claws back the deductions allowed under section DB 66 by treating the amount deducted as income. The property may then be subject to the tax depreciation rules in subpart EE, or the revenue account property rules in section DB 23.

New sections DB 66 and DB 67 override the limitation for expenditure of a capital nature.

**Figure 1: Illustrates the application of the new rules**



## Application date

The amendments apply to qualifying expenditure incurred in the 2020-21 and later income years.

## Detailed analysis

### *Spread deduction rule for feasibility expenditure*

New section DB 66 is directed at expenditure incurred by taxpayers in relation to making progress towards completing, creating or acquiring property that is subsequently abandoned. The term "property" is defined by reference to property that if completed would be depreciable property, including certain types of intangible property, and/or revenue account property.

Progress will, generally, be considered to be abandoned when a decision has been made that no further progress will be undertaken to complete, create or acquire the property. For larger projects, such a decision will likely be documented by the taxpayer. However, for small businesses a decision to not proceed with the property may be reflected in that no further money has been applied to completing, creating or acquiring the property.

The available deduction is equal to the expenditure the taxpayer has incurred in relation to the abandoned property, which is not otherwise deductible under any other provisions of the Act. The intention is to permit a broad range of expenditures to be deducted, including direct costs that would ordinarily be considered to be the "cost" of depreciable or revenue account property, and expenses that have an indirect relationship with the property, such as administration or general overhead costs.

A deduction is not available for expenditure on acquiring property such as land, shares and goodwill in the course of developing another asset that is abandoned. This is because expenditure on such items is not typically associated with feasibility type activity but could potentially otherwise fall within the broad wording of the feasibility rules.

Deductions for the expenditure are spread in equal proportions (one-fifth) over a five-year period, starting in the year of abandonment. However, as discussed below, there is no entitlement to any remaining portions of the deduction if the abandoned property is subsequently completed, created or acquired before the five-year spreading period has expired.

**Example 1: When the new sections apply – wind studies**

Company A, an electricity generator, is exploring the practicability of establishing a new wind farm. It incurs expenditure in the 2020–21 income year associated with measuring wind frequency and speeds (anemology) relevant to the local geography. At the end of the 2021–22 income year, the studies regarding the site are inconclusive as to reliability of wind supply and the project is abandoned.

***Tax impact***

The anemology expenditure relates to the possibility of expanding the capital structure of the business and, as such, is capital expenditure. Regardless of whether or not this expenditure would have been included in the cost of the property for depreciation purposes had the property been completed, created or acquired, it will be deductible under section DB 66 to the extent that it does not relate to land or other property that is not depreciable property or revenue account property. This is because the expenditure was incurred after section DB 66 came into effect and made progress towards creating or completing property that, if it were created or completed, would have been depreciable property (wind turbines). The relevant expenditure will be deductible in equal parts over five years.

**Example 2: When the new sections apply – nanotechnology study**

Company B, a water management company, is working on ways to meet demand in times of low-aquifer inflows and drought, to prevent water restrictions. It is exploring the viability of desalination. The company carries out a number of studies on the practicability of building and operating a desalination plant, and researches how water from the plant could be connected to the wider network. Work on the project is abandoned after an assessment determines it is uneconomic, in terms of energy needs and water output, for the plant to meet forecast demand. The project is shelved pending future advances in desalination nanotechnology.

***Tax impact***

Under section DB 66, the collective desalination study expenditure will be deductible as the expenditure was incurred in relation to making progress towards creating property that, if it were completed, would have been depreciable property (water treatment plant and reservoir). The expenditure will be deductible in equal parts over five years.

**Example 3: When the new sections apply – design property rights**

Company C, an aeronautics company, has plans to redesign the cockpit and airframe canopy for a model of small single propeller aircraft. The redesign is intended to improve flight performance and pilot visibility for such purposes as aerial crop dusting.

The company incurs expenditure in costing the project and scoping initial airframe designs. The multi-year project is shelved when a competing overseas company brings a comparable (and cheaper) improved aircraft to the market.

***Tax impact***

The design expenditure would be deductible under section DB 66 except to the extent the expenditure is deductible under another provision (for example, if some of the design expenditure resulted in depreciable intangible property).

**Example 4: When the new rules will not apply – acquisition of shares**

Company D is seeking to diversify the range of products it provides to commercial clients. It initially considers either directly acquiring the products or acquiring the shares in another firm that is offering comparable products. However, a decision is made to explore acquiring the shares in the firm in order to retain the firm's existing staff, management and the client list built up by the firm. Company D subsequently incurs legal and other consulting expenditure in undertaking a due diligence of the firm. However, Company D's bid to acquire the firm is unsuccessful.

***Tax impact***

The expenditure connected with Company D acquiring the shares in the firm is not deductible under section DB 66 as it relates to the acquisition of shares (which are specifically excluded from the scope of section DB 66 as excepted financial arrangements).

**Example 5: When the deduction starts**

The finance team at Company E is considering the expenditure debited in its work in progress account after balance date for the 2020–21 income year. The expenditure includes a study directed at improving the energy efficiency of the company's plant. The finance team decides not to make any further progress on the energy efficiency work due to cash flow constraints. The abandoned work related to a potential refit of the company's premises for lighting and heating. Had the work been completed, the completed property would have been depreciable property (fitout). No further amounts had been spent on the project after balance date and the decision is made in the 2021–22 income year to abandon the project.

***Tax impact***

The expenditure would be deductible under section DB 66 given its relationship with depreciable property. A deduction of one-fifth of the expenditure can be made in the 2022 income tax return, being when a decision was made to make no further progress on the property, with the remaining deductions spread evenly over the next four years.

### *Application of general permission*

The new rules override the capital limitation, but not the general permission requirements. The general permission requires that the expenditure must have a connection to an existing business or income-earning process of the taxpayer in order to be deductible under the rules. In situations where the expenditure is incurred before any decision is made to enter into the business or income-earning activity, the expenditure will have been incurred too soon and will not be deductible. Similarly, where a business already exists, feasibility expenditure incurred in relation to a new business will still need to have sufficient nexus to the existing business. However, feasibility expenditure that is recurrent and incurred as part of the ordinary income-earning process of a business is likely to be deductible under the new provisions (if not already deductible under existing law in line with the principles in Inland Revenue interpretation statement *IS 17/01: Income tax – Deductibility of feasibility expenditure*).

The correct time for considering whether the expenditure satisfies the general permission is when the expenditure is incurred, not when the relevant property is abandoned.

**Example 6: Expenditure does not satisfy the general permission**

After being made redundant from her job as an architect, Willow decides to investigate starting her own architecture business. She spends $3,000 on market research, a consultant to put together a business plan, brochures and contacts former clients to compile a client database.

***Tax impact***

The expenditure incurred by Willow is not deductible under section DB 66 because it does not satisfy the general permission. The expenditure is merely preliminary to establishing a business or income-earning activity. At the time of incurring the expenditure, a business had not yet commenced.

**Example 7: Expenditure does not satisfy the general permission**

Company F, an operator of a coal mine, is considering becoming involved in a project to construct an aluminium smelter to which it can supply coal. Company F forms a consortium with two other companies and conducts a feasibility study to determine the construction and operating costs and to assess the environmental consequences of building and operating an aluminium smelter. The company also undertakes its own feasibility study of the project and engages various consultants to advise on matters such as industrial relations, finance, environmental issues and negotiating a joint venture agreement. However, the development does not proceed because the other two consortium participants withdraw from the project.

***Tax impact***

The feasibility expenditure incurred by Company F is not deductible under section DB 66 because it does not satisfy the general permission. No nexus exists between Company F's existing business and the smelter feasibility expenditure. The latter was incurred in creating a new business structure.



### *Apportionment*

Expenditure will be deductible under the rules only to the extent that it is connected with making progress towards depreciable or revenue account property. Where an amount of expenditure relates to a mixture of, for example, depreciable and non-depreciable property, then only a portion of the expenditure will qualify for a deduction under the rules.

The legislation does not specify a particular approach or methodology for how expenditure needs to be apportioned in these circumstances. This provides some flexibility to taxpayers in how they approach the apportionment exercise. Any fair and reasonable method of apportionment may be used.

Whether an apportionment is fair and reasonable will depend on the relevant facts and circumstances related to the expenditure. It is not necessary that the apportionment method applied be the most accurate, but it must reflect what an objective person would consider to be fair and reasonable in the circumstances. The method should reflect the contribution of the expenditure towards the relevant item of property. A method that could be considered fair and reasonable in some instances may be one based on estimates by qualified professionals of the values of respective in-scope and out-of-scope property at the time the property was abandoned. There may equally be other methods that can be applied that will provide a fair and reasonable apportionment.

Records that taxpayers would be expected to hold in support of their chosen apportionment method would include (but are not necessarily limited to) the following:

- Any records detailing what their plan was, in terms of what property they were looking to complete, create or acquire.
- Details of categories of expenditures that can be directly attributed to depreciable property, revenue account property, or property that is excluded from the scope of section DB 66.
- Categories of expenditures that relate to both depreciable property/revenue account property and property that is excluded from the scope of section DB 66.

The Inland Revenue interpretation statement *IS 17/01: Income tax – Deductibility of feasibility expenditure* notes that expenditure that is not directed towards a specific project or which is so preliminary as to not be tangibly progressing or materially advancing such a project will be on revenue account and therefore immediately deductible if the business regularly carries out feasibility studies. This being the case, it is expected that, by the time that tangible progress has been made on a specific capital project, the taxpayer will likely have a better understanding of the share of remaining costs between depreciable property and revenue account property, and property that is specifically excluded.

**Example 8: Deduction needs to be apportioned**

Company G, a manufacturer of various cleaning products, is seeking to acquire the intellectual property for an outdoor cleaning product produced by a competitor that is going out of business, along with any remaining stock of that product. After engaging a law firm to provide legal advice on the transaction, Company G makes an offer of $10 million for the intellectual property, including brand rights and the formulation or "recipe" for the product, and an additional $5 million for the remaining trading stock. However, Company G's offer is rejected as the manufacturer of the product receives a higher offer from a different competitor. Company G paid $33,000 for the legal fees.

***Tax impact***

A deduction for the legal fees is not available under section DB 62 (deduction for legal expenses) because the total amount of the expenditure on legal fees in the income year exceeds $10,000. Company G considers that a fair and reasonable allocation approach would result in a deduction of $11,000 (33 percent of the $33,000 it paid on legal fees related to the transaction) under section DB 66. This apportionment method is fair and reasonable in the circumstances because a third of the value of the transaction, had it been successful, would have been in relation to revenue account property.

A deduction is not allowed under section DB 66 to the extent that the expenditure relates to acquiring property that is not depreciable or revenue account property, such as intellectual property that is not fixed life intangible property.

An alternative apportionment methodology could be chosen by Company G if it was also fair and reasonable.

**Example 9: Company unsure whether it would have bought shares or underlying business assets**

Company H is considering purchasing either the shares in a competitor company or the underlying business assets of the company, 40% of the value of which comprises depreciable property and revenue account property. Company H incurs due diligence expenditure totalling $55,000 before committing to a decision as to whether to buy the shares or the underlying assets.

Based on the information gathered from the due diligence exercise, Company H determines that the respective prices the vendor is asking for the shares and for just the business assets are both too high, and so decides during the 2020–21 income year not to proceed with either option.

***Tax impact***

As Company H does not know whether it would have purchased the shares or the assets at the time it incurred the due diligence expenditure, a fair and reasonable apportionment method could involve 50% of the expenditure potentially within scope of section DB 66. This proportion is further reduced by 40% to reflect the proportion of assets within scope of the rules (that is, depreciable and revenue account property) to those outside the scope of the rules. As a result, Company H claims $11,000 ($55,000 × 50% × 40%) of expenditure under section DB 66 over a five-year period, commencing in the 2020–21 income year.

An alternative apportionment methodology could be chosen by Company H if it was also fair and reasonable.

### *Partial abandonment*

It is possible that a capital project may produce a number of distinct items of property that together achieve the overall objective of the project. In the process of developing the overall project, it is possible that some smaller items of property may be considered and abandoned even though the project as a whole is completed. Guidance on how to identify the relevant property can be found in *Interpretation Statement IS 12/03: Deductibility of Repairs and Maintenance – General Principles*.

If the costs that were incurred in exploring the viability of the abandoned property cannot be capitalised to the cost of depreciable or revenue account property resulting from the project and are otherwise not deductible, a deduction for the expenditure relating to the abandoned option may be available under section DB 66. As discussed above under "Apportionment", any deduction would be limited to the extent the expenditure relates to depreciable property or revenue account property, had it been completed.

**Example 10: Partial abandonment**

Company I needs to add a line to its network to transport power from Point A to Point F. The company incurs expenditure in investigating three different potential routes for the power line (A to B to F; A to C to D to F; A to E to F). The expenditure includes resource consent costs and legal fees of more than $10,000 for negotiations with landowners to acquire access rights to the land on the alternative routes via points B, C, D and E.

As a result of its investigations, Company I decides to proceed with a route from A to E to F and the two alternative routes (from A to B to F and from A to C to D to F) are abandoned.

***Tax impact***

Company I cannot take a deduction under section DB 66 for the resource consent costs. This is because a deduction for the resource consent costs is already available under section DB 19. Whether or not a deduction can be taken under section DB 66 for the legal fees relating to negotiations with landowners will depend on whether the access rights would have been fixed life intangible property and therefore depreciable property. If the access rights would have been fixed life intangible property if acquired and no deduction is otherwise available, Company I is entitled to a deduction under section DB 66 for the legal fees. Otherwise, a deduction is not allowed.



### *Immediate deduction for feasibility expenditure*

Section DB 67 works in a similar way to section DB 66, with modifications to reflect that section DB 67 is a compliance cost saving measure. That is, feasibility expenditure can be immediately deducted by the taxpayer if the total expenditure incurred is $10,000 or less in an income year. There is no requirement that the property be abandoned.

However, like the requirements of section DB 66, the expenditure must satisfy the general permission provisions and not be deductible elsewhere under the Act. Section DB 67 is not a replacement for tax depreciation for low-value assets. This means that a person who acquires an item of depreciable property must apply the depreciation rules from the year the property is actually acquired. A deduction for the cost of the property is not available under section DB 67 in this situation.

If the person had incurred expenditure in merely looking into purchasing the property, or started to make or construct the property but did not complete it within the income year so that it could then be depreciated, then a deduction for the expenditure would be available under section DB 67. In this situation, if the property is completed (resulting in an item of depreciable property), then any expenditure relating to the property that has previously been deducted under section DB 67 is excluded from the cost of the completed property for tax depreciation purposes.

**Example 11: When the deduction cannot be immediately claimed – depreciable property**

Retailer J acquires a secondhand vehicle to assist with deliveries. The vehicle and associated expenditure incurred during the income year totals $8,000.

***Tax impact***

The cost of the vehicle is not deductible under section DB 67 as the cost of the vehicle is deductible under the tax depreciation rules.

### *Only one deduction is allowed for the relevant expenditure*

Once a deduction is claimed under section DB 66 or section DB 67, no further income tax deduction is available for this expenditure. This is a function of the income tax rules, which do not allow more than one deduction for the same item of expenditure.

However, if expenditure has been effectively denied by the application of the clawback in section CH 13 (discussed below), it is intended that the expenditure may be subsequently deductible if it otherwise satisfies the requirements to be part of the cost of depreciable or revenue account property.

### *Clawback of deductions*

The feasibility expenditure rules include an integrity measure (referred to as the "clawback") that applies where previously abandoned property is subsequently created, acquired or completed.

The clawback is directed at situations where taxpayers may be incentivised to prematurely abandon work on property. For example, property may be partially abandoned to take advantage of the five-year deduction if this would accelerate the deductions that would have been allowed had the property been completed and depreciated. A further example is where the deductions under the feasibility rules would be greater than would otherwise be available under the tax depreciation rules if the property was completed.

The clawback applies in the income year that the abandoned property is completed, created or acquired. This also applies in the situation where the taxpayer subsequently acquires property that is similar to the abandoned property.

The effect of this measure is to put taxpayers into a similar tax position to where they would have been had they never abandoned the property.

The clawback in new section CH 13 deems an amount of income equivalent to the deductions previously taken under section DB 66 in relation to the property. The requirement to include as income amounts that were previously deducted does not apply to expenditure that has been immediately deducted under the $10,000 de minimis rule.

To minimise compliance costs and provide greater certainty to taxpayers, a seven-year time limit applies to the clawback. The seven-year time limit aligns with the general business record retention requirements in the Tax Administration Act 1994, starting in the year immediately following the income year for which the fifth and final deduction was taken under the rules. This means that the deductions are not clawed back if abandoned property is subsequently created or completed more than seven years after the income year to which the last deduction relates, or if the property or similar property is acquired more than seven years after that income year.



**Example 12: Previous deduction clawed back**

Company K, an electricity generator, regularly undertakes studies to determine the practicability of different power generating options. Following the initial study process many of the options will be shelved. However, some of these options may be reconsidered in the future and result in the creation of electricity generation assets.

One of these studies involves the creation of a wind farm in Gusty Hills, with work on the project abandoned in Year 1. Prior to abandonment, $10 million was expended on various fees. The $10 million incurred by Company K is deductible over a five-year period, starting in the year the project is abandoned. This results in equal deductions to Company K of $2 million in Years 1 to 5.

In Year 7 Company K decides to reinstate the wind farm project in Gusty Hills, with the property being completed in Year 9 using the information from the previous studies.

***Tax impact***

The clawback provision is triggered in the year that the relevant property is subsequently created, acquired or completed, being Year 9. In this case, the property was completed within seven years from the final year of deduction (that is, Year 5) under section DB 66. This means that Company K is required to return clawback income of $10 million in its Year 9 tax return. However, some of this expenditure may be deductible if it forms part of the cost base of depreciable property.

**Example 13: Previous deduction not clawed back – example 2 continued**

A decade after Company B's decision not to proceed with a desalination plant, population growth in the region and the need for greater water infrastructure has led Company B to restart its earlier work on nanotechnology. Development of the plant and reservoir begins and seven years later it is operational and connected to the wider water supply network.

***Tax impact***

The earlier deduction taken for the previous study is not clawed back as the property is completed more than seven years after the end of the income year in which the final deduction was taken under section DB 66.

### *Abandoned property subsequently created, acquired or completed*

In order to apply the clawback, taxpayers need to identify and monitor whether any property subsequently arises from the expenditure that has been deducted under section DB 66.

In many situations a taxpayer will simultaneously abandon work on multiple items that, if completed, acquired or created, would have been depreciable or revenue account property. This may be due to the abandonment of all or part of a project being undertaken by the taxpayer.

In determining whether the clawback applies, the rules require an analysis of each separate piece of property that is subsequently created, completed or acquired. In other words, the relevant assessment is not in relation to the wider project, but to individual items of depreciable or revenue account property for which a deduction was allowed under section DB 66.

This will require an understanding of what property the expenditure relates to, which is an exercise that is likely to have been undertaken as part of the process of claiming a deduction under section DB 66 (for instance, in claiming a deduction there needs to be an apportionment between depreciable/revenue account property and other property).

It is possible that expenditure could relate to multiple potential items of depreciable or revenue account property, of which only some is subsequently created, acquired or completed. In this case, it will be necessary to make an apportionment of this expenditure on a fair and reasonable basis for the purpose of applying the clawback.

**Example 14: Restart of hotel development**

Company L is constructing a hotel on the Auckland waterfront as part of a larger development that includes residential apartments and retail space. Progress on the project stopped and was put on hold indefinitely in 2021 because overseas tourists stopped coming into the country. However, work on the hotel resumes in 2023 (but not the rest of the development) as international travel picks up again, with completion of the hotel in 2025. The design of the hotel is modified from its original design and includes a gym and larger swimming pool. However, the hotel is located on the same site and serves the same purpose (hotel accommodation) as was originally planned. The previously abandoned property was simply finished off (with some adjustments) when the project restarted.

***Tax impact***

Although there are some differences between the completed hotel and the original construction plans for it, the property is based on the original design, performs the same function and is in the same location and as such is considered to be the completion of the abandoned property. Section CH 13 will apply to claw back any expenditure that was deducted under section DB 66 in relation to the hotel after it was abandoned. However, it will not be necessary to claw back any expenditure to the extent it relates to part of the project that has not been completed (the residential apartments and retail space).

*Similar property*

A feature of the clawback is that it also applies to property acquired that is "similar" to the property that was abandoned. The need for the rules to apply where similar property is acquired is to protect against the clawback being ineffectual if the acquired property has even a slight modification or difference to the abandoned property.

It is important to note that the "similar property" requirement only attaches to property that is acquired by a taxpayer, rather than property that is created or completed by the taxpayer. This is because taxpayers will have greater opportunity to acquire property that is similar to (but not the same as) the original property that was abandoned. However, this is not expected to hold true for property that is created or completed by a taxpayer. In this case, the created or completed property is likely to be a continuation of the property that was abandoned.

The term "similar property" is not defined in the legislation. Acquired property is likely to be similar to abandoned property where it has a resemblance in appearance, character, function, purpose or quantity to the property that was abandoned. In determining the appearance, character, function, purpose or quantity of the property, regard may be had to any project and design plans relating to the abandoned property, which may include details of the assets required to be acquired for the project and their respective specifications.

**Example 15: Acquisition of non-similar property**

In order to expand its vegetable handling operations, Company M seeks to develop a new facility that will include an additional potato washing facility. After considering a number of options, Company M decides on a preferred option of a flatbed potato washer and incurs engineering and design costs for integrating the new machine into the existing processes and facilities. Due to a new form of fungal disease that reduces potato crops, Company M decides to abandon the project and does not acquire the potato washing plant. Company M claims a deduction under section DB 66 for the engineering and design costs.

Two years later, new fungus resistant potato varieties have been planted resulting in increased crop yields. As a result, Company M decides to acquire a new potato washing plant. However, instead of acquiring a flat bed washer, it acquires a barrel washer, which is able to wash more potatoes and is able to clean a wider range of vegetables. The original engineering and design work relating to the flat bed washer cannot be used for the barrel washer due to differing specifications.

***Tax impact***

The barrel washer and flatbed washer have similar functions in that they both wash potatoes. However, the specifications between the two different washers are significantly different. This is reflected in that the barrel washer can clean a larger quantity of potatoes and can also clean other types of vegetables, as well as the engineering and design work for the flatbed washer not being able to be directly applied to the acquired barrel washer. Accordingly, the barrel washer is not similar to the flat bed washer and the clawback does not apply to the engineering and design expenditure deducted under section DB 66.

*No further deductions once clawback is triggered*

In some situations, abandoned property may be reinstated and completed before the five-year spreading period has ended, resulting in the clawback being triggered before all the deductions available under section DB 66 have been claimed. In this situation, all the previously claimed deductions are clawed back as taxable income. There is no entitlement to the remaining deductions under section DB 66 once the relevant property is completed, created or acquired. As noted above, clawed back expenditure may be deductible under the depreciation or revenue account property rules, subject to meeting the relevant deductibility criteria.

**Example 16: Interaction between deduction provision in section DB 66 and clawback**

Company N is undertaking a capital project that, if completed, will result in depreciable property. Work on the project is abandoned in Year 1 but is subsequently resumed and then completed in Year 3.

The clawback in section CH 13 applies to the expenditure deducted in Years 1 to 2, meaning that Company N is required to return the deduction portions for Years 1 to 2 as taxable income in Year 3. Company N has no entitlement to the remaining deduction portions for Years 3 to 5.



# Land

## Extending the bright-line test

*(Sections CB 6A, CZ 39, EL 20, FB 3A, FM 18, FO 10, FO 17, GB 52, GB 53, and YA 1 of the Income Tax Act 2007; sections 54C, 54D and 54E of the Tax Administration Act 1994)*

The bright-line test has been extended from 5 years to 10 years.

### Background

Housing unaffordability is caused by a number of supply and demand-side factors. The extension to the bright-line test is part of the Government's response to reduce investor demand for property. Decreasing the tax advantage that property investors can receive will reduce the amount investors are prepared to pay for a given house and the number of houses they will buy. The measure is intended to support first home buyers and help lift New Zealand's home ownership rates.

### Key features

***Extended bright-line test (new section CB 6A)***

The bright-line test, which taxes gains from residential property acquired and sold within a specified timeframe, has been extended from 5 years to 10 years. Income arising under the bright-line test is taxed at a person's marginal income tax rate.

The other policy settings for the bright-line test remain the same, except for the changes to the main home exclusion in section CB 16A and the business premises exclusion in the definition of "residential land", as outlined further in this special report.

Therefore, the following features of the 5-year bright-line test will continue:

- The rules that determine when the property is acquired and disposed of, and when the bright-line period is counted from.
- The definition of "residential land" covered by the bright-line test includes land that has a dwelling on it, land where the owner has an arrangement to build a dwelling on it, and bare land that may be used for erecting a dwelling under the relevant operative district plan. "Residential land" does not include farmland or land used predominantly as business premises (subject to changes to ensure property used to provide short-stay accommodation is treated as residential land and not excluded as business premises – see below).
- The current exclusions and other forms of relief will continue to apply – that is:
  - the main home will continue to be excluded (subject to changes to ensure the exclusion only applies for the periods the property was used as a main home – see below),
  - transfers upon death, and any subsequent disposal by the beneficiary will continue to be exempt,
  - transfers under a relationship property agreement will continue to be treated as a disposal at cost, so the transferor will not be taxed under the bright-line test on any gain, and
  - those who receive land under a relationship property agreement will continue to take on the bright-line start date (the date from which the bright-line period is counted) of the transferor.

- The main home exclusion is available to properties held in trust. However, people cannot use the main home exclusion for multiple properties held through trusts.
- The main home exclusion cannot be used if it has already been used twice in the two year period preceding the date of sale, and also cannot be used by a person, or group of persons, who has a regular pattern of buying and selling their main home.
- Residential land withholding tax will apply to taxable bright-line sales by anyone who is an "offshore RLWT person" (defined in section YA 1 of the Income Tax Act 2007) – in short, a vendor who is living or established outside New Zealand.
- Specific anti-avoidance rules remain, to counter companies and trusts being used to circumvent the bright-line test.
- Vendors will continue to be allowed deductions for property subject to the bright-line test according to ordinary tax rules (subject to amended deductions as a result of changes to the main home exclusion – see below).
- Losses arising from a sale under the bright-line test will remain ring-fenced so they may only be used to offset taxable gains from other land sales.



## Application date

The extended bright-line test applies if a person has acquired an estate or interest in the land on or after 27 March.

## Detailed analysis

### *When an estate or interest in land is acquired*

In a typical land purchase, the purchaser will first acquire an interest in the land when a binding contract to purchase the land is formed (even if some conditions – like getting finance or a building report – still need to be met). There is further discussion of when land is acquired in QB 17/02.[3]

While the date a person acquires property determines whether the 5-year or 10-year bright-line applies, it should be noted that the 5 or 10-year period is then typically counted from the date the land is transferred to the purchaser (generally the settlement date).

### *Irrevocable offer carve-out*

The 10-year bright-line test does not apply to property acquired on or after 27 March as a result of an offer made by the purchaser on or before 23 March 2021, provided the offer could not be revoked before 27 March 2021.

An irrevocable offer is one that cannot be withdrawn before a certain time. For example, it is common as part of the tender process to sign a tender document that states the person cannot withdraw their offer until 5 working days after the tender has closed.

Table 1 outlines some scenarios and whether the 5-year or 10-year bright-line applies.

[3] Available at **www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2017/qb-1702-income-tax-date-of-acquisition-of-land-and-start-date-for-2-year-bright-line-test**

**Table 1: Extended bright-line test application date examples**

| Example | What bright-line test applies? |
|---|---|
| **The following scenarios deal with revocable offers** | |
| Purchaser offers on 21 March 2021, seller accepts on 24 March. Sale and purchase agreement (ASAP) signed 24 March. | 5-year test applies. |
| As above, but the seller accepts the offer and signs the ASAP on 27 March. | Extended 10-year test applies. |
| Purchaser offers on 18 March 2021, seller verbally accepts on 24 March, but does not sign ASAP until 27 March. | Extended 10-year test applies (for property transactions a verbal contract is not binding, and the purchaser does not have an equitable interest in the property at that point). |
| Purchaser offers on 19 March 2021, seller counter-offers on 24 March, purchaser accepts on 25 March. | 5-year test applies. |
| As above, but the purchaser accepts the counter-offer on 27 March. | Extended 10-year test applies. |
| **The following scenarios deal with irrevocable offers** | |
| Purchaser submits offer as part of tender process that closes on 22 March 2021. The tender document states that the offer cannot be withdrawn until 28 March. Seller accepts offer on 27 March and ASAP is signed. | 5-year test applies.<br>Although the purchaser acquires the land on 27 March and therefore is prima facie subject to the extended test, the carve-out for offers made on or before 23 March applies. |
| Purchaser submits an offer as part of a tender process that closes on 16 March 2021. The offer cannot be withdrawn until 22 March. Purchaser does not withdraw the offer, seller accepts on 27 March and ASAP is signed. | Extended test applies.<br>The carve-out does not apply because the purchaser was able to revoke their offer before 27 March. |
| **The following scenarios deal with conditional offers[4]** | |
| Purchaser submits an offer subject to a building report on 18 March 2021. The vendor accepts the offer and the ASAP is signed on 24 March. On 2 April, the purchaser informs the vendor that the condition is satisfied and the agreement goes unconditional. | 5-year test applies.<br>The purchaser acquired the land when the binding agreement (subject to conditions) was entered into on 24 March, not on 2 April when the conditions were satisfied. |
| As above, except the purchaser and seller agree on a reduced price on 2 April, each signing the change in the agreement. | 5-year test applies. The binding agreement was entered into on 24 March, which is before 27 March. |

### *Nominees*

Where a sale and purchase agreement has been entered into before 27 March but the purchaser is "and/or nominee", then that person must have been nominated before 27 March to remain subject to the 5-year bright-line test, otherwise they will be subject to the 10-year test. This is because the nominee does not obtain an "estate or interest" in the land until they have been nominated as purchaser.

**Example 17: Trust nominated as purchaser**

Melissa's offer on a property is signed and accepted on 26 March 2021. She lists the purchaser as herself "and/or nominee". She intends for the property to be owned by her family trust, which is yet to be set up. She sets up the family trust and nominates the trustees as the purchaser on 1 April. Because the nomination is made on 1 April (after 26 March) the property is subject to the 10-year bright-line test.

**Example 18: Additional purchaser added as nominee**

James's offer on a property is signed and accepted on 26 March 2021. He lists the purchaser as himself "and/or nominee". He intends to purchase the property with his brother Will, but Will wasn't available to sign the agreement when he put the offer in. James nominates Will as the other owner of the property on 28 March 2021. Because Will is nominated after 26 March 2021, he will be subject to the 10-year bright-line test for his share of the property. James will be subject to the 5-year test for his share.

[4] The date of acquisition (when the person first acquired an estate or interest in the land) is relevant for determining which bright-line test will apply (the 5-year or the 10-year test). As noted on page 4, in a typical land purchase, the acquisition date is generally when there is a binding agreement between the purchaser and the seller. This includes when the vendor accepts an offer with standard conditions to be satisfied (such as obtaining finance or a building report), not a later date when those conditions are satisfied or settlement occurs.

## The 5-year bright-line test *(section CZ 39)*

The 5-year bright-line test continues to apply in limited circumstances to residential land acquired on or after:

- 29 March 2018 but before 27 March 2021,
- 27 March 2021 as a result of an offer made by the purchaser on or before 23 March 2021, if the offer could not be revoked before 27 March 2021.

The income charging provision for the 5-year bright-line test has been shifted from section CB 6A to section CZ 39.

The main home exclusion that applies for the purposes of the 5-year test has been shifted from section CB 16A to section CZ 40.



## Residential land withholding tax

*(Section RL 1 of the Income Tax Act 2007 (ITA) and sections 54C–54E of the Tax Administration Act 1994 (TAA))*

Residential land withholding tax (RLWT) applies to sales of residential land made by an "offshore RLWT person" if the sale occurs within five years. This is provided for in section RL 1 of the ITA and section 54C of the TAA.

With the extension of the bright-line test from five years to ten years, sections RL 1 and 54C have been updated so that RLWT also applies to sales of residential land made within ten years of acquisition (where the 10-year bright-line test is relevant).

Section RL 1(2)(a) has been amended to include references to new sections CZ 39 and CZ 40, so that a five-year test is still relevant for properties acquired before the application date of the 10-year test.

Section 54E of the TAA provides that the Commissioner is able to issue an RLWT exemption certificate in limited circumstances – including where a seller is in the business of developing land, dividing land into lots, or erecting buildings; and where the property was the seller's main home.

RLWT exemption certificates will continue to be available where a property is used as a main home:

- For properties acquired before 27 March 2021 (or subject to the irrevocable offer carve-out), this is where it was the owner's main home for more than 50 percent of the bright-line period (new section CZ 40).
- For properties acquired on or after 27 March 2021 (excluding where the irrevocable offer carve-out applies), this is where it is used as the owner's main home for the whole bright-line period, including days within the 12-month buffer that are counted as main home days (provided for in new section CB 16A).

Section 54E of the TAA has been amended to refer to both section CB 16A and new section CZ 40 of the ITA (that is, both versions of the main home exclusion).

Where RLWT has been withheld, section 54D of the TAA and section RL 6 of the ITA permit a taxpayer to file a form for their land transactions to obtain a refund if too much RLWT has been paid relative to their overall income tax liability for their land transactions. Section 54D has been amended to refer to both CB 16A and new CZ 40.

## Amendments to the main home exclusion

*(Sections CB 6A, CB 16A, CZ 40, DB 23C and YA 1 of the Income Tax Act 2007)*

The "main home exclusion" from the bright-line test has been amended so that it no longer applies on an all or nothing basis, but rather applies only for the period the property is actually used as the owner's main home. A 12-month buffer applies to allow the property to not be used as a main home for up to 12 months without tax implications.

### Background

A person's main home is not taxed under the bright-line test. Prior to this amendment, a property was either fully in or fully out of the main home exclusion. For example, a person could qualify for the main home exclusion where the property was rented out for some of the time it is owned, provided it was used as the owner's main home for more than 50 percent of the bright-line period. This all-or-nothing approach made sense in the context of a shorter bright-line period. However, it is not appropriate with a longer bright-line test as much more income could be involved. For example, without any changes to the way the main home exclusion works, a person would not have to pay tax under the bright-line test for a property that was rented out for four years if it was used as the taxpayer's main home for five years.

### Key features

- The main home exclusion has been amended so that it no longer applies on an all or nothing basis. Instead, it only applies for the period(s) the property is actually used as the taxpayer's main home. To be within the exclusion, there is still a requirement that the property has been used predominantly (on a floor area basis) as the taxpayer's main home.
- The legislation provides that a property is excluded from the bright-line test if it is the owner's main home for the full bright-line period. Days when the property is not used as the main home will be treated as main home days if:
  - the non-main home days are in a period of non-main home days of 365 days or less (the counted period), and
  - the counted period is immediately before or after a period where the property is the person's main home.

  The effect of this is that there is a 12-month buffer, within which a change of use of a property to or from being the taxpayer's main home does not need to be accounted for. In other words, the main home exclusion still applies if the property was not used as a main home for periods up to 12 months at a time. If the period that the property was not used as a main home exceeds 12-months, the main home exclusion does not apply.
- If the full main home exclusion in new section CB 16A does not apply, the amount the person derives from selling the property is income under section CB 6A. However, if the property has been used as the main home for some of the time it was owned, the legislation provides that the taxpayer is required to pay tax only for periods where the property was not used as their main home, or not counted as their main home. Periods of 12-months or less that are within the buffer discussed above, where the property is not used as a main home, are counted as main home days for the purposes of the calculation. The legislation provides for this as follows:
  - New section CB 6A(6) provides that if the person has excluded days (that is, main home days) in the bright-line period, the amount of income the person derives from disposing of the land is reduced by reference to the formula in section CB 6A(7).
  - New section CB 6A(7) provides that the person's income is reduced by the amount calculated by subtracting the value attributable to the period the property was used as a main home or counted as a main home (that is, the proportion of days the property was used/counted as a main home multiplied by the sale price) from the sale price. This ensures that the taxpayer only has income attributable to the days the property was not their main home (or counted as their main home).
  - New section DB 23C reduces the deduction the taxpayer can claim for the cost of the property (which includes the acquisition cost and any capital improvements). The deduction is reduced in proportion to the time the property was used (or counted as) as the main home. This ensures the proportion of the cost of the property that is deductible reflects the extent to which the property was not used as the main home (as this is the period in respect of which the gain is taxed).

### Application date

The amended main home exclusion applies to property subject to the 10-year bright-line test, that is, property acquired on or after 27 March 2021. However, it does not apply to property acquired on or after 27 March 2021 as a result of an offer made by the purchaser on or before 23 March 2021, provided the offer could not be revoked before 27 March 2021. The existing main home exclusion continues to apply for such properties, as well as properties acquired before 27 March 2021.

### Detailed analysis

#### *Main home exclusion (new section CB 16A)*

The main home exclusion has been amended so that it no longer applies on an all-or-nothing basis in relation to residential land acquired on or after 27 March 2021 (subject to the carve-out for irrevocable offers). The existing main home exclusion continues to apply to properties acquired before 27 March (or after that date but subject to the irrevocable offer carve-out). This has been shifted to new section CZ 40. Table 2 outlines the previous law and the new law.

NEW LEGISLATION

**Table 2: Previous law and new law**

| Previous law | New law |
|---|---|
| CB 16A: Section CB 6A does not apply to a person who disposes of residential land if, for **most of the period** [the bright-line period],[5] the land has been used predominantly for a dwelling that was the main home for the person… | New section CB 16A: Section CB 6A does not apply to a person who disposes of residential land if, for **all of the days** [in the bright-line period], the land has been used predominantly for a dwelling that was the main home for the person… |
| Section YA 1 definition of main home: means, for a person, the one dwelling – (a) That is **mainly** used as a residence by the person…. | Section YA 1 definition of main home: means, for a person, the one dwelling – (a) That is used as a residence by the person… |



**Example 19: Main home exclusion**

William purchased a property in 2023. He lived in it for five years and rented it for four years before selling it in 2032.

William would qualify for the main home exclusion if the current settings for the exclusion were not changed because for most of the bright-line period (that is, more than 50 percent) the house was used as William's main home. As a result, previous section CB 6A would not apply and William would have no tax to pay (though other aspects of the land sale rules, including the intention test, may still apply).

Under the change, the main home exclusion does not apply as it was not William's main home for the full bright-line period. Instead, William is subject to section CB 6A, but his income is reduced to reflect the period for which the property was used as his main home (see quantification section below).

**Example 20: Main home exclusion**

Erica purchased a property in 2022. She lived in it with a flatmate until she sold it in 2027.

Under both the previous and current law, the main home exclusion would apply. This is because for all of the bright-line period the property was used predominantly as Erica's main home. The "predominantly" test looks at whether, on a floor area basis, the property was used at least 50 percent as the person's main home.

### *12-month buffer (new section CB 16A(6))*

Despite the requirement that the property must be used as the person's main home for "all of the days" in the bright-line period, a 12-month buffer applies under which any period of up to 12 months that the property is not used as the person's main home is counted as a main home period, provided the period is immediately before or after a period during which the property was used as their main home. Therefore, the property will still qualify as the person's main home if it was vacant or rented out for a period of less than 12 months before or after main home use.

This is intended to provide leeway for moving in or out of a property (for example, there may be vacant periods between settlement and moving in, or between moving out and sale). It also covers periods of up to 12 months where the taxpayer is not using the property as their main home (for example, if they rented the property out while overseas and it was no longer their main home for that period).

If a period of non-main home use exceeds 12 months, the entire period for which the property was not used as a main home is subject to tax.

If the main home exclusion does not apply to take the property completely outside the bright-line test (that is, because there was a non-main home period that exceeded 12 months), any non-main home period exceeding 12 months will need to be taken into account in working out a taxpayer's income. See quantification section below.

**Example 21: 12-month buffer does not apply**

Catherine purchased her home in 2023. She lived in it until she went on her OE from 2025 to 2027. When she returned, she lived in her home again until she sold it in 2030.

The 12-month buffer does not apply here as the single period that the property was not used as Catherine's main home (2025 to 2027) exceeds 12 months. As a result, the main home exclusion does not apply and Catherine must calculate her income under section CB 6A(6) (see quantification section below).

[5] The bright-line period typically starts on the day the property is transferred to the owner and ends on the day the property is sold (when the sale and purchase agreement is entered into – not when the sale is settled).

**Example 22: 12-month buffer applies**

Gerald purchased his home in January 2022. He did not move in until six months later as he was overseas. He sold the property in 2026.

The 12-month buffer applies as the period Gerald was overseas and not using the property as his main home was less than 12 months, and it was immediately followed by a period where Gerald used the property as his main home. Therefore, the main home exclusion applies despite Gerald not actually using the property as his main home for a 6-month period.

**Example 23: 12-month buffer applies**

Deb and Greg are retired and live in Dunedin. They acquired the property in March 2022 and sold it in January 2031. Every year they go to Brisbane for 3 months over winter. While they are in Brisbane, they stay in an apartment that they own.

Deb and Greg's Dunedin property is likely to be their main home – as they typically live there, it is likely the home with which they have the greatest connection. When someone has two homes, the particular facts and circumstances need to be considered to determine which one they have the greatest connection with. This would include considering factors such as the extent to which they live in each property, and their family, social, employment and other ties to each of the locations. Regardless, in Deb and Greg's situation, if the Dunedin property was not considered their main home when they are in Brisbane, the 12-month buffer would apply for the periods they are in Brisbane (as each period is less than 12 months). Therefore, either way the main home exclusion applies and Deb and Greg do not need to pay any tax on the sale.



### *Quantification (new section CB 6A(6))*

New section CB 6A(6) applies if a person has used their property as their main home for some but not all of the time it is held. Under section CB 6A(6), the person's income from the disposal of the property is reduced by the excluded adjustment amount that is the amount calculated under subsection (7):

*Income from disposal – excluded adjustment amount*

This formula only needs to be used if the property is used as the person's main home for some of the time it is owned. If the property is never used as the person's main home, the person's income from disposal is simply the amount they derive from disposing of the property. They are not required to apply the formula as it does not impact them.

### *Quantification formula (CB 6A(7) to (11))*

The formula for the excluded adjustment amount in section CB 6A(7) is:

$$\frac{\textit{Adjustment days}}{\textit{Total days}} \times \textit{Unadjusted amount}$$

***Adjustment days*** is the total number of days during the bright-line period where the property was used as a main home. It also includes days that are counted as main home days because the 12-month buffer applies.

***Total days*** is the total number of days in the bright-line period.

***Unadjusted amount*** is the amount of income the person derived from disposing of the property.

The effect of this formula is to evenly apportion the sale proceeds from the property over the period it is held. The amount attributable to the period the property was not used as the taxpayer's main home then becomes income for tax purposes. There is no option to pay tax based on the actual valuations of the property at the start and end of the period the property was not the taxpayer's main home. The following examples illustrate how the formula works:

**Example 24: Apportionment following change of use**

Everly bought a property for $1 million. It was transferred to her on 13 March 2030. She sold the property on 31 December 2037 for $1.8 million. She lived in the property and it was her main home from 13 March 2030 until 28 June 2035. Everly then rented it out until 31 December 2037. Her income is calculated as follows:

Excluded adjustment amount in subsection (7):

$$\frac{1{,}934}{2{,}851} \times \$1.8 \text{ million} = \$1{,}221{,}045.25$$

Under subsection (6):

$1.8 million – $1,221,045.25 = $578,954.75

Therefore $578,954.75 is Everly's gross income from the sale. A portion of the acquisition cost needs to be deducted to determine the net amount of income from the sale that is subject to tax (see below).

**Example 25: Apportionment and the 12-month buffer**

Shanti bought a property for $700,000. It was transferred to her on 20 May 2025. She lived in it from then until 2027, when she went overseas for nine months. While Shanti was overseas, the property was not her main home. When she returned, she lived in the property until 22 March 2029. Tenants moved in a few weeks later and Shanti rented the property out until 9 November 2033 when she sold it for $1 million.

The days in the 9-month period when Shanti went overseas are counted as "main home" days, even though the full main home exclusion does not apply to her because she exceeded the 12-month buffer period when she no longer used the property as her main home (from the day after she moved out (23 March 2029) until the date she sold the property – 9 November 2033).

The total number of days between 20 May 2025 and 9 November 2033 (inclusive) is 3,096. Her main home days total 1,403 (between 20 May 2025 and 22 March 2029, inclusive). For the purposes of the formula, total days is 3,096 and adjustment days is 1,403. The unadjusted amount (the amount derived on the sale) is $1 million.

Shanti's bright-line income is calculated as follows:

Excluded adjustment amount:

$$\frac{1{,}403}{3{,}096} \times \$1 \text{ million} = \$453{,}165.37$$

Gross income from the sale per CB 6A(6):

$1 million – $453,165.37 = $546,834.63

Shanti's gross income from the sale is $546,834.63. A portion of Shanti's acquisition cost needs to be deducted to determine the net amount of income subject to tax (see below).

### *Cost of some residential land reduced (DB 23C)*

A person can claim a deduction under section DB 23 for the cost of property subject to the bright-line test.

Where new section CB 6A(6) applies, new section DB 23C reduces the deduction that can be claimed under section DB 23 as follows:

$$\textit{Excluded adjustment amount} = \frac{\textit{Adjustment days}}{\textit{Total days}} \times \textit{cost}$$

Adjustment days and total days have the same meaning as in CB 6A. Cost means the cost of the residential land.

**Example 24 continued: Cost of residential land reduced**

Continuing with Example 22 (Everly), Everly bought the residential land for $1 million, and it was transferred to her on 13 March 2030. Her total days is 2,851 and her adjustment days is 1,934.

Using the formula in section DB 23C(2), Everly's excluded adjustment amount is:

$$\frac{1{,}934}{2{,}851} \times \$1 \text{ million} = \$678{,}358.47$$

Under DB 23C(1), Everly's deduction for the cost of revenue account property under section DB 23 will be:

$1 million – $$678,358.47 = $321,641.53

NEW LEGISLATION

### *Combined impact of sections CB 6A and DB 23C*

The Income Tax Act 2007 operates on a gross basis and the structure of income charging and deduction provisions in different subparts does not allow for the provision of one single mathematical formula. However, it is possible to mathematically simplify the formula as follows:

$$\textit{(disposal price} - \textit{cost of the property)} \times \frac{\textit{total days} - \textit{adjustment days}}{\textit{Total days}}$$

**Example 24 continued: Combined effect of CB 6A and DB 23C**

Continuing with Example 22 (Everly), Everly's income under section CB 6A is $578,954.75 and her deduction for the cost of revenue account property under section DB 23 (and DB 23C) is $321,641.53. Her net income from the sale is therefore:

$578,954.75 – $321,641.53 = $257,313.22

Everly would therefore pay tax at her marginal rate on $257,313.22.

Alternatively, using the mathematically simplified formula from above and the original information from Example 22:

$$(\$1{,}800{,}000 - \$1{,}000{,}000) \times \frac{2{,}851 - 1{,}934}{2{,}851}$$

$$= \$800{,}000 \times \frac{917}{2{,}851}$$

$$= \$257{,}313.22$$

## Treatment of short-stay accommodation

*(Section YA 1 of the Income Tax Act 2007)*

The "business premises exclusion" from the definition of "residential land" has been amended to ensure that residential property used to provide short-stay accommodation, where the accommodation is provided in a dwelling that is not the owner's main home, is subject to the bright-line test. The amendment also ensures short-stay accommodation is subject to the residential rental deduction ring-fencing rules in subpart EL of the Act.

### Background

The bright-line test and residential rental deduction ring-fencing rules apply to "residential land" as defined in section YA 1. The previous definition of "residential land" had a carve out for land used predominately as business premises. Because there was no qualification to this carve out, residential property used to provide short-stay accommodation via predominantly digital platforms as part of the sharing economy was potentially able to qualify for the business premises exclusion and therefore be out of scope of the bright-line test and residential rental deduction ring-fencing rules. This was not intended.

### Key features

#### *Bright-line changes (paragraph (b) of the definition of "residential land")*

The definition of "residential land" has been amended to include land with a dwelling on it if it is used predominantly for a business of supplying accommodation and the dwelling is not the main home of the owner.

This is intended to ensure the bright-line test applies to short-stay accommodation properties (including a property that is rented out as part of the sharing economy on digital platforms, or a bach that is sometimes rented out when the owner does not use it) unless it is an accommodation facility that is also the owner's main home and they rent out rooms for short-stay accommodation such as a bed and breakfast. This ensures that the treatment is the same between a person who rents out a property on a long-term basis (that is, has tenants) and a person who rents out a property on a short-term basis – that is, both are subject to the bright-line test. The carve-out for bed and breakfast type properties that are the owner's main home ensure they are treated the same as a homeowner who rents spare rooms to flatmates – that is, neither are subject to the bright-line test. This is necessary because in a bed and breakfast situation the property may not be used predominantly as the owner's main home.

#### *Residential rental deduction ring-fencing (paragraph (b) of the definition of "residential land")*

The amendment to the definition of "residential land" discussed above also ensures that residential properties used to provide short-stay accommodation are subject to the residential rental deduction ring-fencing rules.

### *Hotels, motels and other commercial accommodation*

Hotels, motels and other similar commercial accommodation are not "residential land" and are therefore not subject to the bright-line test or the residential rental deduction ring-fencing rules. This is because they are specifically excluded from the definition of "dwelling" in the Income Tax Act.

## Habitual buying and selling

*(Sections CB 16A, CB 16 and CB 19 of the Income Tax Act 2007)*

The amendments expand the regular pattern restrictions in the main home exclusion, the residential exclusion and the business premises exclusion to apply to regular patterns of buying and selling land by a group of persons acting together. The amendments ensure that taxpayers cannot structure around the regular pattern restrictions by using different people or entities to carry out separate transactions, or by varying what is done to the land in each transaction so that there is no "pattern".

The amendments also clarify that the regular pattern restrictions in the residential and business premises exclusions will only apply when the land was acquired with a purpose or intention of disposal.



### Background

The land sales rules in subpart CB contain various exclusions for land used as a main home, residence or business premises. If one of these exclusions applies, an amount that would otherwise be subject to tax under one of the land sales rules, will not be taxable. For example, an amount derived by a land dealer from selling land is usually subject to tax, but will not be taxable if the land dealer used the land as their residence while they owned it.

However, the following exclusions do not apply when there has been a regular pattern of buying and selling land used for such purposes:

- The main home exclusion in section CB 16A (which applies for the bright-line test in section CB 6A).
- The residential exclusion in section CB 16 (which applies for some of the other land sales provisions).
- The business premises exclusion in section CB 19.

The restrictions assume that a person who has a regular pattern of buying and selling land primarily acquires that land for sale and should be taxed on any gain, whether or not they used the land as their residence or business premises while they owned it.

There were concerns that the original regular pattern restrictions allowed taxpayers who habitually buy and sell land to structure around the rules. This could be done by using different people or entities to carry out separate transactions, or by varying each transaction so that there was no "pattern". Those actions undermined the integrity of the tax system by allowing people to take advantage of the exclusions in circumstances when this was not intended.

### Key features

The amendments:

- expand the regular pattern restrictions in the main home, residential and business premises exclusion so they apply to a group of persons undertaking buying and selling activities together, rather than the activities of a single person
- expand the regular pattern restrictions in the residential and business premises exclusions so they apply to a regular of pattern of buying and selling land, focusing on the regularity of the transactions rather than what is done on the land while it is held, and
- clarify that the regular pattern restrictions in the residential and business premises exclusions apply only when the land was acquired with a purpose or intention of disposal.

### Application date

The amendments apply to land acquired after the date of enactment. However, land acquired before the application date will be considered for the purposes of determining whether a group of persons have a regular pattern.

### Detailed analysis

#### *Group of people acting together*

The original regular pattern restrictions applied quite narrowly to the activities of a single person. This allowed taxpayers to circumvent the application of the regular pattern restrictions by buying and selling land using different people and entities each time.

The amendments expand all of the regular pattern restrictions so they apply to a group of persons undertaking buying and selling activities together.

### *Main home and residential exclusions*

For the main home and residential exclusions, a "group of persons" will be treated as undertaking buying and selling activities together when:

- all the natural people in the group occupy all of the properties together as their residence, and
- where a property is owned by a non-natural person, at least one of the natural people who occupy all the properties has significant involvement in, or control of, that non-natural person.

It is intended that the "group of persons" test captures relationships where people would not ordinarily be "associated persons" as that term is defined in the Act. What is important for the purposes of regular pattern restrictions in the main home and residential exclusions is that all the natural people live together in the house.

For the avoidance of doubt, the legislation confirms that if a natural person in the group is able to direct, alone or as part of a group, the activities of a non-natural person, the natural person will have significant involvement in, or control of, the activities of the non-natural person. This will result in a non-natural person also being included in the group of persons.

**Example 26: Residential exclusion**

Chris and Stephan have been best friends since College. They decide to make some money from buying old houses, doing them up, and then selling them. They end up buying and selling four properties over a period of four years. The first property was acquired by Chris. The second property was acquired by Stephan, the third property was acquired by a trust established by Chris (the C Trust), and the fourth property was acquired by a trust established by Stephan (the S Trust). Chris and Stephan are trustees of their respective trusts and are considered to have significant influence or control over the trusts. While they own the properties, Chris and Stephan occupy them together as their shared home.

Chris, Stephan and their respective trusts acquired the properties with an intention of disposing of them. Therefore, on the face of it, the profits from the sales of the properties will be subject to tax (under section CB 6). Chris and Stephan occupied all of the properties as their home so the residential exclusion applies. However, because Chris and Stephan occupied all the properties as their home, and they have significant influence or control over the trusts that owned two of the properties, Chris, Stephan and the two trusts will be considered a "group of persons". Because the group of persons has established a regular pattern of buying and selling land used as a residence, the residential exclusion will not apply to the fourth or any subsequent sales in the pattern.

**Example 27: Main home exclusion**

Over a 10-year period, Mr and Mrs Bug bought and sold four properties (at reasonably regular intervals) that they used as their main home. The first property was owned by Mr Bug. The second property was owned by a trust established by Mr Bug (the Mr Bug Trust). The third property was owned by Mrs Bug. The fourth property was owned by a trust established by Mrs Bug (the Mrs Bug Trust). Mr and Mrs Bug are trustees of their respective trusts and are considered to have significant influence or control over the trusts.

Because all of the properties were sold within five years of the date the title was transferred, on the face of it, the bright-line test (in section CB 6A) applies. Mr and Mrs Bug used each of the properties as their main home so the main home exclusion is applies. However, because Mr and Mrs Bug occupied all the properties as their home, and they have significant influence or control over the trusts that owned two of the properties, Mr and Mrs Bug and the two trusts will be considered a "group of persons". Because the group of persons has established a regular pattern of buying and selling land that was used as a main home, the main home exclusion will not apply to the fourth or any subsequent sales in the pattern.

**Example 28 – Property not included in the pattern**

Chris and Stephan (from example 26 above) have another friend, Turner. He lives with Chris and Stephan in their third property (owned by the C Trust). Turner then buys another property which he occupies by himself as his home.

Turner will not be included in the "group of persons" because he did not occupy all of the properties owned by Chris and Stephan or their trusts. In addition, Turner's property will not be included when considering whether there is a regular pattern because Chris and Stephan did not occupy that property. For the purpose of the residential and main home exclusions, the important factor is that all the natural persons occupy all of the properties as their homes.

### *Business premises exclusion*

The proposal to amend the regular pattern restriction in the business premises exclusion aims to ensure that there is consistency with the other regular pattern restrictions. It also ensures that the regular pattern restriction currently contained in the business premises exclusion cannot be structured around by, for example, using subsidiaries to carry out different transactions in order to avoid a pattern being established. This ensures that the current restriction operates as intended.

For the business premises exclusion, a group of persons will be treated as undertaking buying and selling activities together where:

- all persons in the group occupy premises mainly to carry on a substantial business, irrespective of the nature of any business carried on, and
- a person, whether or not they also occupy land as a business premises, has significant involvement in, or control of, the activities of all those in the group.

The inclusion of the requirement that the regular pattern restrictions will not operate unless land is acquired with a purpose or intention of disposal (discussed further below) will ensure that large taxpayer groups will not be disadvantaged by this amendment simply due to the scale of their transactions.

**Example 29: Business premises exclusion**

Big Co sells widgets through retail stores around the country. In order to ensure that it has appropriate stores on prime land, Big Co prefers to purchase land and build its stores itself. However, in many situations Big Co does not want to continue to own the land and intends that the land will be sold to property investors after the store is established, with an agreement that Big Co will lease the land back for the purpose of running the store. Big Co uses a different subsidiary company to purchase and establish each store.

To the extent that Big Co's subsidiaries purchase the land with the intention of selling it to property investors after the store is established, the land is acquired with a purpose or intention of disposal and the profits are subject to tax (under s CB 6). Because the properties have been used as business premises the business premises exclusion applies. However, because Big Co (and its shareholders) has significant influence and control over all of the subsidiaries, the subsidiaries will be considered a "group of persons". Therefore, the combined buying and selling activities of the group will be taken into account in determining whether there is a regular pattern of buying and selling business premises and, if so, whether the business premises exclusion can continue to apply.

### *Regular pattern of buying and selling*

For the residential exclusion the regular pattern restriction previously applied when a person engaged in a regular pattern of acquiring and disposing of, or erecting and disposing of, dwellinghouses occupied mainly as a residence by the person. For the business premises exclusion the regular pattern restriction previously applied when a person engaged in a regular pattern of acquiring and disposing of, or erecting and disposing of, premises used by the person for a substantial business.

In contrast, the regular pattern restriction for the main home exclusion applies when the person has engaged in a regular pattern of acquiring and disposing of residential land used as their main home.

Because of the language used in the residential exclusion and the business premises exclusion, the regular pattern restrictions in those provisions have been interpreted very narrowly to apply only when there is a similarity or likeness between the transactions (for example, a pattern of buying land, building a home on the land and then selling). This meant that the regular pattern restrictions did not apply if a person had a pattern of buying and selling land that they occupy as a residence or business premises and they carried out different activities on the land while they hold it. For example, the restriction did not apply where the first property was bought, lived in and sold, the second was renovated while it was lived in and sold, and the third was a bare section where a house was built and occupied then sold. This problem does not appear to arise from the more general wording used in the main home exclusion.

The amendments expand the regular pattern restrictions in the residential and business premises exclusions to align them with the main home exclusion. This ensures they apply to any regular pattern of buying and selling land used as a residence or business premises, with a focus on the similarity or likeness of the acquisition and disposal transactions, rather than on whether similar activities (for example, building, renovating, etc) have been done on each piece of land while it is owned.

***Purpose or intention***

Expanding the regular pattern restrictions gives rise to an increased risk that they could catch ordinary residential transactions that occur for family reasons, and small businesses that are upgrading premises as the business grows. In particular, this risk arises for people who are associated with a person in a business involving land (such as a dealer, developer or divider, or builder). This is because they are, prima facie, subject to tax on all sales of land within ten years of acquisition, whether or not the land is used in a business or other income-earning scheme. Such people are entitled to rely on the exclusions to ensure their genuine homes and business premises are not taxed on sale.

Therefore, the proposed amendments clarify that the regular pattern restrictions in the residential and business premises exclusions apply only when the land was acquired with a purpose or intention of disposal. This ensures that the restrictions are better targeted at people who regularly buy and sell land on a speculative basis.

The inclusion of the requirement that the regular pattern restrictions will not operate unless land is acquired with a purpose or intention of disposal will ensure that large taxpayer groups will not be disadvantaged by this amendment simply due to the scale of their transactions.



**Example 30: No intention**

Retail Co sells thingies through retail stores around the country. The shareholders of Retail Co also own a company that develops and sells large retail outlets. Each of Retail Co's stores is owned by a separate subsidiary, which purchases the properties solely for the purpose of establishing and running the stores. Over time, new stores are purchased by various subsidiaries and other stores are closed. It is often the case that stores are sold within 10 years of acquisition due to the ordinary development of city centres.

Because Retail Co (and its subsidiaries) are associated with a land development company, all of the properties used for the stores are tainted and potentially subject to tax if the properties are sold within 10 years (under section CB 10). However, Retail Co's subsidiaries can rely on the business premises exclusion. While Retail Co and its subsidiaries may form a "group of persons", the properties used for the retail stores were not acquired with an intention of resale, so the regular pattern restriction does not apply.

## Cost of revenue account property

*(Section DB 23)*

Section DB 23 has been amended to clarify that the cost of revenue account property is deductible even if it was not known when the costs were incurred that the property would be subject to tax on sale, or if the property was used privately while it was held.

### Background

In most cases, there has to be sufficient connection between expenditure and income, or between expenditure and a business carried on for the purpose of deriving income before expenditure can be deducted. This is known as the general permission (section DA 1). Whether the general permission has been satisfied is judged at the time the expenditure is incurred.

Section DB 23, which allows a deduction for the cost of revenue account property, was previously subject to the general permission. However, in some situations involving land subject to the land sale rules there may not be the required connection between expenditure on acquiring or improving the land and income. This is because, at the time the expenditure is incurred, it may not be known whether the disposal of the land will be taxed. This may be the case for land that is taxed if sold within a particular timeframe (for example, land that is taxed under the bright-line test), or if certain circumstances eventuate during the time the land is held (for example, if a division or development is carried on).

In addition, section DB 23 was previously subject to the private limitation. That meant that technically, where there was private use of land that was subject to tax on sale, part of the costs of acquisition and improvements should have been denied to take into account the private benefit received. This was not intended.

It was clearly intended that the cost of acquiring and improving land that is taxed under any of the land sale rules would be fully deductible to ensure that only the net proceeds are income (or a loss). That is how the provisions operated before the rewrite of the Act, under the "profits or gains" approach. However, it seems that the splitting out of income and deductions into separate provisions may have inadvertently created some uncertainty in respect of land taxed under some of the land sales provisions.

### Key features

The amendment clarifies that section DB 23, which allows a deduction for the cost of revenue account property, supplements the general permission and overrides the private limitation.

### Application date

The amendment applies from 1 April 2008, being the commencement date of the Income Tax Act 2007.

## Definition of dwelling

*(Section YA 1 of the Income Tax Act 2007)*

The definition of the term "dwelling" in section YA 1 of the Income Tax Act 2007 has been amended to clarify that a dwelling includes a structure configured as a place of residence or abode, whether or not it is used as such. The amendment ensures that vacant residential properties are subject to the same tax rules as occupied residential properties, consistent with the policy intent.

### Background

The term "dwelling" is used in the definition of other terms such as "residential land" and "residential building" to determine whether a property is subject to the bright-line test, residential land withholding tax and the residential rental loss ring-fencing rules, and whether building depreciation and separate depreciation of commercial fit-out are available.

Prior to the amendment, paragraph (a) of the definition of the term "dwelling" was defined as "any place used predominantly as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place". There were concerns that the focus on actual use as a residence excluded residential properties that are predominantly vacant. This means they would not be subject to the bright-line test and rental loss ring-fencing rules, which would not be consistent with the policy intent.

### Key features

Paragraph (a) of the definition of the term "dwelling" has been amended so that it refers to "any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place". This ensures that the focus for determining whether the bright-line test or residential rental loss ring-fencing rules applies is on the physical structure of a building, rather than how it is used.

The original wording of paragraph (a) has been retained for the purposes of subpart EE of the Income Tax Act 2007 and the depreciation rules, where a focus on use is still appropriate. This is reflected in new paragraph (ab).

### Application date

The amendment applies from 1 October 2015, in line with the introduction of the bright-line test.

## Content of the Land Transfer Tax Statement

*(Sections 77, 79, 83, 227 and Schedule 1 of the Land Transfer Act 2017)*

The Land Transfer Act 2017 (the LTA) has been amended to allow the content of the Land Transfer Tax Statement (LTTS) to be set by regulations made under the LTA.

This change makes it easier to adjust the LTTS, for example to make changes that would reduce compliance costs for property transfers.

### Background

From 1 October 2015, sellers and purchasers of land have been required to complete an LTTS at the time of transfer. The LTTS collects information used for assessing compliance with tax obligations. It also gathers statistics for use in housing policy.

The content of the LTTS is currently largely prescribed by the LTA. Making any changes to the information required on the form have previously required an amendment to the LTA.

### Key features

The amendments allow the content of the LTTS to be set by regulations made under the LTA. This will enable the content of the LTTS to be updated more easily and enable streamlining of property transfer information requirements.

### Detailed Analysis

Amended section 79 requires that the tax statement must contain the prescribed information. Section 227(1) and (3) provides that the Governor General may make regulations prescribing information to be contained in, and documents that must accompany, any instrument, application, notice, certificate, record, or any other thing for the purposes of the LTA. A clarification to section 227 inserts a reference to "statement" to make it clear that regulations can be made to prescribe information requirements for the LTTS.

The definition of "tax information" in Section 77 is amended to refer to information specified in accordance with section 79(1)(a). This means any information prescribed under regulations made under the LTA, or –until regulations are made and prior to the amendments coming into force– the content set out in the LTA.

Amendments to section 83 update the references to the types of information which may be released under this section. The purpose of this section is to continue the current rules regarding disclosure of information in aggregate form. This is achieved by including a definition of identifying information and allowing future regulations to deem any further information as identifying information.

Transitional provisions in clause 15 of Schedule 1 of the LTA specify that the current LTTS requirements apply until the new regulations are made.

### Application date

The amendments apply from the date of enactment.

A transitional rule provides for the current requirements in section 79 of the LTA to continue to apply until the first regulations which prescribe the content for the LTTS come into force.

## Direct sharing of LTTS information

*(Sections 82A, 85-86 of the Land Transfer Act 2017)*

This amendment facilitates direct information sharing of LTTS information between LINZ and Statistics NZ.

### Background

The information collected on the LTTS is used to prepare quarterly releases on property transfers. The releases include information on the citizenship, visa status, or tax residency of people and companies involved in property transfers. The role of preparing these releases moved from LINZ to Statistics NZ in May 2018.

Prior to this amendment, in accordance with the legislative provisions set out in the LTA, LINZ was only able to share the information collected on the LTTS with Inland Revenue. To facilitate Statistics NZ's role in preparing the quarterly releases, Inland Revenue currently on-shares the information collected on the LTTS with Statistics NZ under the information sharing provisions in the Tax Administration Act 1994.

### Key features

The LTA is amended to enable the direct sharing of LTTS information from LINZ to Statistics NZ.

### Detailed analysis

New section 82A of the LTA provides that LINZ must share the information collected on the LTTS with Statistics NZ if requested by the Government Statistician for the purposes of the Statistics Act 1975. It is intended that this information sharing will commence once the existing Memorandum of Understanding between LINZ and Statistics NZ has been revised to incorporate processes enabling direct information sharing of LTTS information.

The disclosure rules in sections 85 and 86 are amended to support the sharing of information under new 82A.

- Section 85 is amended to include a cross-reference to new section 82A to clarify that this section does not limit disclosures to Statistics NZ under section 82A.
- Section 86 is amended to include the Statistician or an authorised employee as authorised persons for the purposes of disclosure of information collected on the LTTS.

## Purchase price allocation

The new purchase price allocation rules in sections GC 20 and GC 21 of the Income Tax Act 2007 (the Act), inserted by the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act refer. The rules reinforce and extend existing provisions requiring parties to a sale of business assets with different tax treatments to adopt the same allocation of the total purchase price to the various classes of assets for tax purposes.

### Background

Sales of business assets are often subject to more than one tax treatment. These sales are sometimes referred to as "mixed supplies". For example, a sale of commercial property will normally include depreciable buildings and fitout, and land held on capital account (non-taxable/non-deductible). The vendor and purchaser will agree a total price for the transaction, but may or may not allocate the price between the different assets. For tax purposes, however, the parties are usually required to make an allocation, to determine the vendor's tax liability and the purchaser's basis for deductions. This is referred to as a "purchase price allocation".

Allocations must reflect market values for the various assets, but market value is a range rather than a single figure. Current law requires a purchaser of trading stock in a mixed supply to treat the trading stock as acquired for the same value as the vendor treats it as sold for (section EB 24(3) of the Act). Trading stock for the purposes of section EB 24 is broadly defined, to include livestock, land held on revenue account, and timber. Section DP 10(1) reinforces this rule for timber. However, these rules do not contain a mechanism for the vendor's allocation to be communicated to the purchaser, if the allocation is not stated in an agreement. Also, there is no explicit consistency requirement for depreciable property or financial arrangements. As a result, under prior law there were many cases where the vendor and the purchaser in mixed supplies ascribed different market values to the same assets often with the effect that their aggregate reported income was lower than if they had applied consistent valuations.

**Example 31**

Shark Attack Commercial Limited (Shark) is a commercial property owner with a number of buildings in the Auckland CBD. It wishes to sell one of its prime buildings, the Waiata Centre, to Corroboree Properties Limited another commercial lessor. The assets being sold comprise the land, building and fitout of the Waiata Centre. Shark and Corroboree agree on a purchase price of $150 million but they do not allocate that purchase price between the land, building and fitout.

When Shark files its tax return it allocates the purchase price as follows:

| Item | Amount |
|---|---|
| Land | $100m |
| Building | $40m |
| Fitout | $10m |
| **Total** | **$150m** |

However, Corroboree obtains a valuation of the building and applies that valuation to determine the values in its tax return:

| Item | Amount |
|---|---|
| Land | $80m |
| Building | $50m |
| Fitout | $20m |
| **Total** | **$150m** |

This results in a tax mis-match between the two taxpayers over the same assets giving Corroboree a higher tax depreciation base than the amount returned by Shark in determining its depreciation recapture income.

The purchase price allocation rules address this lack of consistency and of information, applying to agreements for the disposal and acquisition of property entered into on or after 1 July 2021. An agreement is entered into once it is binding on the parties, whether or not there are conditions (for example, a standard finance condition for the benefit of the purchaser) that remain to be met and which if not met will mean the transaction does not proceed.

### Key features

- Purchase price allocations are to be made at the level of the following classes of "purchased property":
  i) trading stock, other than timber or a right to take timber
  ii) timber or a right to take timber
  iii) depreciable property, other than buildings
  iv) buildings that are depreciable property
  v) financial arrangements, and
  vi) purchased property for which the disposal does not give rise to assessable income for person A (the vendor) or deductions for person B (the purchaser).

#### *Agreed allocations*

- If the parties agree an allocation to the classes of purchased property and record it in a document before the first tax return for the year in which the transaction occurs is filed, they must both follow that allocation in their returns. This agreed allocation over-rides any prior unilateral allocation that may have been made (see below).

#### *Unilateral allocations meeting timeframes*

- If the parties do not agree an allocation and record it in a document before the first tax return for the transaction is filed, the allocation will be determined by a notification made by one of the parties, or the Commissioner. However, a unilateral allocation does not need to be notified if the total consideration for the purchased property is less than:
  a) $1 million, or
  b) $7.5 million, if the only purchased property is residential land (which includes residential buildings) together with its chattels.
- The vendor has three months after the change in ownership of the property to notify an allocation to the purchaser and the Commissioner, which then binds the vendor and the purchaser.
- If the vendor does not notify an allocation within three months, the purchaser has three months (that is, until six months after the change in ownership) to notify an allocation to the vendor and Commissioner, which then binds the purchaser and the vendor.

#### *No unilateral allocation meeting timeframes*

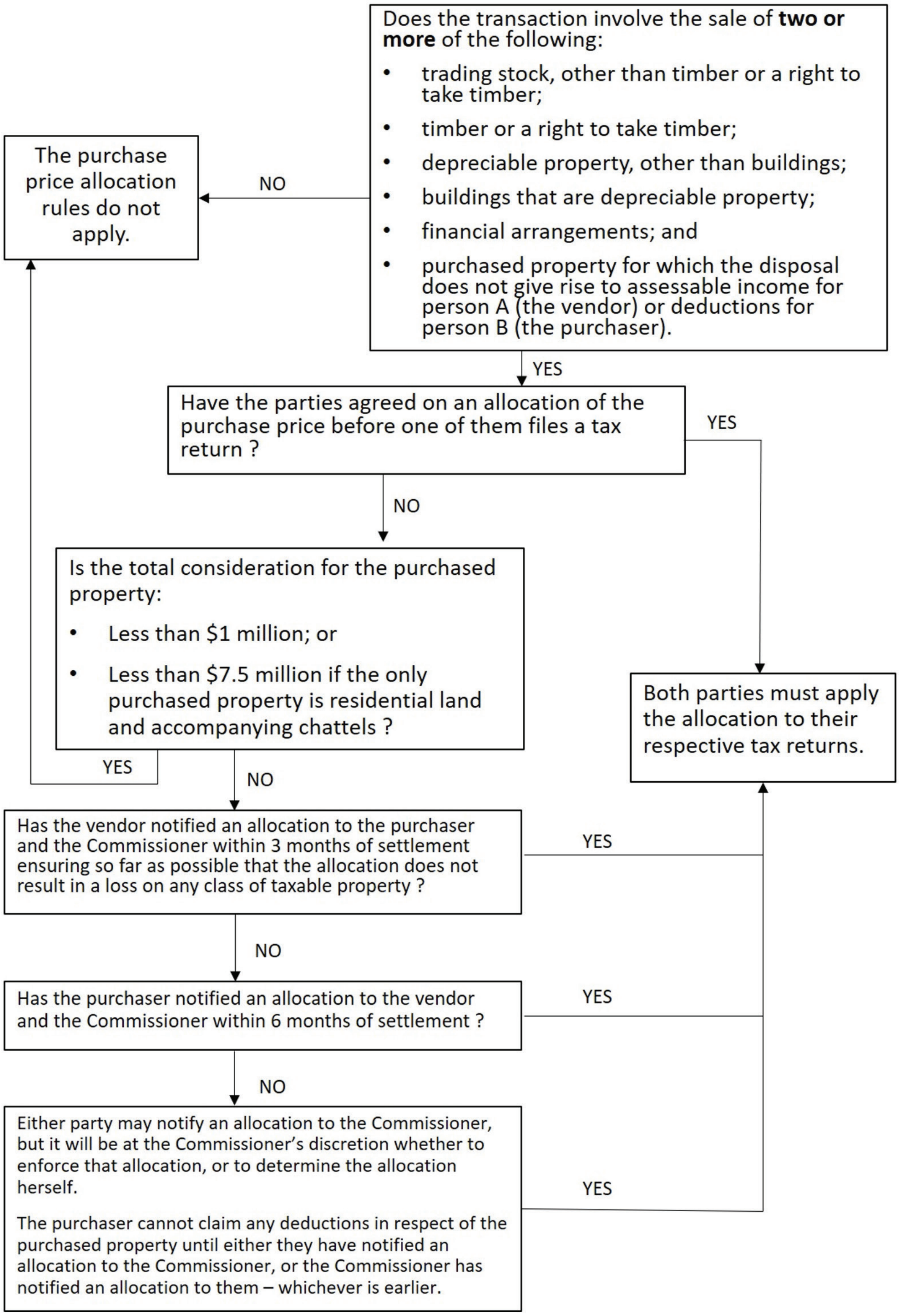
- Where the parties have not agreed an allocation, and neither party notifies a unilateral allocation (filing of a return containing an allocation is not notification of an allocation):
  – the Commissioner may determine the allocation,
  – the purchaser is not entitled to any deductions for the purchased property until the Commissioner notifies an allocation to the purchaser.

#### *General market value requirement and exceptions*

- Allocations must be based on the relative market values of the assets, except when the tax book value minimum on a unilateral vendor allocation applies to make the value allocated to a class of assets higher than market value, or the low-value depreciable property exception applies (see third bullet point below).
- The Commissioner can dispute an allocation that she considers is not based on relative market values.
- However, the Commissioner cannot challenge an allocation to an item of depreciable property if its original cost is less than $10,000, the total amount allocated to the item and any identical items is less than $1 million, and the amount allocated to the item is no less than its tax book value and no greater than its original cost.

Figure 2 illustrates the application of the purchase price allocation rules.

**Figure 2: Application of the purchase price allocation rules**




## Application date

The rules apply to agreements for the disposal and acquisition of property entered into on or after 1 July 2021.

## Detailed analysis

### *Effect of purchase price allocation agreement*

Generally, parties to a sale and purchase agreement who agree an allocation of the transaction price to specific assets will follow that agreement when filing their tax returns. However, sometimes, purchasers have agreed an allocation in a sale and purchase contract and then argued that they are entitled to use a different figure in their tax return, on the basis that the agreed figure is less than market value. New section GC 20 requires parties who have agreed a purchase price allocation in writing to file their income tax returns on the basis of that allocation, even if they do not think it reflects market values. This is achieved by section GC 20(2)(a).

**Example 32**

Dizrythmia Consultants Limited (DCL) enters into negotiations to sell its commercial office building to Double Happy Properties Limited (Double Happy). The sale consists of land (class (vi)), building (class (iv)), and building fit-out (class (iii)). DCL asks a price of $10 million, but states that this price is contingent on Double Happy agreeing to the following purchase price allocation:

| Item | Amount |
|---|---|
| Land | $4m (valuation) |
| Building | $4.5m (tax book value) |
| Fitout | $1.5m (tax book value) |
| **Total** | **$10m** |

Double Happy is convinced that the cost base for the building fit-out is too low – and has a valuation to support that view – but nevertheless agrees to the allocation because it considers $10 million to be an acceptable price for the whole bundle of assets.

DCL and Double Happy must file their respective returns of income on the basis of the agreed allocation.

If the Commissioner considers that the agreed amount does not reflect the relative market value of the class of property, the Commissioner can treat the class of property as disposed of and acquired for a different amount. This is achieved by section GC 20(2)(b). Relative market values should be determined either at the time the parties enter into their agreement or, if later, when they agree their allocation.

Section GC 20(3) is an exception to the Commissioner's ability to challenge an agreed allocation. The Commissioner cannot challenge an allocation to an item of depreciable property if:

a) the original cost of the item for the vendor is less than $10,000, and

b) the total amount allocated to the item and to any identical items is less than $1 million, and

c) the amount allocated to the item is no less than its tax book value and no greater than its original cost.

This exception is primarily included to give certainty to vendors taking a low compliance cost approach to allocating to low-value depreciable assets.

Condition (a) of the exception sets the de minimis ceiling of a single item at $10,000.

Condition (b) is a caveat to condition (a). If there is a large number of identical low-value assets with an aggregate allocated value under the transaction of $1 million or more, the exception does not apply.

**Example 33**

Matinee Idyll Property Limited (Matinee) is selling a commercial building with 600 identical office desks. Matinee has agreed with the purchaser an allocation to depreciable property which is based on an aggregate allocation to the desks of $2 million – their tax book value. The desks were entered as one item on the vendor's depreciation register. While the value of each individual desk is low, the aggregate value of the set is high, and any aggregate discrepancy between tax book value and market value could be material. Therefore, the Commissioner will retain the right to challenge an allocation in respect of these assets.

Condition (c) sets the range of unchallengeable values. The allocation must be no lower than tax book value and no higher than original cost. The rationale for this range is that the immediate effect of an allocation within it will be either revenue neutral or positive, and symmetrical. However, an allocation below tax book value would give the vendor a loss, and an allocation above original cost would give the vendor an untaxed capital gain but a higher cost base for the purchaser's deductions.

### *Purchase price allocation required: no agreement*

New section GC 21 provides a hierarchy of unilateral allocation rules that apply where the vendor and purchaser do not agree an allocation to the classes of property before the first tax return for the year of the transaction is filed. The purpose of these rules is to give parties a mechanism to file on the basis of a single allocation in cases where they are unable to agree one.

*De minimis*

Section GC 21(2) sets out two thresholds below which the unilateral allocation rules do not apply. A unilateral allocation does not need to be notified where the total consideration for the purchased property is less than:

a) $1 million, or

b) $7.5 million, if the only property in the disposal is residential land (which includes residential buildings) together with its chattels.

"Consideration" encompasses both the purchase price and the value of any vendor liabilities assumed by the purchaser (such as warranty obligations).

**Example 34**

Amy is selling her small software business – "Twelfth Dimension Software" – to Titus. The business assets include software (class (iii)) and goodwill (class (vi)). Titus offers Amy $950,000 for the business, which Amy accepts. They do not agree a purchase price allocation between the software and goodwill, but because the total price is less than $1 million, and section EB 24 does not apply to the software or goodwill, they are not subject to any consistency rules. Therefore, they are able to adopt their own allocations in their tax returns, based on their own respective assessments of market value.

Suppose the facts are varied so that Titus also agrees to take over certain obligations to customers, which the parties value at $60,000 (in addition to the $950,000 cash payment). The consideration is now above the de minimis, and section GC 21 applies. The amount allocated to the business assets will of course be increased by the $60,000.

"Residential land" is defined in the Act and includes residential buildings. Chattels are any items sold with the residential building that do not form part of the building.

The vast majority of residential property sales will be below the $7.5 million threshold. Residential sales data for 2018–2021 shows there were only 115 sales at or above $7.5 million over the period – 0.03% of total sales. Of these, some are likely to have been sales of a house by one owner-occupier to another, which are not affected by the purchase price allocation rules, since all the property is outside the tax base for both parties. The residential transactions that are likely to be caught are sales of high-end rentals, or multi-dwelling buildings such as apartment blocks.

A higher threshold for residential property transactions is justified on the basis that residential buildings are non-depreciable, so the scope for tax manipulation in these transactions is low.

**Example 35**

Hermit McDermitt owns a number of high-end rental properties. One such property is located in a prime area in Nelson and Hermit has decided to sell the property. Sandy Allen has been looking for a property she can rent out to wealthy tourists once the borders have opened for travel and puts in an offer for the property of $7.2 million which is $1.5 million over the RV of the property and Hermit accepts this.

They do not allocate the purchase price between, land (class (vi)), house (class iv)) and chattels (class (iii)). Because the consideration is less than $7.5 million and the only property being sold is the land, house and chattels, the purchase price allocation rules do not apply. Section EE 45(10) requires Hermit McDermitt to allocate market value to the chattels.

If Hermit has been occupying the property as his main home, the sale will be non-taxable for him, and he will not need to make an allocation.

*Vendor allocation*

Section GC 21(3) provides that, if the vendor uses different income tax treatments for two or more of the classes of property (and is thus required to make an allocation), the vendor may notify the Commissioner and the purchaser of an allocation within three months of the change in ownership of the property. The amount allocated to each class of property must be the greater of the relative market value and the tax book value of the class. "Tax book value" is defined in subsection (13) as: "the total amount that person A uses or would use, for purchased property in the class of property, in calculating person A's tax position for their income year in which the change in ownership of the purchased property occurs."

The tax book value minimum protects the purchaser from an unreasonably low allocation to taxable/deductible property by the vendor, which the Commissioner may not wish to challenge.

The vendor will not be able to comply with the tax book value floor where the aggregate tax book value of all the classes of taxable property plus the relative market value of the class of non-taxable property exceeds the total purchase price. This could be the case in a distressed sale where the vendor is making a genuine loss. Section GC 21(4) provides a mechanism to deal with the excess of the amount required to be allocated by the previous subsection above the total purchase price. The excess is applied:

a) first, to reduce any amount allocated to the class of non-taxable property (for example, goodwill, or non-taxable land)

b) second, to reduce, pro rata, any amounts allocated to the other classes of property.

Therefore, where the amount allocated to the class of non-taxable property is higher than the excess, the excess can be eliminated entirely by reducing the allocation to that class. Where the amount allocated to that class is already zero – whether by virtue of having been reduced by the first step, or of there being no non-taxable property in the transaction in the first place – the tax book values of the classes of taxable property must be reduced proportionately until they collectively equal the purchase price.

**Example 36**

Frenzy Fabrics Limited (Frenzy) is selling one of its factories to Poor Boy Pastels Limited (Poor Boy). The sale consists of land (class vi)), building (class (iv)), factory fit-out, and machinery (both class (iii)). During negotiation, Frenzy and Poor Boy try to reach agreement on an allocation, but Frenzy is adamant the fitout and machinery are worth $4 million less than tax book value of $7 million but that the land has appreciated significantly. Poor Boy claims the land has not moved much in value, but the machinery is worth closer to its original cost of $10 million. Frenzy has obtained a valuation for the underlying land that is much higher than Poor Boy's assessment of the land value.

Despite not being able to agree an allocation with Frenzy, Poor Boy is committed to purchasing the factory, and the two companies complete the deal for $50 million.

Having not agreed an allocation with Poor Boy, Frenzy has the first allocation right under the new rules. Based on its valuation, Frenzy wants to make the following allocation:

| Item | Amount |
|---|---|
| Land | $35m (valuation) |
| Building | $12m (tax book value) |
| Fitout & machinery | $3m (own assessment of market value) |
| **Total** | **$50m** |

However, the aggregate tax book value of the fit-out and machinery is $7 million. Because Frenzy is making a unilateral allocation, it is required to allocate at least tax book value. Three weeks after settlement, it therefore notifies the following allocation to Poor Boy and to the Commissioner of Inland Revenue:

| Item | Amount |
|---|---|
| Land | $31m (valuation less additional allocation to fitout and machinery) |
| Building | $12m (tax book value) |
| Fitout & machinery | $7m (tax book value) |
| **Total** | **$50m** |

The allocation binds Poor Boy, and both companies file their returns on the basis of it, as required by the new rules. The Commissioner may only dispute the allocation of $7 million to fitout and machinery if she believes it is less than market value.

*Purchaser allocation*

In some cases, the vendor may not make an allocation. For example, if the vendor is a dealer (taxable on all the property), or tax exempt, they are not able to make one.

Section GC 21(5) provides that if the vendor does not notify an allocation within the three months, the purchaser may notify the Commissioner and the vendor of an allocation within six months of the change in ownership of the property. An allocated amount must reflect the relative market value of the relevant class of property proportional to the other classes of property. There are no other constraints on the purchaser's allocation.

Parties must notify each other following the requirements of sections 14A to 14G of the Tax Administration Act 1994. This means that in the case of a purchaser allocation, so long as they do this it will not matter that the vendor may no longer exist at the time the purchaser notifies their allocation (for example, where the vendor has wound up or liquidated after settlement).

**Example 37**

Time and Tide Financing Limited (TnT) is selling its finance business as a going concern to Charlie. The business's assets are receivables (financial arrangements class (v)), goodwill (class (vi)), and software (class (iii). TnT claims most of the business's value is in the goodwill, and that the receivables should be significantly discounted because there has recently been an economic downturn and some of TnT's clients have been laid off and had to enter into special debt repayment plans.

Charlie believes that the economy will soon recover and that the clients will pay quickly and in full and wants the receivables to be allocated their tax book value. They claim the goodwill is worth substantially less than TnT's assessment.

The parties do not agree an allocation, but Charlie wants to go ahead with the transaction and buys the finance business for $8 million.

After settlement, the owners of TnT start focusing on their next business venture and neglect to notify a purchase price allocation to Charlie and the Commissioner. Three months pass, and Charlie – having received no allocation – notifies their own allocation, based on their assessment of market values, to the owners of TnT and to the Commissioner:

| **Item** | **Amount** |
|---|---|
| Receivables | $5m |
| Goodwill | $2m |
| Other intangibles | $1m |
| **Total** | **$8m** |

The allocation binds both parties and they file their respective tax returns on the basis of it, in accordance with the rules. The Commissioner may challenge this allocation, if satisfied it was not made on the basis of relative market values.

*No timely notification*

If no allocation is notified on a timely basis – that is, within six months of settlement – the power to determine the allocation passes to the Commissioner.

If the vendor or purchaser notifies an allocation after the six months, it will be at the Commissioner's discretion whether to bind both parties to it, or to instead notify her own allocation in accordance with market values, which both parties must then adopt.

Where neither party notifies an allocation at any stage, they will still have to make allocations in filing their tax returns. Such allocations will be subject to adjustment by the Commissioner. The Commissioner may require a party to allocate, to the classes of purchased property:

a) the amounts allocated by the vendor to the classes of purchased property, or

b) the amounts allocated by the purchaser to the classes of purchased property, or

c) amounts that reflect the relative market value of the relevant class of purchased property, proportional to the other classes of purchased property.

The Commissioner will notify the required allocation to both the vendor and the purchaser, either for them to use in filing their respective tax returns, or – if they have already filed returns – in an amended assessment for one or both parties.

*Allocated amounts enforced*

Subsection GC 21(7) provides that a class of purchased property is treated as disposed of and acquired for the amount allocated under subsections (3) to (6). In effect, a unilateral vendor, purchaser, or Commissioner allocation is binding on the parties, with no right for a party to contest the allocation by filing a notice of proposed adjustment or to take any other proceedings to challenge the allocation. The Commissioner retains the right to dispute an allocation by one of the parties that is not market value, unless it is an allocation made in accordance with section GC 21(3)(b) and is higher than market value, or it is an allocation to low-value depreciable property protected by the exception (see section GC 21(11)).

*No deductions for purchaser until allocation*

To incentivise the purchaser to notify an allocation when they have the allocation right, sections GC 21(8) to (10) provide that the purchaser is not entitled to any deductions in relation to the purchased property until the first income year for which they file a return of income on a timely basis after the earlier of the following:

- The purchaser's notification of their allocation to the Commissioner, and
- The Commissioner's notification of her allocation to the purchaser.

The purchaser should therefore notify their allocation to the Commissioner and the vendor as soon as possible to ensure they can claim deductions in their next tax return, and not have them deferred. Any deductions that are deferred will be able to be claimed in the return that is filed on a timely basis after an allocation is notified to or by the Commissioner. This will result in the claiming of deductions for more than one year in a single return.

**Example 38**

Missing Person Detective Agency Limited (MPDA) a very successful private investigation firm has decided to sell its business to I Hope I Never Security Limited (IHNS) in the 2023–24 income year. The assets being sold are the building premises (class (iv)), fit out (class (iii)), customer database and goodwill (both class (vi)). MPDA and IHNS agree on a purchase price of $28m but do not agree on an allocation.

Time moves on and neither MPDA nor IHNS notifies an allocation to the other party or the Commissioner. Both parties file tax returns for the 2023–24 income year recognising the transaction, with different allocations. MPDA allocates tax book value to its fit out, while IHNS allocates a greater amount.

In early 2026, when reviewing the 2023–24 tax return for IHNS, the Commissioner realises that no allocation has been notified by the parties. She determines that IHNS's allocation is the more reasonable. She therefore issues an amended assessment to MPDA increasing its income in the 2023–24 year by the additional depreciation recovery implied by IHNS's valuation. She also issues an amended assessment to IHNS denying a deduction for depreciation of the premises and fit out altogether for the 2023–24 year. These assessments trigger an obligation to pay UOMI, and shortfall penalties may also apply. IHNS will be able to claim the denied deductions in its next tax return, along with the deductions for that year.

*Exception for low value depreciable property*

The low value depreciable property exception in section GC 20(3) is replicated in section GC 21(11).

*Relationship with other provisions of the Act*

Several existing provisions in the Act deal with amounts allocated to property sold in a mixed supply.

Section EB 24 provides that when trading stock is disposed of together with other business assets, the sale proceeds must be apportioned between the trading stock and the other assets in a way that reflects their respective market values. Also, the purchaser must use the vendor's allocation to the trading stock. Section DP 10 contains rules consistent with section EB 24 that relate solely to disposals of timber.

Section EE 45(10) provides that when depreciable property is sold with other items, the amount allocated to the depreciable property is its market value.

Section GC 21(12) provides that any such existing provision of the Act that expressly requires the use of market value for purchased property is overridden by the purchase price allocation rules to the extent to which the amount allocated to that property is determined under the purchase price allocation rules.

This override serves two main purposes. First, it prevents parties from attempting to use two different market values for an item or class of property on the argument that one value is determined under the purchase price allocation rules and another is determined under a different provision of the Act. Second, it allows the tax book value floor on a unilateral vendor allocation to operate correctly; where the relative market value of a class of property is lower than its tax book value, the tax book value is used.

**Example 39**

Parrot Fashion Pines Ltd (PFP) is selling one of its forests, which comprises trees (timber, class (ii) and freehold land (class (vi)), along with depreciable equipment (class (iii))with a cost of $73,000 and a book value of $20,000. PFP has incurred expenditure on the land within various categories described in schedule 20 Part G of the Income Tax Act 2007. The original amount of such expenditure was $150,000, and it has been depreciated down to $85,000 at the end of the year before the sale, using the rates provided for in Part G.

PFP and the buyer, Bold as Brass Ltd have agreed a price and an allocation of:

| Item | Amount |
|---|---|
| Depreciable Property | $20,000 |
| Land | $1,800,000 |
| Trees | $180,000 |
| **Total** | **$2,000,000** |

***First variation***

Assume that:

- PFP bought the forest by way of an asset purchase 2 years before the sale to Bold as Brass and paid $300,000 for the trees (log prices have declined significantly since then). PFP has not incurred any other expenditure which has had to be added to the cost of timber, and
- PFP and Bold as Brass have not agreed an allocation.

If PFP makes an allocation under section GC 21(3), it must treat itself as selling the trees for $300,000 for tax purposes. This will also be Bold as Brass's cost for the trees. This will reduce the allocation to land to $1,680,000.

***Second variation***

Assume that Bold as Brass and PFP are associated parties, and that they have agreed the $180,000 allocation to the timber. In this case, the sale price will be respected for tax purposes (subject to the Commissioner's ability to challenge it as not in accordance with relative market values). However, PFP will only be entitled to deduct $180,000 as cost of timber (section DP 10(4)) and Bold as Brass will add the "missing" $120,000 to its cost of timber (section DP 10(5)), giving it a cost of $300,000.

When a mixed supply involves an acquisition of depreciable property by a person (purchaser) from an associate (vendor), sections GC 20 and GC 21 operate in conjunction with section EE 40(7), which limits the amount of depreciation that can be claimed in such a case. The person's depreciation claim is based on the lesser of the cost to the person and the cost to the associate. While the cost to the person is determined by sections GC 20 or GC 21 if the acquisition from the associate was a mixed supply, if this amount is greater than the cost of the item to the associate, the person's depreciation claim is based on the lesser amount.

### *Definitions*

Section GC 21(13) provides definitions for three terms used in the purchase price allocation provisions.

The term "allocation notification" is used in sections GC 21(9) and (10), which defer a purchaser's deductions. "Allocation notification" means the earliest of the following:

i) the time when the purchaser's notification of their allocation is provided to the Commissioner in the form prescribed by the Commissioner, and

ii) the time when the Commissioner's notification of her allocation under subsection (6) is provided to the purchaser.

The term "pre-allocation deduction" is also used in sections GC 21(9) and (10). It means the purchaser's deductions for purchased property that, ignoring sections GC 21(9) and (10), would be allocated to an income year before the income year in which allocation notification occurs. In effect, pre-allocation deductions are the deductions that are deferred.

The term "tax book value" is used in sections GC 20(3)(c)(ii), GC 21(3)(b) and GC 21(11)(c)(ii). "Tax book value" means the total amount that the vendor uses or would use, for purchased property in the class of property, in calculating their tax position for their income year in which the change in ownership of the property occurs.

For trading stock, the tax book value is the value of the stock on hand at the time of the transaction as calculated under the valuation method used by the vendor for the income year in which the transaction takes place.

For depreciable property, the tax book value is the amount the property has been written down to at the end of the year before the transaction, less a pro rata portion of the depreciation for the vendor in the year of the transaction.

For financial arrangements, the tax book value is the consideration that would give an amount of income or expenditure under section EW 31 (base price adjustment formula) equal to the income or expenditure the vendor would have for the purchased property in the year of the transaction, for the part-year period before the transaction, using the relevant spreading method for the property for the part-year period, pro-rata.

Subsection (b) of the trading stock definition in section YA 1 is amended to include sections GC 20 and GC 21. This means that in the purchase price allocation rules, trading stock:

i) includes anything produced or manufactured
ii) includes anything acquired for the purposes of manufacture or disposal
iii) includes livestock
iv) includes timber or a right to take timber
v) includes land whose disposal would produce income under any of sections CB 6A to CB 15 (which relate to income from land)
vi) includes anything for which expenditure is incurred and which would be trading stock if possession of it were taken
vii) does not include a financial arrangement to which the financial arrangement rules or the old financial arrangement rules apply.

This is the broad definition of trading stock used for the purposes of section EB 24 and several other sections.

*Notifications by vendor or purchaser*

Notification to the Commissioner of an allocation should be made online via MyIR, or via a letter. This notification should include the phrase "Purchase Price Allocation" in the subject line and contain the following information:

- The names, IRD/GST numbers and contact details of the vendor and purchaser
- The date of agreement to the transaction
- The date on which the property was transferred (that is, settlement/change in ownership)
- The total consideration (including the value of any liabilities assumed)
- The amounts allocated to each of the following classes of property sold, allocating zero to any class of property not sold:

i) trading stock, other than timber or a right to take timber

ii) timber or a right to take timber

iii) depreciable property, other than buildings

iv) buildings that are depreciable property

v) financial arrangements, and

vi) purchased property for which the disposal does not give rise to assessable income for person A (the vendor) or deductions for person B (the purchaser)

- A statement that the amounts have been allocated in accordance with section GC 21
- If desired, supporting documents such as the sale and purchase agreement and the notification provided to the other party.

### *Practical variations*

*Nominees*

In some transactions the acquirer of the purchased property will be a nominee of the purchaser, rather than the purchaser named in the contract. If the vendor agrees an allocation with the purchaser, and the agreement also allows for nomination, the vendor should include a provision in the sale and purchase agreement to ensure that any nominee is bound to that agreed allocation. If the vendor makes a unilateral allocation under section GC 21, that allocation will bind the purchaser or the nominee without the need for any special contractual provision.

NEW LEGISLATION

*Mortgagee sales*

The purchase price allocation rules may apply to a mortgagee sale, where the vendor is a bank or other lender (mortgagee) recovering funds by selling the property of an owner (mortgagor) who can no longer meet their repayment obligations. Neither the mortgagee nor the mortgagor is likely to be engaged on the issue of allocation, but if the purchaser wants to agree an allocation with the mortgagee, they should ensure that the mortgagee has been authorised by the mortgagor to agree an allocation.

*Auctions and tenders*

In competitive bid processes such as auctions and tenders, purchasers may often have to submit bids without the opportunity to agree a purchase price allocation. The outcome of the initial bidding process could be influenced by whether particular bidders have specified a potential purchase price allocation, since the allocation could impact on the vendor's returns.

Parties may navigate these commercial realities in a number of ways. For example, in a tender, purchasers may express bids as being conditional on a specified allocation. Or the vendor in an auction may specify an allocation, to ensure that all bids are made on an even footing.

*Purchase price adjustments*

When an agreement provides for contingent payments to be made, the amount of those payments will often not be known before the parties agree an allocation or make a unilateral allocation. However, the parties may agree, or in the case of a unilateral allocation, specify, the "in principle" allocation of those payments to particular categories of assets. For example, earn out payments may be allocated to goodwill. If the allocation is agreed or specified in that way, sections GC 20 and GC 21 should apply to that allocation in the same way as they apply to non-contingent payments. If the non-contingent amounts have not been allocated in that way, their allocation will be dealt with under existing law.

*Dealers and tax-exempt parties*

In some transactions the vendor or purchaser may treat the entire amount of the consideration in the same way. This will be the case if the party is a dealer or an exempt entity.

A dealer or exempt party is not able to make an allocation. If the other party to the transaction is required to make an allocation because they use two or more different tax treatments for the purchased property, then as a practical matter that other party will be able to determine the allocation. Whether the formal mechanism for this is agreement or a unilateral allocation should not be significant, since the dealer or exempt party will not be applying the allocation in any event.

Where both parties to a transaction are dealers or exempt entities, the purchase price allocation rules do not apply.

## Unclaimed money

The Taxation (Annual Rates for 2020–21, Feasibility Expenditure and Remedial Matters) Act 2021 ("ARFERM Act") was passed on 23 March 2021 and received the Royal assent on 30 March 2021. This Act amends the Unclaimed Money Act 1971 ("UCM Act"). The amendments modernise the unclaimed money regime with the aim of simplifying the process of reporting and transferring unclaimed money to the Commissioner of Inland Revenue. The reforms also recognise that customers are increasingly interacting with their accounts in new ways (for example, online or using institution specific software such as an "app").

### Background

Unclaimed money refers to money which has become detached or somehow disconnected from its owner for a given period. A common example is money which has been left untouched in a bank account by its owner for several years. That is, the owner of the account has not made any withdrawals or deposits, or provided written instructions to the bank. Once the money has been left in an account for a given period, it will become unclaimed under the UCM Act. It is then passed from the holder (for example, bank or service provider) to Inland Revenue, who will hold the money until the owner claims it.

The unclaimed money regime had not been reviewed substantially since its enactment in 1908. Accordingly, the administrative procedures required by the UCM Act were reflective of an era in which the use of paper and postage dominated administration. Inland Revenue's ongoing transformation programme provided an opportunity to modernise the administration of unclaimed money. The reforms make the administration of unclaimed money more efficient by lowering compliance costs for holders of unclaimed money and make it easier for owners to be reunited with their money.

### Key features

The reforms to the UCM Act include the following:

- Reducing the amount of time which must pass before money is deemed unclaimed by replacing the previous deeming periods of 6 and 25 years with a single period of five years for all funds.
- Expanding the forms of account interaction which will prevent money from becoming unclaimed to include new forms of account activity (for example, online banking).
- Allowing holders to, in limited circumstances, transfer money to the Commissioner before it is unclaimed.
- The repeal of the requirement for a holder to keep and maintain a register of unclaimed money.
- A quarterly reporting regime (which will allow holders to transfer unclaimed money to Inland Revenue on a quarterly basis).
- Transitional provisions to assist holders who will require further time to update their systems to align with the reforms.



### Application date

The amendments apply from the date of Royal assent, with the exception of section 178 of the ARFERM Act, which took effect on 1 March 2021.

### Detailed analysis

The Amendment Act amends the Tax Administration Act 1994, the Unclaimed Money Act 1971, and the KiwiSaver Act 2006. These amendments support the administration of unclaimed money.

#### *The definition of unclaimed money (section 4 of the UCM Act)*

This section refers to money that is more than $100. This is intended to refer to money in the traditional sense. The UCM Act is not intended to apply to other stores of value such as units in Portfolio Investment Entities (PIE). Money covered by the Public Finance Act 1989 is excluded by section 5(3) of the UCM Act.

Inland Revenue is aware that some PIE fund managers choose between transferring unclaimed money to the Commissioner under the UCM Act or to the Crown under the new section 149 of the Trusts Act 2019. There is merit in allowing the flexibility to transfer unclaimed money under both Acts. As noted, units in PIEs are not included within the definition of unclaimed money. Therefore, although Inland Revenue will not accept units in PIEs, it will remain possible for fund managers to transfer the redeemed units (in money) to the Commissioner once it has remained in the holder's possession for the required deeming period (or where the holder wishes to transfer the money earlier).

**Example 40**

B&E Limited is a PIE fund manager which administers several PIE funds. Natisha is an investor in the Ultra risky fund which has high volatility. Each year Natisha is contacted by an employee of B&E to see if she is happy with her investment mandate. Over the last two years B&E has not received any reply from Natisha and some letters have been returned to B&E as undeliverable.

Three years later B&E decides that Natisha's investment is effectively unclaimed money. B&Es terms and conditions provide that if they cannot contact a client after four years, they can convert the investment to cash, which they do for Natisha's investment. At this point the unclaimed money deeming period starts. However, B&E decides that it has made reasonable efforts to contact Natisha and decides to pay the funds to Inland Revenue as unclaimed money before the five-year deeming period has ended.

#### *Monetary threshold (section 4 of the UCM Act)*

Amounts of $100 or less are not unclaimed money for the purposes of the UCM Act. However, the UCM Act retains the alternative use provision in place under the previous UCM Act, which allows fund holders to transfer amounts of $100 or less to the Commissioner as unclaimed money. Holders have a choice between paying these amounts to the Commissioner or putting them to another purpose (such as donating them to charity). Money applied for the benefit of the holder, or another use, will cease to be unclaimed money. However, this does not affect any claim that the owner of the money may have against the holder for repayment. Amounts which are retained by a holder which are not unclaimed money will be income in the hands of the fund holder.[6]

[6] See Inland Revenue public rulings- BR Pub 17/01 Income Tax – Treatment of unclaimed amounts of $100 or less and BR Pub 17/02 Income Tax – Treatment of unclaimed amounts of $100 or less - amounts held on trust

**Example 41**

Crimson Permanent Assurance Limited (Crimson) is a life insurance company that provides life insurance for pets at very low premiums (with very low pay outs). Over the last few years Crimson has received many claims from clients but have been unable to locate the owners after the claim has been made. There are 24 claimants and all the claims are under $100. Despite trying to contact the claimants through multiple channels, Crimson has received no reply from any of them.

Crimson holds the money for five years and then decides these claimants are never going to claim the funds and so decides to donate them to a charity that finds homes for former greyhound racing dogs. As the money does not meet the definition of unclaimed money (being $100 or less) Crimson can do whatever it wishes with it, although they will need to return the amount as taxable income for the year and a donation credit for the donation.



Under the former section 4(1), any amounts owed to the same owner were combined to determine whether the value of the unclaimed money was $100 or less. This was designed to avoid amounts which were individually $100 or less but collectively more than $100 being applied to some other purpose rather than transferred to the Commissioner. This approach is preserved under section 4(3) of the amended UCM Act.

### *Length of time until money is unclaimed (section 4 of the UCM Act)*

Previously, the length of time which was required to pass before money was deemed unclaimed was either 6 or 25 years from the date of the owner's last interaction with the holder, depending on the type of funds.

The reforms consolidate the prior two deeming periods into one uniform deeming period of five years. In other words, the standard deeming period of five years will apply to all amounts of money.

To avoid engaging the deeming period, an owner must request information or provide instructions to the holder about the money or another matter, within five years. If owner does not do so, the money will be deemed unclaimed. The deeming period will commence from the date of the owner's last interaction with the money.

A common issue for some holders arises from money which is discovered during a routine financial remediation process. These amounts can now be paid to the Commissioner immediately where there is little prospect of reuniting them with their owner (see "Transfer of money to the Commissioner before it becomes unclaimed" below).

### *Account activity (section 4(3)(a) of the UCM Act)*

To recognise modern forms of account interaction which will prevent money from becoming unclaimed, section 4(3)(a)(i) and (ii) now refer to owners "requesting information" or "providing instructions" to the holder. This includes, for example, customer interaction through internet banking (for example, where a customer views their account balance online). This broadens the 1970s definition of forms of account activity from making a deposit, withdrawal or providing instructions in writing.

### *Institutional approach to account activity (section 4(3)(a) of the UCM Act)*

The reforms apply a customer's account activity on one account to all accounts the customer holds with the same institution. This is reflected in the wording of section 4(3)(a)(i) and (ii) which refer to the owner requesting information or providing instructions to the holder about "another matter". This is intended to avoid money at the same institution from becoming unclaimed while the owner remains engaged with their funds. Account activity will also include an owner's interaction with a joint account or another product held with the same institution (for example, an account holder's cash-PIE investment).

**Example 42**

Sabena has $1,000 in a savings account with Money Bags Bank (MBB). She is keen to save the money, so she decides to leave the $1,000 untouched and does not withdraw any money for ten years. She also holds an on-call account with MBB which she accesses frequently for her everyday purchases.

The institutional approach to account activity means that Sabena's interaction with her on-call account will prevent the funds in either account from becoming unclaimed.

The broad wording of this section gives banks and other holders the ability to determine for themselves whether customers have been interacting with another of their accounts at that institution. Holders are expected to apply their best judgement when determining account interaction, as the nature of account interaction may vary between institutions.

### *Transfer of money to the Commissioner before it becomes unclaimed (section 4(3)(b) of the UCM Act)*

Historically there was no ability for holders to pay unclaimed money to the Commissioner before the expiry of the six or 25-year holding periods specified under the previous regime.

In some circumstances, however, Inland Revenue appreciates that there is little to be gained by requiring holders to retain amounts owed to former clients where they have identified that the owner is unable to be contacted.

To assist holders, section 4(3)(b) allows holders to choose to pay money which has not yet become unclaimed to the Commissioner where they have made reasonable efforts under section 5B and have been unsuccessful in locating the owner. There is no requirement that a holder first contact the Commissioner before transferring such money to Inland Revenue.

Allowing holders this option is intended to increase the chances of an owner being reunited with their money. This may assist holders who owe, for example, amounts identified during a routine remediation process or backdated holiday pay.

**Example 43**

Really Big Bank (RBB) conducts a financial remediation process and identifies that it has overcharged their client (Mr. Bach) $105 in account fees. However, before RBB realises its error, Mr. Bach closes his accounts with RBB and moves to a remote location in the Northern Territory.

Once its process is complete, RBB seeks to contact Mr. Bach to return the funds and apologise for the error. However, despite its best efforts, Mr. Bach cannot be located. While the refund of fees owed to Mr. Bach will become unclaimed money five years from when the error first arose, RBB takes the view that there is little sense in it retaining the funds any longer.

To increase the chances of reuniting Mr. Bach with his money, RBB chooses to pay the $105 to the Commissioner as unclaimed money before the five-year deeming period has expired.

### *Treatment of renewing term deposits (section 4(6)(b) of the UCM Act)*

The reforms recognise that it is common for term deposits to be automatically reinvested on similar terms and conditions upon maturity. The amended section 4 refers to these as "renewing-term arrangements." The definition in section 4(6)(b) is intended to cover a deposit which contains an option for repayment but is treated as reinvested where the option is not exercised.

There may be situations in which a term deposit is the only investment which a customer has with a financial institution. In such a situation, the standard deeming period would conventionally apply five years from the date the customer last provided instructions to the bank.

To ease the administrative burden on institutions and depositors, section 4(3)(a)(ii) provides an exception to the usual deeming period. Where the deposit is the only investment which the customer has with an institution, the five-year deeming period will not commence until the second term (that is, first rollover) of the renewing term arrangement.

Once the deeming period starts and five years has passed with no interaction, the money will be deemed unclaimed money. However, to avoid breaking a deposit mid-term, section 4(3)(a)(ii) prevents a deposit becoming unclaimed money before the end of a term.

**Example 44**

Josh is a customer of Conservative Cash Bank (CCB) but he decides to try his chances at investing in a one-off account with Money Bags Bank (MBB). He invests $1,500 in a two-year term deposit with an option for repayment, but which is treated as reinvested where that option is not exercised. This is his only investment with MBB. Provided Josh does not exercise the option for repayment, the timeline looks as follows:

| Investment period | Period of investment | Total length of time unclaimed |
|---|---|---|
| Period one | Two years | N/A |
| Period two | Two years | Two years |
| Period three | Two years | Four years |
| Period four | Two years | Six years |

Josh's first period of two years does not engage the unclaimed money regime. The UCM Act views the first period of investment as a free period. Once the term deposit rolls over for another two years, the unclaimed money deeming period begins. However, Josh does not have any linked accounts with MBB and does not check his balances over this time.

Period two represents years one and two of the deeming period. Without any directions from Josh, the money rolls over into period three, which represents years three and four of the deeming period.

When the money rolls over into period four of the renewing term arrangement, Josh has completely forgotten about the money and does not interact with MBB. The unclaimed money deeming period stops at five years, but the money will not be deemed unclaimed until the end of period four. This removes the need for the bank to transfer a deposit before the end of the fourth term. In this example, the money will become unclaimed once six years have elapsed since the first roll-over.

### *Holder (section 5(2) of the UCM Act)*

The reforms allow a person, firm, body or institution which holds money:

- which is not unclaimed money under section 4(2) or 4(7) of the UCM Act, and
- if it excluded by section 4(5), it meets the requirements of section 4(7)

to elect to be a holder under the UCM Act.

### *Obligations of holders*

#### *Reasonable efforts (section 5B of the UCM Act)*

The reforms require a holder to make "reasonable efforts" to locate an owner of unclaimed money. Section 8(1) of UCM Act requires that holders have met this requirement within one month and 20 days of the end of their reporting period (see below, "Payment and transfer of unclaimed money.") However, for some holders, the requirement to make "reasonable efforts" to locate the owner of the money may already have been met owing to past attempts to contact the owner having been unsuccessful.

The obligation on a holder to make reasonable efforts is intended to encourage holders to use their resources and the information they hold efficiently. This is a move away from the formalistic process for contacting owners prescribed by the previous legislation. Holders are required to pursue the avenues of contact which they consider will be most productive. This will require holders to exercise reasonable judgement.

However, this is not intended to impose additional compliance costs upon holders and does not require them to pursue avenues of contact which they know will prove unproductive. For example, a holder is not required to attempt to contact an owner using a phone number or email address which is considered or known to be no longer current.

**Example 45**

Fantastic Filing Bank Ltd (FFB) has many customers who hold renewing term arrangements. Every so often, FFB reaches out to account holders to provide an account update. FFB has tried to update Baz who holds a single account with the bank.

Baz does not interact with the account for three years. During this time, FFB sends two emails to update him on his account but they both "bounce back" as undeliverable. FFB decides to send a letter to his last recorded physical address, but the letter is returned to sender as Baz no longer resides at that address.

As FFB's attempts to contact Baz using known avenues prior to the conclusion of the deeming period are reasonable, FFB will not have to repeat its efforts to contact Baz once the five-year deeming period has elapsed.

The obligation to make reasonable efforts simply requires holders to use the information available to them in each situation. To optimise the customer experience, holders may wish to develop their own guidelines to be applied in accordance with the contact options available to the holder in each case.

Inland Revenue would expect most holders would, in providing good customer service, make multiple attempts to contact the customer before the deeming period ends. The holder may, at its discretion, send a final notice to the customer once the funds become unclaimed, but this is not required.

**Example 46**

Another Institution Ltd (AIL) is not up to speed with the unclaimed money rules. An employee of AIL notices that one account of $625 has just become unclaimed money. AIL's internal system has three avenues of contact recorded for the account owner: an email address, a cell phone number, and a physical address. Standard practice at AIL is to send a pre-formatted letter to the owner's physical address because this saves time.

However, in this case, the letter is returned as the customer no longer resides at that address. AIL does not attempt to contact the owner by cell phone or email, although it has no reason to believe they are not current.

The Commissioner would not consider AIL's actions satisfy the standard of reasonable efforts required by section 5B. Ideally, AIL would attempt to contact the customer using the other avenues of contact which it has available to it.

*Information collection and transfer (section 5B(2) of the UCM Act)*

This section requires holders of unclaimed money to provide the Commissioner with any information in their possession or control relating to the owner of the money and the amount. Section 8(1) of the UCM Act requires holders to provide this information to the Commissioner within 1 month and 20 days of the end of their reporting period (see below, "Payment and transfer of unclaimed money"). Information which holders should provide to the Commissioner includes (in summary):

- how the money came to the holder
- the identity and whereabouts of the owner (if known)
- why the money belongs to the owner, and
- any identifying data (for example, the owner's IRD number).

For example, a bank which submits information to Inland Revenue using the relevant schedule could categorise money as arising from a range of sources including bonds, credit cards, investments or bank charges. The bank could also use the space within the schedule to note any particulars associated with the owner (such as the owner's name, date of birth, contact details and IRD number). A detailed guide to the transfer of unclaimed money may be obtained from Inland Revenue.

However, this is not intended to impose any added information collection requirements on holders of unclaimed money. Rather, holders should provide the Commissioner with any readily available information which they hold relating to the owner or the money. This will assist the Commissioner in verifying the owner.

Inland Revenue will provide holders with an electronic template to facilitate the transfer of relevant information from the holder to Inland Revenue. To send the template, holders will need to register as a holder in myIR and submit their schedule online.

*Maintaining a register (section 6 and 7 (register sections) of the UCM Act repealed)*

A holder is no longer required to maintain a publicly available register of unclaimed money. Holders are instead encouraged to maintain internal records which align with the information collection requirements of section 5B. Inland Revenue will supply holders with appropriate electronic schedules for submitting information.

*Payment and transfer of unclaimed money (section 8 of the UCM Act)*

The reforms institute a reporting and transfer regime. This, in summary, allows holders to combine all the money which became unclaimed during a reporting period and transfer it to Inland Revenue within one month and 20 days of the end of the reporting period.

*Reporting period*

Section 8(5) sets out the reporting periods available to a holder. Holders are expected to report quarterly. A quarter is defined in section 2 as a period of three consecutive calendar months ending on the last day of March, June, September, or December. Holders may apply to the Commissioner to seek a longer reporting period of two consecutive quarters either as a "one-off" or on an ongoing basis.

**Table 3: The UCM Act's reporting and transfer periods**

| Reporting period | Transfer of money and information by |
|---|---|
| 1 January – 31 March | 20 May |
| 1 April – 30 June | 20 August |
| 1 July – 30 September | 20 November |
| 1 October – 31 December | 20 February |

**Example 47**

Really Big Bank (RBB) has noted that three deposits of money will be deemed unclaimed on the 1st of March. These will be reported as unclaimed for the quarter 1 January – 31 March.

RBB will have one month and 20 days from the end of the quarter to make reasonable efforts to locate the owners. However, as the money became unclaimed at the beginning of March, RBB can start seeking the owners in early March. If the owners cannot be located, it must transfer any relevant information and the deposits to the Commissioner by 20 May.

### *Transitional periods*

Due to the change in timelines from the old deeming periods to the new five-year deeming period, transitional provisions are necessary. To assist in explaining the money that will be affected by the reforms, it is helpful to distinguish between the "flow" and "stock" of unclaimed money.

*Flow*

For present purposes, "flow" refers to money which becomes unclaimed (that is, satisfies the five-year deeming period) the day on which the Amendment Act receives Royal assent, and in the days which follow.

Holders of money that becomes unclaimed the day the Amendment Act receives Royal assent will be subject to the new reporting requirements unless they apply for the extended reporting period available to applicants in the new section 8(5)(c) of the Act. However, for most holders, the first reporting period will commence on 1 April 2021 (refer to table 3 above).

Where a holder requires more time to update its computer systems to comply with the reforms, the holder will need to apply to the Commissioner for an extension of the reporting period. Where a holder receives the maximum available extension, the relevant reporting and transfer dates are as follows:

**Table 4: Reporting timetable for money that becomes unclaimed on or after 30 March 2021**

| Amendment Act receives assent | Date money becomes UCM under the new definition | First reporting period end date | Date to transfer UCM and file return by | Maximum extension of first reporting period | Extension to transfer UCM and file return by |
|---|---|---|---|---|---|
| 30 March 2021 | 30 March 2021 | 30 June 2021 | 20 August 2021 | 31 March 2023 | 20 May 2023 |

Holders who are granted the full extension will be reporting on all amounts deemed unclaimed money over the preceding 24-month period.

Normal reporting requirements will then apply to these holders' second reporting period.

This means that holders will be required to report quarterly unless the holder has applied for an alternative reporting period of two consecutive quarters (that is, six months) which has been approved by the Commissioner under section 8(5)(b).

*Stock*

The reforms also contain transitional provisions to deal with the large amount of money which will be rendered unclaimed money overnight once the reforms implement the five-year qualifying period.

The issue of "stock" arises because the prior regime had longer deeming periods of either six or 25 years depending on the category of unclaimed money.[7] Once the reforms take effect, the five-year deeming period will apply "instantly" to the pool of money ("stock") which had not yet qualified as unclaimed money under the previous deeming periods.

[7] These two categories were described as fixed term deposits and renewing term deposits. In the case of fixed term deposits, the prior regime required the money to have been unclaimed by its owner for a period of 6 years. Conversely, in the case of a renewing term deposit, the prior regime required the money to have been left for a period of 25 years.

Money which falls into the category of "stock" must be transferred to the Commissioner within the period which is two years after the Amendment Act receives Royal assent. This is expressed in section 210(5) of the ARFERM Act 2021. As the reforms received the Royal assent on 30 March 2021, the "stock" of unclaimed money must be transferred to the Commissioner no later than 30 March 2023.This deadline applies irrespective of any extension in reporting period applied for under section 8(5)(c) of the Act.

*Unclaimed money yet to be transferred under the previous regime*

The previous regime imposed a reporting calendar upon holders. For the 2021 year, this ran from 1 June 2020 to 31 May 2021. If the UCM Act had remained unchanged, the required steps of a holder in 2021would have looked like this:

**Table 5: Due dates under the former regime**

| 01/06/2020–31/05/2021 | 01/06/2021 | 30/06/2021 | 30/09/2021 | 31/10/2021 |
|---|---|---|---|---|
| UCM accrues | Holders enter particulars of unclaimed money arising in the past year into their registers. | Holders write to owners of unclaimed money by post. | Holders send list of unclaimed money to the Commissioner. | Holders transfer any remaining unclaimed money to the Commissioner. |

Money deemed unclaimed between 1 June 2020 and the day prior to enactment would usually not have been transferred to Inland Revenue until 31 October 2021. However, as the reforms come into force mid-way through this reporting calendar, some holders will hold money which has become unclaimed but has not yet been transferred to Inland Revenue.

This category of money does not fit easily within the categories of "stock" and "flow" which we have described above. Therefore, to assist holders in managing the transfer of this unclaimed money, (section 210(7) of the ARFERM Act 2021) allows holders to transfer it over two years, along with the category of "stock" noted above. This means that holders must transfer such money within the period which is two years after the day the reforms receive Royal assent.

***Capacity of trustees***

The reforms insert a new section 11B which affirms the principle that a person acting in the capacity of a trustee of a trust acts in a capacity which is separate from the person's other capacities. These other capacities include the person's personal capacity, their capacity as a body corporate which is a legal person, or as a trustee of another trust.

Therefore, in applying the institutional approach to account interaction, holders should be mindful that a person's interaction with an account of a trust of which they are a trustee cannot be taken as interaction with an account which they hold in their personal capacity, or in their capacity as trustee of another trust.

However, there will be situations in which a person's interaction with an institution may establish interaction in more than one capacity. An example might be where a person is able to log into his or her online banking "portal" and view both personal accounts and any accounts of which they are a trustee. Accessing accounts in this way will constitute interaction with all the accounts accessed. The deeming period will therefore not commence in connection with any of the linked accounts.

*Amounts no longer claimable under the reforms (sections 11(6) – (8) of the UCM Act)*

The reforms make three categories of money received or held by the Commissioner unclaimable. These are amounts which:

- have been unclaimed money for 25 years or more
- have no identifying information, or
- are $100 or less.

Amounts that fall within these categories are removed from the list of unclaimed money by the Commissioner and may not be claimed by their owners. In each case, these amounts cease to be unclaimed money when they meet the requirements for delisting by the Commissioner. The Crown becomes the owner of this money.

*Amounts aged 25 years or older*

Previously there was no time limit on an owner's ability to claim money held by the Commissioner. This meant an owner could make a claim for money which had accrued as long ago as the regime's beginning in 1908. However, the longer the money remains with Inland Revenue, the less likely it is to be returned to its owner. This is typically due to incomplete information or a lack of eligible claimants.

The reforms introduce a time bar of 25 years upon an owner's ability to claim money from the Commissioner. A time bar allows Inland Revenue to focus public resources on the amounts of unclaimed money which have the best chance of being reunited with their owners, while also allowing sufficient time for owners to claim their money.

*Un-associated amounts*

Amounts of unclaimed money which have no information associated with them are referred to as "un-associated amounts". It is impossible for the Commissioner or the fund owners to establish an entitlement to these amounts.

*Amounts $100 or less*

Although holders are not required to pay amounts of $100 or less to the Commissioner, they may transfer such amounts to Inland Revenue if they choose.

***Amendments to other Acts***

*Defining the UCM Act as an Inland Revenue Act (schedule 1 of the Tax Administration Act 1994)*

The reforms amend the Tax Administration Act 1994 (TAA) to bring the Unclaimed Money Act 1971 within the Inland Revenue Acts included in Schedule 1 of the TAA. This will allow Inland Revenue to use the existing tax information which it holds in its system to assist in validating claims. This should increase the likelihood of owners being reunited with their money.

*Disclosure permitted (schedule 7, part A, clause 13C of the TAA)*

As the UCM Act will become an Inland Revenue Act, administrative matters will be covered by the general confidentiality provisions of the TAA in section 18. The amendment creates a specific exclusion from the confidentiality provisions of the TAA which will allow the publication of unclaimed money data.

This will allow the Commissioner to publish searchable information on Inland Revenue's website and make it easier for owners to find and claim funds. This information will include the name of the owner and the amount, the name of the holder who sent Inland Revenue the unclaimed money, and broad physical location of where the money was located (for example, Christchurch).

Due to the inclusion as an Inland Revenue Act, the bespoke secrecy provision in section 12 of the UCM Act is no longer necessary and has been repealed.

*Extension of binding rulings regime (section 91C(1)(db) of the TAA)*

The TAA has been amended to include the UCM Act within the binding rulings regime. This allows Inland Revenue to make binding rulings in respect of matters affected by the UCM Act to offer certainty to taxpayers as to the Commissioner's application of the UCM Act.

*Alignment of the KiwiSaver Act 2006 with the reforms (section 83(1)(a) of the KiwiSaver Act 2006)*

Section 83(1)(a) of the KiwiSaver Act 2006 deals with KiwiSaver contributions that the Commissioner is unable to administer in accordance with the UCM Act due to insufficient information. Inland Revenue acts as a holder for the purpose of these funds and is subject to the unclaimed money rules. This amendment aligns section 83 of the KiwiSaver Act 2006 with the new five-year deeming period.

*Consolidation of deeming period under KiwiSaver Act 2006 (section 83(3)(ab) of the KiwiSaver Act 2006)*

Previously, under the KiwiSaver Act 2006, different dates could apply to determine when employee and employer KiwiSaver contributions were deemed to be in the Commissioner's possession. This could create administrative issues where it has not been possible to associate the contribution with a specific member. To simplify this process, the date the money is in the Commissioner's possession will be deemed to be the last day of the month to which the employment income information applies for the purposes of unclaimed KiwiSaver contributions.

*Allowing use of unclaimed money to offset a tax liability (section 173V of the TAA)*

The reforms insert the new section 173V into the TAA. This section allows a taxpayer with a valid claim to an amount of unclaimed money held by the Commissioner to apply all or some of that amount to a liability the taxpayer owes to Inland Revenue. This option is available to taxpayers on a voluntary basis.

## Business continuity test

*(Sections GB 3BA, GB 3BAB, GB 3BAC and subpart IB of the Income Tax Act 2007)*

The Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 introduced a business continuity test to the Income Tax Act 2007 to loosen the loss continuity rules to help stimulate growth and innovation in the economy. The business continuity test acts as a secondary test to the current ownership continuity test permitting loss carry forward if there is a breach in ownership continuity of a company as long as there is no major change in the nature of the business activities of the company. The test is accompanied by measures to support the policy objective:

- A purpose provision setting out the objective of the test (to promote growth and innovation while preventing loss trading).
- Exclusion of dormant companies from the rules.
- Anti-injection rules to prevent schemes that would permit the purchaser of a company to use up losses by diverting income into the company or by reducing expenditure of the company.
- A rule to stop pre-emptive changes to the business being made before the change in ownership to defeat the purpose of the business continuity test.
- Maintaining the current approach to loss grouping.



### Background

The loss continuity rules in subpart IA 5 of the Income Tax Act 2007 determine whether a company can carry tax losses forward to offset income in a future year. Previously, New Zealand's loss continuity rules required 49 percent continuity of ownership. This was designed to guard against loss trading but also created an impediment to businesses obtaining capital to innovate and grow because, in doing so, they could breach the 49 percent threshold. While this is particularly an issue for start-ups, some businesses recovering from the economic impacts of COVID-19 have looked to recapitalise and innovate in order to survive.

**Example 48**

Starting Today Limited (STL) was founded in 2003 and operates in the electronics industry. In 2006, a venture fund invested $2 million for a 40% interest in the company.

The investment was used by STL to fund further development to advance to the commercialisation stage. At the same time, 20% of STL's shares were set aside for employees as part of an employee share scheme plan in order for the company to retain those employees and align their interests and rewards with those of other shareholders. The founder retained a 40% shareholding.

This 60% change of ownership resulted in the forfeit of approximately $4 million of tax losses that had accrued since inception.

In 2008, the company expanded into the US market and received an initial capital investment of US$10 million, followed by further capital rounds over the following four years that resulted in a 60% change of shareholding and all tax losses, $6 million, from 2006 to 2009 being forfeited.

A business continuity test works by assuming that if a business is carried on after a change in ownership the motivation for acquiring a company is a genuine commercial one. If the business is not so carried on, the motivation for acquiring the company could be loss trading (that is, acquiring a company with historic losses in order to reduce tax payable in relation to another business). The New Zealand business continuity test has been designed to remove an impediment to sensible business reorganisations, including recapitalisations, while preventing loss trading.

### Key features

Subpart IA of the Income Tax Act 2007 sets out the rules for when tax losses may be carried forward to a later income year to offset future income (the "loss continuity" rules) by requiring at least a 49 percent continuity of ownership from when a loss arises to when it is used. Subpart IB provides an alternative loss continuity rule by introducing a business continuity test. This allows a company to carry losses forward after a change in ownership as long as the business fundamentally continues without major change.

The business continuity test starts with the presumption that a company can carry forward losses following a change in ownership unless there is a major change in the nature of its business activities, having regard to the assets used, within five years (or less if losses are used earlier) of the change in ownership. The proposal carves out changes which are just a consequence of natural development. As a whole, the test is intended to focus on the inputs a company employs and not its outputs to allow a business to pivot. The test specifically requires reference to assets as these are a key resource which a company uses to generate income. A significant change in the asset base could be a good indication that the fundamental business activities are not being continued post acquisition and that there has been a major change.

If a company is carrying forward losses comprising 50 percent or more bad debt deductions claimed under section DB 31(3) of the Income Tax Act 2007 the five-year rule will not apply. Instead, the continuity period for these companies will run from the time immediately before the breaching change in ownership until the time the loss is used up. This feature is designed to prevent failed finance type companies from being acquired for loss trading purposes.

To support the test and ensure it is not manipulated to enable loss trading the following measures have been implemented:

- A purpose provision setting out the objective of the test (that is, permit capital raising while preventing loss trading).
- Exclusion of companies where the scale of activities in its business have reduced to nothing or almost nothing (dormant or "zombie" companies) from the rules.
- Anti-injection rules to prevent schemes that would permit the purchaser of a company to use up losses by diverting income into the company or by reducing expenditure of the company.
- A rule to stop pre-emptive changes to the business being made before the change in ownership to defeat the purpose of the business continuity test.
- Maintaining the current approach to loss grouping. Companies acquired as part of a corporate group may continue to offset losses within that group, however, a company cannot be purchased and have its losses made available within a new group.



## Application date

The business continuity test applies to breaches of ownership continuity occurring in the 2020–21 and later income years and to losses arising from the 2013–14 income year onwards.

## Detailed analysis

### *Purpose statement*

The business continuity test is new subpart IB (Carrying forward companies' loss balances: continuity of business activities) of the Income Tax Act 2007. The business continuity test is intended to loosen the current loss continuity rules so that a taxpayer can carry forward tax losses even where there has been a breach in ownership continuity.

Section IB 1 sets out the purpose of the business continuity test. This is to permit loss carry forward after a change in ownership in order to remove impediments to:

- innovation and economic growth
- corporate reorganisations
- changes in the direct or indirect ownership of companies
- companies accessing new sources of share capital
- corporate reorganisations (including changes in shareholding with no immediate sourcing of new capital), and
- companies adapting their businesses in order to grow or be resilient.

Importantly, section IB 1 also makes clear that loosening the loss continuity rules by introducing this test is not to encourage loss trading.

Loss trading is where there is little or no economic basis for the transaction in which a company is acquired. Its principal purpose is the purchase of losses that would otherwise not be used. This is done to offset income that the acquirer would otherwise have needed to pay tax on. Preventing loss trading is the reason loss continuity rules are part of the tax system.

Overall, the purpose statement is designed to provide context to support the interpretation and application of the business continuity test, it is not itself a test for loss carry forward. It is expected that the proposed purpose statement will have value in cases at the margin where it is unclear how the business continuity test applies.

### *Core test*

Section IB 3 contains the core business continuity test. This test can be relied on to carry losses forward if a company breaches the 49 percent ownership continuity threshold, as long as there is no major change in the company's business activities that would suggest it is not being continued post-acquisition. The test applies to all companies with the exception of mineral mining companies. There is a tailored business continuity test already available to these companies in section IS 2 of the Income Tax Act 2007.

*Similar business: no major change*

A company will meet the business continuity test as long as there is no major change in the nature of the business activities carried on by the company (s IB 3(c)). In determining whether a particular change is a major change in the nature of the business activities the taxpayer would need to evaluate the extent to which the same business activities are undertaken to generate assessable income. Subsection (4) specifically directs the taxpayer to consider the extent to which the same or similar assets are used to generate assessable income.

The phrase "business activities" is intended to consider the particular actions carried out by the business to generate income and the processes or methods by which they are carried out. For example, a bakery may predominantly bake its own products for sale, but may also buy in some specialty items that it resells. Likewise, the bakery may sell its products through its own retail outlet but may also sell direct to local supermarkets and cafes.

The use of the phrase "business activities" is intended to deal with the situation where a company discontinues one business and starts another. It is normal for a company to establish new businesses as part of its growth. Absent a change in ownership a company is permitted to do this while maintaining their losses to offset income of both the old and the new businesses. The business continuity test also permits this as long as the starting of a new business is something that could reasonably be expected to have happened without a shareholding change. The test is not intended to be applied granularly on a business-by-business basis.

Overall, elements to evaluate include:

- the business processes
- the scale of business activities
- use of suppliers or other inputs
- the markets supplied to
- the type of products or services supplied, and
- the assets used.

"Assets" is intended to take an ordinary meaning and includes tangible and intangible (for example, goodwill) assets. It is accepted that some categories of asset require replacement. The phrase "same or similar assets" is used to clarify that the normal replacement of specific assets with similar assets would not be part of the assessment of whether there has been a major change.

**Example 49**

If I Can Dream CGI Limited (I Can Dream) is a start-up company that produces CGI effects for television and movies. It has been operating for a number of years now and has had a number of successful projects. However, it really needs a cash injection from a new investor to take the business to the next level. It is in desperate need to update its ageing computer equipment to state of the art technology. The computer equipment represents around 95% of the assets of the company.

Largely due to the initial cost of setting up a CGI effects company, I Can Dream has been in a loss position for a number of years and Kelvin, the owner, looks for a new investor. Ben has an interest in the film industry and decides to invest in the company, however, he wants to take a controlling interest due to some question as to Kelvin's ability to run the company efficiently. After much discussion Kelvin agrees to an investment which will give Ben a 55% ownership stake in the company.

Shortly after the share subscription, I Can Dream uses the additional funds to completely replace its assets with new cutting-edge computer equipment. The equipment essentially produces the same product, but the quality has increased significantly.

Kelvin is concerned that the replacement of the assets will be a major change for the purposes of the business continuity test. For the purposes of assessing whether there has been a major change, section IB 3(4) requires a taxpayer to assess the extent to which the assets used in deriving the company's assessable income have changed during the continuity period.

In the case of I Can Dream the company has replaced all of its assets, however, those assets are essentially the same as the old assets albeit newer and shinier. The assets do the same functions as the old ones but in a more efficient way, producing a better product and they look better in the office.

The policy intent is that such a replacement of assets with new versions of essentially the same assets should not be considered as a factor when evaluating if there has been a major change.

Not every change will be a major change. Any change in business activities (including use of assets) must be considered against the unchanged business activities (including use of assets) employed by the company to generate income to establish whether the change is "major". Generally, this is a question of scale (in other words, how significant is the change in the context of the operations of the entire company). The test is not intended to give special weight to any particular factor.

**Example 50**

Flip Flop and Fly Eggs (FFF Eggs) has been producing eggs to supply to supermarkets for 20 years. The eggs have always come from battery farmed chickens. Over the last 20 years this operation has become large scale with two large sheds, containing 45,000 chickens each, occupying the land.

Consumers have started to become more conscious of the source of their food and the demand for battery eggs falls. Consumers prove to be more interested in animal welfare than in saving a few dollars per tray of eggs. FFF Eggs finds itself sustaining losses several years in a row as supermarkets buy less of their eggs and offer a lower price. FFF Eggs realises that it needs to change and decides to chase the free-range egg market. This requires an overhaul of its farm at a significant cost. A new investor is brought in who is keen to see the business become focused on animal welfare first. Ownership continuity is breached.

The battery sheds are torn down and in their place grass is seeded, a roosting barn set up and a fence erected around the land. 60,000 chickens are given to rescue centres. This leaves the 30,000 chickens the land can support free-range. This dramatically reduces the number of eggs FFF Eggs can supply, but it is able to double its price.

FFF Eggs can carry forward its pre-breach losses because, while a significant portion of the assets have changed, when weighting other factors there has not been a major change in the nature of the business activities. FFF Eggs has changed some but not all business processes, it still supplies to the same market (supermarkets and consumers of eggs), it uses the same suppliers to get chicken feed and replacement chickens, and there is no change in the type of product it is supplying.

Subsection (2)(a) limits the application of the business continuity test to losses arising from the 2013–14 income year onwards. It will also not apply if the company ceases to carry on business activities during the continuity period (subsection (2)(b)).

### *Carve-outs from major change*

The test is designed around the fact that changes to the inputs used to generate income indicates that the fundamental business is not being continued. However, some changes to business activities and assets will be a consequence of natural development that could have happened absent the change in ownership. This behaviour is not about tax but about a company being able to position its resources in a way that maximises returns. Where there is no loss trading motivation and the fundamental business is continued the business continuity test should allow losses to carry forward. Tax should not be a barrier to normal business development.

To recognise this, section IB 3(5) includes a number of carve-outs from what might be considered a "major change". These carve-outs are intended to permit loss carry forward in spite of a major change where there is a genuine commercial reason for changing business activities or assets that is not related to the availability of losses. The carve-outs are not a comprehensive list of major changes is and only need to be referred to if there is a major change. In combination with the core major change test, the carve-outs ensure that the business continuity test has the intended input focus.

The first carve-out covers changes made to increase the efficiency of the business activities. This contemplates changes that are made to decrease costs (without artificially moving costs – refer to section GB 3BAC) or otherwise increase the efficiency of the company.

The second carve-out covers changes made to keep pace with developing technology. This contemplates situations, for example, where companies take advantage of new technology that becomes available or if they switch from a physical store to online.

**Example 51**

Maowang Chan has developed a method to identify purebred cats from imposter breeds. This is important in the competitive world of exhibiting cats. His method uses a unique barcode that is tattooed at the base of the tail of the cat to identify the breeder of the cat and the family tree of the particular cat. This barcode is then read by a scanner and the code is located in a database of cat pedigree.

His company Go-Cat-Go Limited (GCG) supplies the cat identification service which breeders use like a virtual certificate of a cat's pedigree. The company both tattoos the cats and maintains the database.

GCG has enjoyed some success with cat breeders, however, some breeders do not like this method of identification as it is invasive and the barcode can only be read by shaving off some of the fur which makes it limited to appeals from competitions where someone suspects a non-purebred cat has been awarded a prize.

Maowang wants to investigate other means of identifying the cats which are less invasive and make better use of technology. However, as the company has been incurring losses over the last few years, he needs a partner to help with funding the new ideas.

Alex is a cat lover who has previously exhibited his 12 cats and sees a great opportunity to make some money from the ideas that Maowang has. He offers to invest in GCG and Maowang sells Alex 52% of his company which breaches shareholder continuity.

In the year after the breach GCG works on developing a new technology which involves inserting a new microchip designed by GCG into the cats which can be read with a new patented scanner which GCG has manufactured. This has involved GCG replacing its old tattoo equipment with the new electronic scanners and microchip manufacturing equipment. The scanners and microchips are then sold to vets, who place the chips into clients' cats and can search them on the database on request. In that year GCG looks to use some of the tax losses brought forward after the breach.

GCG has had a major change during the year as its assets have completely changed, and although its business activities have remained similar on balance there has been a major change so it will need to rely on a carve-out to use the losses. Section IB 3(5)(b) allows a major change which is made to keep up to date with technology. As GCG has changed its assets to keep up with advances in technology it will be able to use the carve out in subsection (5)(b).

In the next year GCG discovers an even newer technology that utilises the cat's tail as an antenna to broadcast the signal from the microchip to a central point to enable faster identification of the cats. GCG's assets completely change again to produce the new microchip and receivers. Again, GCG has had a major change due to the change in the assets of the company being such a big part of the business, however, again GCG has made those changes to keep up with technology the underlying business of the company has not really changed. GCG will be able to rely on the technology carve-out to utilise its carry forward losses.

The third carve-out covers increases in scale, including a company entering a different market for its products or services.

The fourth and final category of carve-out covers changes in product or service type. Overall, this carve-out permits:

- a company to pivot and drop a type of product or service and start producing or supplying another that has a close connection (for example, a restaurant operator switching to a cooking school), and
- a company to be able to retain its existing product/service type but also add to it as opportunities arise, as long as there is a close connection (for example, a clothing manufacturer starting a range of commercial cleaning cloths using offcuts from the clothing).

Any new type of product or service needs to relate to those already being produced in some way. This might be because they are made using mainly the same assets or processes, or there is some other close connection between those already being produced.

**Example 52**

For the Heart Flour Co. Limited (HFC) has developed a revolutionary technique for adding high levels of quality protein into flour. This creates flour which is superior for bread making. HFC has been producing and suppling this flour to artisan bread makers for several years. Despite its rising business HFC has made losses over the last few years.

Always on my Mind Foodstuffs Limited acquires 100% of HFC and continues its flour business. Three years in HFC discovers that their method of adding protein would have application in sport protein powders.

***HFC starts producing the protein powder and stops producing the flour***

This results in enough of a change in activities and assets to breach the major change test. Always on my Mind Foodstuffs Limited wants to know if a carve-out under section IB 3(5) will apply to allow HFC to carry forward its losses.

Section IB 3(5)(d) allows HFC to change the types of products produced if that involves the company using the same or similar assets or the product is closely related to a product that was provided immediately before the start of the continuity period. The protein powder uses the same IP surrounding the special technique that HFC developed and the old and the new product have a close connection in that they centre around the use of the IP to fortify something with high quality protein. This situation should pass. Likewise, if HFC decided to produce flour and the protein powder the situation should pass under ss (5)(d). HFC is using its existing resources to expand its product offering.

***The market for the protein powder shrinks and HFC sees an opportunity to simply sell up its assets and get into cryptocurrency mining – a new craze that the small group of shareholders have latched onto as the next big thing***

When compared to the time immediately before the breach in ownership until the time the loss has been used there has been a major change. In dropping the flour and eventually the protein powder, HFC sold off all its assets and acquired computers to mine for cryptocurrency. The product it is not related to any aspect of the HFC business before the change in ownership and it does not use any of the same assets. Even though HFC can cease to make its original product and retain the losses from the earlier enterprise, the rules do not permit it to make anything that it wants following an ownership change and still access those losses. There needs to be a clear connection between the replacement product and the original product. The carve-out for technology will not apply either because this is only intended to cover situations where different technology is used within the continued business, not where a business sees an opportunity in a new technology-based industry.

Section IB 3(7) provides that land (excluding fixtures to land) would be excluded from consideration when a company is looking at whether it can rely on the change in product/service carve-out. This is because land is a big enough asset to skew the way the carve-out is intended to apply.

**Example 53**

Nikki owns and operates All I Needed Was the Rain Limited (ANR), a deer farm in the Wairarapa. Venison prices have been falling lately and ANR is carrying forward losses from the last three years.

In 2023, Nikki sells ANR to David breaching ownership continuity.

David takes stock of his new acquisition. The assets are the land, the fencing set up around large flat paddocks, an irrigation system, water troughs, and several storage sheds for farm equipment, plus 300 head of deer.

David spends the rest of the 2023–24 year farming the herd of deer but not replacing any. In the 2024–25 year he sends off the last of the deer and buys sheep to start producing wool. At this point ANR has experienced a major change, the deer have been switched out for sheep, the product type has changed from meat to wool, the customer has changed, and some suppliers have changed. His assets have changed somewhat but not totally. ANR has also had to do-up an old shearing shed situated on the land at a cost of $100,000. He also spends $150,000 on a flock of sheep.

However, David is able to apply the subsection (5)(d) carve-out for change in the type of product. This is because, although he cannot include the land in his assessment, he uses mainly the same assets in the production of wool as he did for the venison. He leaves the fences, the troughs, and the irrigation system intact. The storage sheds still house farm equipment. All up, $1 million worth of non-land assets are still being used, while $250,000 worth of new assets have been added (including the shearing shed).

In the 2025–26 year, David decides that dairy farming is the future. He sells the sheep and converts the farm. David must look at the business activities at the time he acquired ANR and compare them to the business as it is presently. ANR has experienced a major change in the nature of its business because of the switch from being a venison farm to a dairy producer selling within a cooperative. David again looks to the carve-out for product type. However, in this case the carve-out would not apply as he is not using mainly the same assets anymore. David cannot consider the land value when coming to this conclusion, but he can include other assets. The dairy conversion required a $1.5 million automated milking shed to be installed and the fencing to be replaced to create smaller paddocks centred around a new race system that the cows would use to get to the milking shed. The fencing and raceway cost $200,000 to complete. $400,000 is spent acquiring a herd of cows.

ANR did use much of the same farm equipment and continued to use the storage sheds to keep it. However, these remaining assets only have a value of $500,000 combined. The shearing shed is no longer used. ANR will forfeit any losses carried forward after the change in ownership that were not used prior to the 2025–26 year.

### *Measurement period for core test*

The core test must be met for the duration of the business continuity period in order for a tax loss component[8] included in a loss balance of a company to be carried forward. Section IB 4 defines "business continuity period".

For most companies, the business continuity period requires there to be no major change from the time immediately before the breaching change in ownership up until the end of the fifth income year following the change in ownership. As the point of comparison remains the time immediately before the ownership change against the time an amount of the tax loss component is to be used, gradual change can amount to a major change over time.

The five-year period is a maximum length of time that the major change test will have to be considered for most companies. When a tax loss component has been used by a company it no longer exists to be carried forward to a future year. The test therefore only ever considers whether a company can continue to carry forward existing tax loss components and has no bearing on the validity of losses already used. If all pre-ownership breach losses are used within the five years, the company will no longer have to consider the business continuity test as there are no existing tax loss components to which it would apply.

Part year loss provisions in section IP of the Income Tax Act 2007 will continue to apply. If a company breaches ownership continuity part way through an income year and is unable to carry its loss forward using the business continuity test the part year rules can be relied on to use pre-breach part year losses.

Limiting the business continuity period is intended to reduce compliance and administrative costs while also ensuring that a business is not unduly constrained from making major changes indefinitely as this would impede innovation. It is costly to run a company as a genuine business for five years simply to access its losses. This makes loss trading less attractive and less of a concern at the end of the continuity period.

[8] Tax loss component is defined in section IA 2(7) of the Income Tax Act 2007 as an amount included in a tax loss for the tax year (a net loss for the year and any additional amounts for the year). Section IA 5 provides that a tax loss component carried forward includes any unused tax loss component from an earlier year.

**Example 54**

All Shook Up House Repilers Limited (All Shook Up) is a company that specialises in repiling and levelling older houses. They have been doing very well over the last number of years due to increased work from various earthquakes around the country.

Bartholomew, the owner of All Shook Up has been looking for new ways to expand his successful business and sees an opportunity in acquiring a comparable business. Steamroller Blues Contracting Limited (Steamroller Blues) is a company that undertakes land works for domestic customers. It has not been doing very well in recent years as Talia, the owner of the company, has not been pricing jobs well. As a result, Steamroller Blues has carried forward tax losses of $5 million.

Bartholomew purchases 100% of Steamroller Blues on 1 June 2021 and keeps the business operating but focuses on pricing the jobs more appropriately. In addition, the acquisition increases the customer base of the company. It is clear that Steamroller Blues has not had a major change during the business continuity period.

At the end of the company's 2026–27 income year (31 March) Steamroller Blues has $600,000 of the original tax losses still available. In the 2027–28 income year Bartholomew sees an opportunity in school classroom construction and wants to make some changes to the company by selling all of its assets and replacing these with heavy machinery to erect buildings.

As Steamroller Blues is outside the five-year business continuity period the major change requirements will no longer need to be satisfied and therefore there are no tax restrictions on Steamroller Blues making changes to its business. The company will continue to be able to access the remaining losses.

However, if instead Steamroller Blues uses $4 million of its carried forward losses but has a major change at the end of the 2025–26 income year, it would forfeit the $1 million of unused losses.

The five-year business continuity period will not apply to all companies. For companies carrying forward losses consisting of significant deductions for bad debts claimed under section DB 31(3) of the Income Tax Act 2007 section IB 4(1)(a) provides that the business continuity period will remain until the losses carried forward are utilised.

This condition addresses concerns that a failed finance type company could be an attractive loss trading proposition. Failed finance companies may too easily satisfy the business continuity test even when they should not. A failed finance company may be acquired and, although the company is largely inactive, satisfy the test because the financial arrangement assets remain, and its activities are continued at a minimal level for five years to satisfy the business continuity test period. After five years the acquiror would be free to inject income into that company in order to use up the losses, for example, by transferring a profitable restaurant business into what was the finance company.

Losses arising as a result of bad debt deductions are the primary concern. Bad debt deductions arise when a taxpayer is in the business of "holding or dealing" financial arrangements and that taxpayer writes off a debt as unrecoverable. These are the types of deductions that can result in the large losses failed finance companies carry forward. By applying the business continuity test until the pre-breach losses have been used, the losses acquired are restricted for use within the business that generated them, and Inland Revenue will be able to apply anti-avoidance rules to any loss trading type activity.

Section IB 4(2) contains the formula to be used when calculating whether section IB 4(1)(a) would apply. Section IB 4(3) defines the items in the formula. In short, the calculation requires that all deductions in years a company records a loss that is included in its loss carry forward balance immediately before the breach in ownership continuity starting from the 2013–14 income year to be totalled. This total deduction amount is compared to the amount of section DB 31(3) deductions taken in those loss years. Any income derived under section CG 3 as a result of the recovery of DB 31(3) bad debts should be subtracted from the total deductions and from the DB 31(3) deductions claimed in those years. If the formula results in 50 percent or more of the loss carried forward being attributed to DB 31(3) deductions then the business continuity test applies until the losses are used.

**Example 55**

Always on my Mind Finance Limited (AMF) is a company that is in the business of holding or dealing in financial arrangements. It has incurred some losses relating to bad debt deductions under section DB 31(3) which relate to the amounts owing under financial arrangements.

It has incurred these losses over four years as follows:

| Year | Income | Deductions (other than DB 31(3)) | DB 31(3) deductions/ (recoveries) | Net taxable income/(loss) |
|---|---|---|---|---|
| 2016–17 | 5,000,000 | 1,500,000 | 6,000,000 | (2,500,000) |
| 2017–18 | 2,000,000 | 3,000,000 | 7,500,000 | (8,500,000) |
| 2018–19 | 1,500,000 | 600,000 | 600,000 | 300,000 |
| 2019–20 | 1,000,000 | 2,000,000 | (200,000) | (800,000) |
| Total | 9,500,000 | 7,100,000 | 13,900,000 | (11,500,000) |

Way Down Mortgages Limited (Way Down) is a mortgage lending company which is looking toward expansion and although AMF has not been performing well, Way Down thinks that with the right management this business can be turned around as the remaining portfolio of the company is promising.

AMF wants to understand how the new business continuity rules will apply to the tax losses carried forward by Way Down. It asks Lloyd, the company's accountant, for some advice. Lloyd has a look at section IB 4 and also the tax returns for Way Down.

| Year | Deductions (other than DB 31(3)) | DB 31(3) deductions/ (recoveries) | Net taxable income/(loss) |
|---|---|---|---|
| 2016–17 | 1,500,000 | 6,000,000 | 7,500,000 |
| 2017–18 | 3,000,000 | 7,500,000 | 10,500,000 |
| 2019–20 | 2,000,000 | (200,000) | 1,800,000 |
| Total | 6,500,000 | 13,300,000 | 19,800,000 |

Lloyd advises that, because in the years that Way Down has made losses the ratio of DB 31(3) deductions to the total deductions is 67.2% ((13,300,000 ÷ 19,800,000) × 100), Way Down can carry forward its losses but the five-year rule will not apply to them. They will need to meet the requirements of the business continuity test until the losses are utilised.

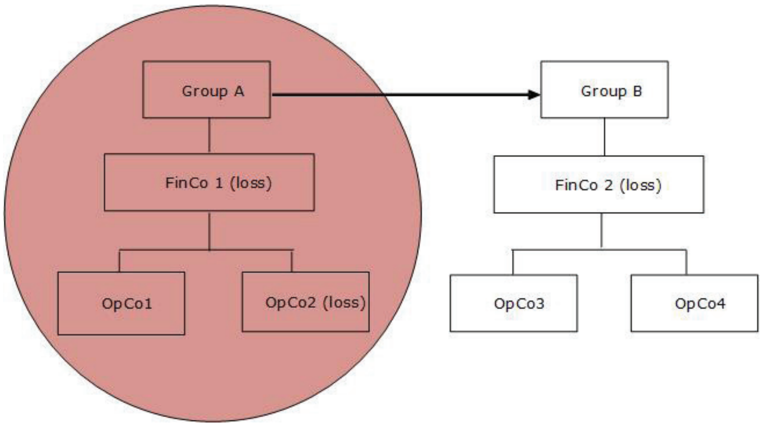
*Application to corporate groups*

The commonality rules in section IC 3 of the Act, which permit a company to offset its losses against other companies' profits if it has at least 66 percent common ownership with the companies from when the loss is incurred to when it is offset, have not been changed.

Companies in the original group that are acquired together would meet the group test (for example, they were 100% commonly owned when the loss was made and remain 100% commonly owned when the loss is to be offset). The acquired group will also form a new group with the acquiring company/group. However, because the commonality rules would fail to allow loss offsetting within the "new" group, the pre-acquisition losses cannot be offset with other companies in that "new" group.

Section IB 5 treats companies which meet commonality requirements immediately before and immediately after acquisition as a single company for the purposes of applying the business continuity test to carry forward pre-acquisition losses under the business continuity test. When assessing if there has been a major change, the acquired group must be looked at as if it was a single company rather than separate entities.

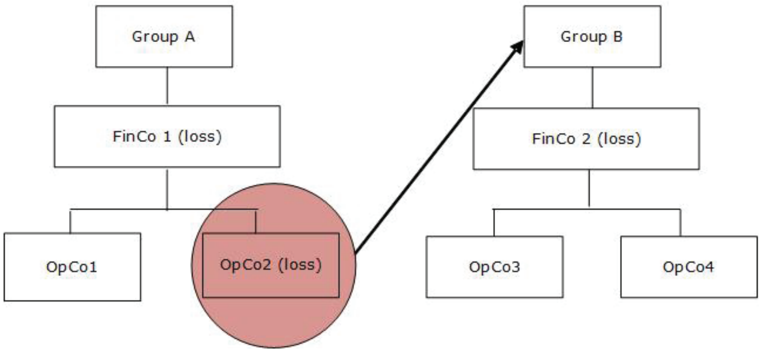
**Figure 3: Group B acquires Group A**




***Group A:*** As Group A is acquired as a group it can continue to use OpCo2 and FinCo1 losses to offset the income of the group as long as Group A does not breach the business continuity test. The business continuity test applies to Group A on a group basis (that is, companies in the red circle are treated as if they were a single company).

***Group B:*** No impact on Group B. However, Groups A and B could group for the purposes of any losses arising post acquisition, with no need to meet the business continuity test unless there is a further breach of ownership continuity. The result is three possible sets of losses. Pre-acquisition losses (Group A's losses, Group B's losses) and post-acquisition losses (A+B "new group" losses).

**Figure 4: Group B acquires OpCo2**



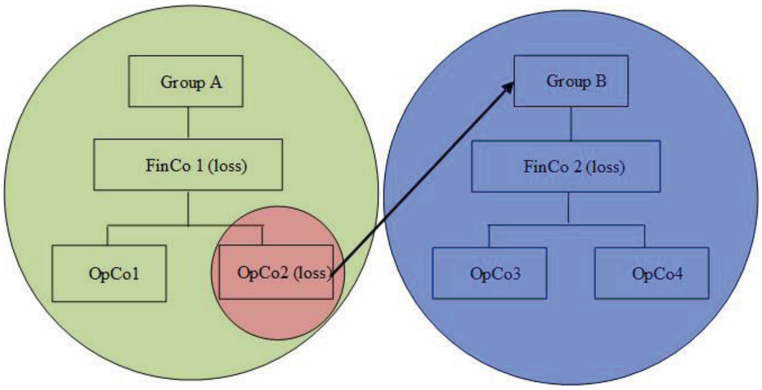

***Group A:*** When acquired, OpCo2 will have breached ownership continuity and will be subject to the business continuity test. The remaining members of Group A are not subject to the business continuity test.

***Group B:*** No effect on pre-acquisition Group B companies and their ability to offset. However, OpCo2 cannot offset any pre-acquisition losses with Group B due to insufficient commonality of ownership from the time the losses arose. OpCo2 is subject to the business continuity test as a single company (red circle). Consistent with current settings, OpCo2 can offset post-acquisition losses within Group B as long as commonality requirements continue to be met.

The result is three sets of losses. Pre-acquisition OpCo2 losses subject to the business continuity test, pre-acquisition Group B losses and post-acquisition losses available for grouping.

A subsequent ownership continuity breach for OpCo2 within five years will reset the business continuity test and start the five-year time period again.

**Figure 5: Same situation (OpCo2 acquired) but both Group A and Group B have had an earlier ownership continuity breach**




***Group A:*** As Group A is relying on the business continuity test to carry forward the losses of the group it must assess the disposal of OpCo2 (and therefore the ceasing of part of the group's business) against the test. The business continuity test continues to be applied on a group basis by treating the companies in the green circle as if they were a single company.

The result may be a breach if the exit of OpCo2 is a major change in the nature of the business activities and does not fit within one of the permitted major changes. This mirrors the situation that would have existed had the activities of the group been in one company rather than split across a number of subsidiaries.

***Group B:*** As above, no effect on pre-acquisition Group B companies and their ability to offset as OpCo2's pre-acquisition losses sit outside the group and cannot be used by Group B. OpCo2 is subject to the business continuity test as a single company (red circle). The business continuity test continues to apply to Group B as if it was a single company (blue circle). Consistent with current settings, OpCo2 can offset post-acquisition losses within Group B as long as commonality requirements continue to be met.

The result is three sets of losses. Pre-acquisition OpCo2 losses subject to business continuity test, pre-acquisition Group B losses subject to business continuity test, and post-acquisition losses.

**Example 54**

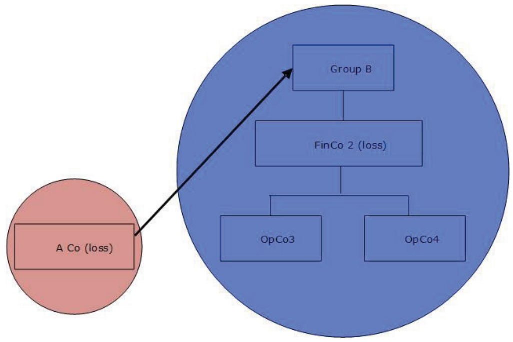
The Fame and Fortune Casino Group (FFG) is a group of companies operating a casino business. This Group is made up of a holding company and a number of subsidiaries which, as a whole, operate the casino business. One of these subsidiaries provides the finance function of the group. The finance subsidiary is carrying forward a loss.

FFG is acquired by the Money Honey Casino Group (MHG), another casino operating group of companies. MHG has a finance company and, because it is inefficient to keep two finance companies, FFG's subsidiary finance function is wound down after the acquisition.

When MHG acquired FFG ownership continuity was breached. When applying the business continuity test to determine whether the losses of FFG can be carried forward after the change in ownership the business activities of the whole group must be considered. When considered as a single company the Group carries on the same income generating business activities it did before – being the casino. It also uses the same income generating assets to do so. On these facts FFG should be able to carry forward any pre-acquisition losses its group members might have, and those losses will remain available to offset income within FFG but not within the new group formed with MHG because the commonality requirements are not met for those losses.

Consequential amendments have been made to the consolidation and amalgamation rules to incorporate the business continuity test but no changes are proposed to how these regimes operate.

**Figure 6: A Co is acquired by Group B. Group B forms a consolidated group which includes A Co**




***A Co:*** A Co is the joining loss entity. Pre-acquisition losses of A Co will be subject to the business continuity test as there has been a change in ownership. Consistent with the current consolidation rules, pre-consolidation losses where commonality requirements are not met can only be used up to the amount A Co could have used to offset its net income if it were not part of the consolidated group. The business continuity test continues to apply to the activities of A Co for five years after the change in ownership. Any post-acquisition losses will sit with the consolidated group.

***Group B:*** Pre-consolidation losses that arose before the acquisition of A Co can only be used to the extent the companies in Group B which meet the commonality requirements have income that could have been offset if there had been no consolidation with A Co. If Group B was relying on a business continuity test before consolidation to carry forward losses then the business continuity test would continue to apply on a group basis (blue circle).

**A Co is acquired by Group B. Group B amalgamates A Co and OpCo3**

Any losses carried forward by A Co up to the point of acquisition will be forfeited because there is insufficient commonality.

If Group B is subject to the business continuity test on a group basis and wants to amalgamate all companies in that group, it can do so and, because commonality requirements are met for FinCo2 losses, these can be transferred into the amalgamated company. The business continuity test will continue to apply for the remainder of the five-year time period. The five years will not be restarted.

### *Anti-avoidance*

A number of provisions have been introduced to support the core test and ensure it does not open up opportunities for loss trading. The key purpose of the loss continuity rules remains to prevent this activity.

#### *Dormant company rule*

Section IB 3(3)(a) would disallow the carry forward of losses if the change in ownership occurs at any time after the business activities of the company have ceased and before any revival of the business. The rule does not require assessment of whether a company is completely dormant, but it should deal with companies that are no longer viable and really only have value in their stock of tax losses. Similarly, section IB 3(2)(b) would disallow any further carry forward of losses where a company ceases to carry on any business activities (in effect becomes dormant after the change in ownership).

The dormant company rule does not apply to a temporary reduction in activity. A company may be seasonal or may have to temporarily suspend trading due to Government order but as long as the income earning infrastructure remains ready to be operational there is no cessation of the business that will trigger the dormant company rule. Likewise, the proposal does not consider low activity industries to trigger the rule. It does not matter that a company is being run by receivers or liquidators as long as there remains a sufficient level of business activity.

**Example 57**

Golden Coins Ltd operates claw game machines in thirty shopping centres. It installs the machines and staff regularly visit the sites where they are installed to collect any money and replenish the supply of novelty stuffed animals.

Buying and installing the machines was an expensive exercise, it also proves expensive to service and stock the machines. Golden Coins incurs significant losses over the two-year period it operates.

The machines are poor quality and the claws constantly break. The number of players dwindles as the machines become known as unreliable and stingy with their prizes. Golden Coins decides not to stock or service the machines anymore and leaves them to slowly empty out. The shopping centres ask for them to be removed and they are all taken back to a warehouse that Golden Coins is leasing. After a month, the sole shareholder Jim, sells the business to his friend Rob. The machines are defunct and all that is left is the idea that maybe they could be refurbished and the warehouse where they are stored could be leased. There is otherwise no other activity happening.

The policy intent is for the dormant company rule to apply in this situation to not allow the carry forward of losses as at the time of the change in ownership the business activities carried on by Golden Coins had ceased.



*Change in business activities prior to acquisition*

Section GB 3BA is a specific anti-avoidance rule to prevent arrangements that are made between the purchaser and seller of a company prior to a transaction that are intended to defeat the business continuity test or the dormant company rule. If taxpayers are able to avoid the intended application of the test, then avenues for loss trading schemes could arise.

**Example 58**

***Change in assets***

Milkcow Blues Boogie Cheese Limited (MBBC) is a poorly managed manufacturer of cheese with significant tax losses to carry forward. The cheese MBBC is known to produce has a terrible reputation and the shareholders have decided to sell the company rather than fix it. Spinout Limited (Spinout), a manufacturer of very good pulled toffee, hears the shareholders of MBBC are looking to sell and that the company has significant losses. The assets MBBC currently has are not very useful for toffee, but the staff can probably be retrained. Spinout knows that replacing the assets of MBBC after the change in ownership is going to breach the business continuity test and arranges for MBBC to dispose of speciality cheese equipment and to acquire toffee machines before the sale of shares takes place.

Section GB 3BA would apply to this situation to prevent MBBC from carrying forward its pre-acquisition losses because in the two years prior to the ownership continuity breach, MBBC and Spinout entered into a verbal arrangement where the sale of shares of MBBC was made conditional on the assets being changed so that the business of Spinout could be carried out after the ownership change without breaching the core business continuity test.

***Change to a dormant company***

A Little Less Conversation Limited (ALLC) was a publishing company that put out a popular political magazine. However, the operations were mothballed when the chief editor quit and the content became less popular. ALLC sustained substantial losses. After three years, Judy, a shareholder with a 10 percent stake in ALLC, had an idea to start a high fashion magazine. They approached the other shareholders in ALLC offering to purchase the remaining 90 percent of the shares if ALLC's business was restarted and produced the magazines as requested by Judy for six months. ALLC began to produce the magazines. Six months later, as agreed, the remaining 90 percent of shares in ALLC were transferred to Judy who continued on with the fashion magazine.

Section GB 3BA would apply to this situation to prevent the dormant company rule being circumvented by an arrangement to restart a business before the change in ownership.

### *Anti-injection rules*

Sections GB 3BAB and GB 3BAC are specific anti-avoidance rules which aim to deter loss trading by preventing the injection of funds into a business or the transfer of costs out of the business that are small enough not to be regarded a major change. These rules will only apply where a company is relying on the business continuity test to carry forward losses. The rules will not apply to companies more broadly.

The anti-injection rules will apply if all of the following conditions are met:

- The company is party to an arrangement.
- The effect of the arrangement is that the company derives assessable income or is allowed a deduction for an amount of expenditure or loss that, but for the arrangement, an associated person would have derived or incurred, would in all likelihood have derived or incurred, or might have been expected to derive or incur.
- The sole or main purpose of the arrangement is tax avoidance.

The rules will not apply where, for example, employment contracts are shifted to a group member and there is a recharge to the loss company or where efficiencies are made by using other group employees to now provide services to the acquired company rather than, say, using consultants. For example, a loss company that uses a firm as tax advisors but the acquirer has a tax division who would now undertake that task.

In the case of income injection, section GB 3BAB applies to deem the amount of injected income to be schedular income of the loss company. This results in tax to pay on that income (plus any associated shortfall penalties). In the case of cost shifting, section GB 3BAC applies to disallow the deduction for expenditure or loss in the profit company resulting in tax to pay on the income it offset (plus any associated shortfall penalties). The loss company is then treated as having incurred the amount of expenditure or loss.

The anti-injection rules are intended to prevent arrangements that would allow companies to get around the grouping rules by effectively permitting a loss offset between a purchasing and newly acquired company despite there being no commonality of ownership at the time the losses arose. The following examples demonstrate some non-arm's length arrangements which, if allowed, would circumvent the grouping rules.

**Example 59**

Moody Blue Boat Ltd (Moody Blue) is a failing manufacturer of fish finding equipment for boats. It has sustained significant losses over the last five years due to mismanagement. It's Midnight Music Ltd (Midnight) buys and licences songs for use in events. It is a profitable business with no tax losses available to offset any income it derives.

In August 2020, Midnight acquires Moody Blue and carries on manufacturing the standard fish finding equipment it is known for and ensures the business is properly managed. There is no major change in the activities or assets of Moody Blue and so it is able to carry forward its losses relying on the business continuity test.

Midnight also sees an opportunity to assign some of its income to Moody Blue Co in order to take advantage of the available losses and reduce overall tax paid on the business of Midnight. In November 2020, an arrangement between Moody Blue and Midnight is entered into whereby some of Midnight's licences are assigned to Moody Blue. This becomes a very small part of Moody Blue's business and does not reach the threshold of major change.

However, the section GB 3BAB anti-injection rule applies to prevent the injected income from being offset with any remaining losses in that year. This applied because Moody Blue had a tax loss component it was carrying forward in reliance of the business continuity test and but for the arrangement Midnight would have derived the income from the licencing activity, the income was injected with the sole purpose of tax avoidance – Midnight entered the arrangement to reduce tax on its own business activities. There is no relationship between fish finding and music licensing that would suggest that there is a genuine commercial reason for the assignment of some of Midnight's licences to Moody Blue.

**Example 60**

Patch It Up Paint Ltd (Patch It Up) does painting and decorating for domestic clients. In recent years it has run into difficulty – it is poorly managed, and staff do not work efficiently or neatly. The client list slowly begins to shrink and Patch It Up suffers significant losses from 2016–2019. Patch It Up has found itself on the edge of failure and Barbara, the owner of the business, starts looking for a buyer.

Di owns and operates Rip It Up Decorators Ltd (Rip it Up). Rip It Up also does painting and decorating for domestic clients and has been very successful. In the 2020 year, Di secures the ownership interests in Patch It Up for a bargain price. This breaches ownership continuity but Di relies on the business continuity test to carry Patch It Up's losses forward. Di thinks there is an opportunity to unlock the value of the losses by moving some costs to Rip It Up.

It seems logical to Di for Rip It Up to secure all the paint for both companies. A deduction for the paint arises in Rip It Up, Patch It Up no longer incurs this cost. In addition, Patch It Up has a loan with a bank that is resulting in deductions for interest payments. Di arranges for Rip It Up to pay the loan back on behalf of Patch It Up, but funds this repayment with a loan from another bank. Deductions for interest payments now arise in Rip It Up. The combination of these two arrangements results in Patch It Up returning to profit and therefore using its losses.

Rip It Up wants to use the deductions for interest payments and paint acquisition to reduce its own tax. However, Rip It Up's accountant notes that section GB 3BAC applies to disallow these deductions. This is because there has been an arrangement between related parties which is not arm's length and resulted in deductions that would have been incurred by Patch It Up being incurred by Rip It Up. Tax avoidance was the main purpose because Di entered these arrangements in order to access the losses of Patch It Up. GB 3BAC applies to treat Patch It Up as having incurred the expenditure that gave rise to the deductions. Rip It Up is reassessed and has tax to pay once the deductions have been taken away, shortfall penalties are also imposed.

*Previously forfeited losses*

Sections IB 3(3)(b) and (c) are incorporated to confirm a taxpayer cannot revive a tax loss component:

- that has previously been subject to a change in ownership followed by a major change, or
- that was subject to a change in ownership before the 2020–21 income year.

*Consequential amendments*

Other consequential amendments have been made to sections of the Income Tax Act 2007 which reference the loss continuity rules to ensure that, where appropriate, reference is made to the proposed business continuity test. These include amendments to rules relating to the carry forward of certain tax credits which are intended to mirror the rules for the carry forward of losses. These are research and development tax incentive credits, attributable controlled foreign company income tax credits, and tax credits for supplementary dividends.

## Temporary increase to the automatically calculated individual income tax write-off threshold

*Section 84 - Schedule 8, part B, clause 1 of the Tax Administration Act 1994*

Amendments have been made to the rules for automatically calculated individual income tax to temporarily increase the write-off threshold.

### Background

Section 22J of the Tax Administration Act 1994 allows the Inland Revenue to write off certain amounts of tax payable under the automatic calculation rules. As part of the Government's response to the financial pressures on New Zealanders caused by COVID-19, this amendment temporarily increases the write-off threshold from $50 to $200 for income tax assessments that are automatically calculated for qualifying individuals with reportable income (income that has had tax withheld at source and is reported to Inland Revenue by the payers, for example, salary, wages and investment income).

The amendment is designed to reduce the financial pressure on individuals with a tax bill for the 2019–20 income year while New Zealand recovers from the effects of COVID-19.

An increase to $200 to the write-off amount for automatically calculated income tax assessments was made by Order in Council and applied from 3 June 2020. This amendment replaces that Order. As this threshold increase was only seen as a temporary measure, the threshold is reduced back to $50 for the 2020–21 and later income years.

### Key features

Schedule 8, part B, clause 1 of the Tax Administration Act 1994 is amended to:

- increase the amount of a tax assessment that may be written off by the Commissioner from $50 to $200 for the 2019–20 income year; and
- decrease the amount of a tax assessment that may be written off by the Commissioner from $200 to $50 for the 2020–21 and later income years.

### Application date

The amendment to increase the threshold to $200 applies for the 2019–20 income year only. The amendment to return the threshold to $50 applies for the 2020–21 and later income years.



## COVID-19 tax relief for donations of trading stock

*(Sections FZ 9, GZ 4, GZ 5, CZ 38 and YA1 of the Income Tax Act 2007; section 225ABA of the Tax Administration Act 1994)*

The new legislation provides tax relief for businesses that have made, or are contemplating making, donations (or supplies for less than market value) of trading stock during COVID-19.

Rules in the Income Tax Act 2007 impose tax on the market value of trading stock disposed of for no consideration or an amount that is less than the market value. The application of the rules can act as a significant disincentive to donate trading stock. As a COVID-19 relief measure, a temporary amendment has been made so that disposals of trading stock between 17 March 2020 and 16 March 2022 (inclusive) are not subject to these rules if the recipients are donee organisations, public authorities, or other persons not associated with the transferor.

The amendment requires trading stock deductions to be offset by an amount of deemed income in certain circumstances.

A new section authorises the making of an Order in Council to extend the period for which the new sections apply or to declare a later period for which the new sections apply.

### Background

Trading stock is generally deductible in the income year it is purchased as a business expense. If it is not sold in the year of purchase, closing stock is included as income at the end of the year and then becomes deductible as opening stock the following year.

Deemed income rules in sections GC 1 and FC 2 apply when a person disposes of trading stock for less than market value or when it is transferred on the making of a gift. The rules deem the market value of donated trading stock to be assessable income. This means businesses are effectively taxed on a deemed profit margin for the donated goods, (that is, the difference between the deemed market value and the deduction obtained on purchase or in the opening stock adjustment).

The deemed income rules were introduced to counter tax avoidance, including situations where sole traders use their trading stock for private purposes. However, the application of the rules can act as a significant disincentive to donate trading stock. For example, a hand sanitiser business may be liable for tax if it donates some of its products to a hospital, or a farmer may be liable for tax if they donate livestock for meat to be sent to a foodbank.

In 2010–2011 an 18-month exclusion was introduced to provide relief for trading stock donations made in response to the Canterbury earthquakes. A permanent provision allows relief when trading stock is donated to a person not associated with the donor for the use in a farming, agricultural or fishing business that is affected by a self-assessed adverse event.

### Key features

The following changes have been made to the Income Tax Act 2007 and to the Tax Administration Act 1994.

- Inserting new sections GZ 4 and GZ 5. Section GZ 4 provides an exclusion for disposals of trading stock to public authorities and donee organisations from section GC 1. Section GZ 5 provides an exclusion from section GC 1 for disposals of trading stock by a business to persons not associated with that business.
- Inserting new section CZ 38, which applies where a business disposes of trading stock to a person not associated with that business (other than a public authority and donee organisation) and there is no business purpose for making the disposal. In these circumstances, the deduction they have taken for the trading stock is offset by a deemed income amount.
- Amending the definition of trading stock in section YA 1 for the purposes of the new sections to exclude timber or a right to take timber or land whose disposal would produce income under any of sections CB 6A to CB 15.
- Inserting new section FZ 9, which provides an exception from the rule in section FC 2(1) that requires the transfer of property on the making of a gift to be treated as a disposal and acquisition at market value.
- Inserting new section 225ABA into the Tax Administration Act 1994. That section authorises the making of an Order in Council to extend the period for which the new sections in the Income Tax Act 2007 apply or to declare a later period for which the new sections apply.



### Application dates

The amendments to the Income Tax Act 2007 apply from 17 March 2020.

The amendment to the Tax Administration Act 1994 applies from the date of enactment.

### Detailed analysis

#### *Sections GZ4 and GZ 5 of the Income Tax Act 2007*

Sections GZ 4 and GZ 5 both provide exceptions from the deemed income rule in section GC 1 for the period that starts on 17 March 2020 and ends on 16 March 2022.

Section GZ 4 provides an exception from section GC 1 where a business disposes of trading stock to a public authority or donee organisation. The exception applies even if the public authority or donee organisation is associated with that business. This exception recognises that public authorities and donee organisations exist for the public benefit, are subject to regulation and are publicly transparent, so it is appropriate to remove disincentives to donate to these organisations, particularly as a response to COVID-19.

Section GZ 5 provides an exception from section GC 1 where a business disposes of trading stock to a person not associated with that business (that is not a public authority or donee organisation). However, this provision includes a new offset rule, which applies when there is no business purpose for disposing of the trading stock. It ensures that if trading stock is disposed of to a person that is not a donee organisation or public authority for no business purpose (for example, by way of gift), a net deduction for the trading stock is not available to the business. The deduction the business would normally take for the trading stock, being either the cost or the value under section EB 3 at the end of the previous income year, is offset by a deemed income amount under section CZ 38. The deemed income amount is reduced to take into account consideration received for the trading stock (if any).

For the purposes of sections GZ 4 and GZ 5, trading stock has the meaning given in section YA 1 paragraph (b). However, it does not include timber or a right to take timber or land whose disposal would produce income under any of sections CB 6A to CB 15. This narrower definition of trading stock has been used because the temporary amendments are a COVID-19 relief measure and are not directed at significant disposals of this nature.

Section GC 1 will continue to apply where trading stock is disposed of to associated persons, which are not donee organisations or public authorities, for no consideration or an amount that is less than the market value of the trading stock at the time of disposal.

#### *Section CZ 38 of the Income Tax Act 2007*

When trading stock disposals are excluded from the deemed income rules in sections GC 1 and FC 2, the person disposing of the trading stock will typically qualify for a deduction. The deduction is available under section DA 1 if the stock is purchased in the year it is disposed of and section DB 49 if the disposal is from opening trading stock.

If section GZ 4 applies, the person disposing of the trading stock will not be required to offset the deduction by a deemed income amount.

If section GZ 5 applies, the person disposing of the trading stock may be required to offset the deduction by a deemed income amount under section CZ 38. The formula for the deemed income offset is contained in section GZ 5 and is explained above.

#### *Section FZ 9 of the Income Tax Act 2007*

Section FC 2(1) requires the transfer of trading stock, being revenue account property, to be treated as a disposal by the transferor at the market value.

There is some overlap between subpart FC and section GC 1 in the case of gifts. To have effect, any adjustment to section GC 1 must be accompanied by a corresponding adjustment to subpart FC.

Section FZ 9 provides an exception from the rule in section FC 2(1) in respect of trading stock, provided the transferee is not associated with the transferor or, if they are associated with the transferor, the transferee is a donee organisation or a public authority. The exception applies to transfers made in the period that starts on 17 March 2020 and ends on 16 March 2022.

For the purposes of section FZ 9, trading stock means property that is trading stock under section EB 2 as well as livestock not used in a dealing business and consumable aids to be used in the process of producing trading stock.

#### *Section 225ABA of the Tax Administration Act 1994*

Section 225ABA authorises the making of an Order in Council to extend the period for which the new sections in the Income Tax Act 2007 apply or to declare a later period for which the new sections apply.

The Minister of Revenue may only recommend extending the period if satisfied that people in New Zealand are likely to continue to be significantly adversely affected by COVID-19.

The Minister may recommend specifying a new application period if satisfied that there is an emergency event that significantly adversely affects people in New Zealand. The event must meet the requirements of paragraphs (a) and (b) of the definition of emergency in section 4 of the Civil Defence Emergency Management Act 2002.

## Mycoplasma Bovis tax issue

*(Sections CZ 37, EH 1, EH 5, EH 13, EH 35, EH 36, EH 61, EZ 4B, EZ 80, EZ 81, YA 1 of the Income Tax Act 2007)*

These amendments enable the taxable income arising from the culling of certain qualifying Mycoplasma bovis affected livestock to be spread over six income years.

### Background

Some farmers have significant unexpected taxable income through their herds being culled following a primary sector and government decision to eradicate Mycoplasma bovis in New Zealand.

Federated Farmers requested an amendment to ensure there would be no income tax implications from culling and replacing dairy and beef cattle impacted by Mycoplasma bovis. They cited the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes as a precedent.

The issue arises for farmers who have used a cost-based method (that is, national standard cost (NSC) and the self-assessed cost scheme)[9] to value their breeding stock on hand for tax purposes. This is because the difference between the total proceeds received from the cull and the cost of the stock is income. This creates a cash-flow issue for those farmers who purchase replacement livestock after the cull. The replacement stock is valued at its purchase price and cannot, for tax purposes, be immediately written down to the homebred cost to offset the income.

To avoid this outcome, the legislative changes enable the proceeds from the cull to be transferred from the year of the cull and to be spread evenly over the following six income years. This ability to spread is optional.

### Key features

The income can only be spread if:

- The business has been subject to Biosecurity Security New Zealand requiring a cull of Mycoplasma bovis affected stock.
- The business is a dairy or a beef breeding operation, with the breeding stock that is culled being valued under NSC or the cost price method. The expectation is that the breeding stock that is culled comprises mainly mixed-aged cows, in combination with any other class of breeding stock.
- The stock is substantially replaced through purchasing equivalent breeding stock by the end of the income year following the cull year.
- The replacement stock continues to be valued using, as relevant, NSC or the cost price method. This is to ensure that farmers cannot enter the herd scheme on more advantageous terms than those not affected by Mycoplasma bovis.

Given that a livestock owner might use a couple of valuation methods in combination,[10] not all of the breeding stock might be valued at cost. However, only the income derived from the culling of the breeding stock valued under NSC or the cost price method can be spread. For this purpose, breeding stock includes immature female stock intended for future breeding in the business.

Owners of the affected livestock, including sharemilkers, are covered, that is, the ability to spread income from the cull is not be limited to just the owners of farmland with livestock.

The qualifying proceeds from the cull would comprise payments from the slaughterhouse, top-up compensation from the government for the difference between the normal market value for the stock and the payments from the slaughterhouse, and in some cases, further compensation to cover the additional cost of purchasing equivalent replacement stock.

The income arising from the culling of stock valued under another valuation method, or stock culled from a fattening stock business valued under NSC, do not qualify for this spreading provision. The Income Equalisation Scheme is available in those circumstances to mitigate the income implications of the cull.

Livestock owners who have previously made deposits into the Income Equalisation Scheme or the now repealed Adverse Events Income Equalisation Scheme to mitigate the impact of the additional income, can retrospectively switch to the income spread. In such cases, the tax effects of the deposit will be reversed.

### Application date

The amendments apply for the 2017–18 and later income years.

### Detailed analysis

The Act amends the Income Tax Act 2007.

#### *Relevant current legislation*

The livestock valuation rules are contained in subpart EC of the Income Tax Act 2007, including the requirements that apply when using multiple valuation options and the restrictions on switching between valuation options. These rules ensure that the cost of stock on hand is valued appropriately and that the cost of purchases is not deducted ahead of their being sold.

#### *Precondition for the spread (section EZ 4B(1))*

New section EZ 4B(1) sets out the following preconditions:

- A person needs to have, as part of their business, mixed-age cows on hand at the start of the cull year that they use for breeding and those cows need to be valued under either NSC or the cost price method at the end of the income year before the cull year. The cull year would need to be before the 2028–29 income year. (The focus on mixed-age cows is to ensure that the spread is provided to those who have sizeable additional income as a result of the cull given that female breeding stock make up a high proportion of a standard herd. The 2028–29 income year cut-off is in the expectation that Mycoplasma bovis should be less significant by that stage).
- In the cull year, some or all of the person's cattle need to be destroyed, because of Mycoplasma bovis, using the powers in either sections 121 or 122 of the Biosecurity Act 1993 that enable Biosecurity New Zealand to examine organisms and give directions. (Normally the whole herd is destroyed but in some isolated cases only a portion needs to be destroyed).

[9] The NSC scheme values the animals at, if the animal is homebred, a standard cost (determined by the Commissioner of Inland Revenue) for the respective age and type of animal that reflects that animal's average costs of production, or at its purchase cost if the stock is purchased.
The self-assessed cost scheme involves farmers using their own farm costs rather than standard costs. It is a Commissioner approved "cost price method" under section EC 25. Its details are set out in *Tax Information Bulletin, Volume 4, No.7, March 1993, Appendix A.*

- A significant portion of the culled stock need to be replaced by the end of the income year following the cull year. The expectation is that the culled livestock are replaced with purchased stock. Specifically, the requirement is that the number of mixed-age cows valued under the national standard cost scheme or the cost price method that the person has on hand (or expects to have on hand) at the end of the income year following the cull year is at least seventy five percent of the number of mixed-age cows valued under the national standard cost scheme or the cost price method that the person had on hand at the start of the cull year.

### *The spread (sections EZ 4B(2), (3) and (5) to (13))*

There are two parts to the spread. Section EZ 4B(2) enables the income calculated under section EZ 4B(5) to be spread evenly over the six income years following the cull year. Section EZ 4B(3) spreads the deduction that the livestock owner would otherwise be able to claim under section EC 2 for the equivalent number of stock.[11] Their combined effect is that the net income arising from the culling of the relevant livestock is spread.

For the income spread component, the formula in section EZ 4B(5) is:

*∑(number × (sale proceeds + compensation) ÷ culled stock)*

This formula works on a livestock class basis, where:

- ∑ is the summation of the amounts calculated using the formula for each of the following classes of each of the beef cattle and dairy cattle types of livestock:
  (a) rising 1 year heifers
  (b) rising 2 year heifers
  (c) mixed-age cows; and
  (d) breeding bulls.
- **Number**, for a class of livestock, is the number that is the lesser of:
  (a) the number calculated using the formula in section EZ4B(12):
  *valuation method breeding stock + culled stock − opening stock*
  (b) the number of livestock of that class that:
  (i) were breeding stock or stock that the person expected to be capable of, and intended be used for, breeding upon reaching maturity, and
  (ii) the person valued under NSC or the cost price method in the income year before the cull year.
- **Sale proceeds**, for a class of livestock, is the amount of income the person derives from the disposal of the livestock of that class that are part of the destroyed cattle.
- **Compensation**, for a class of livestock, is the amount of compensation which the person is entitled to under section 162A of the Biosecurity Act 1993 and that the person receives by the end of the income year following the cull year for:
  (a) the difference between the stock's market value and the sale proceeds; and
  (b) the cost of the replacement cattle of the same class being greater than the total amount received in relation to the stock it replaces.
- **Culled stock**, for a class of livestock, is the number of livestock of that class that are part of the destroyed cattle.
- **Valuation method breeding stock** is the number of livestock of that class that:
  (i) were breeding stock or stock that the person expected to be capable of, and intended be used for, breeding upon reaching maturity; and
  (ii) the person valued under NSC or the cost price method in the income year before the cull year.
- **Opening stock** is the number of livestock of that class that the person had on hand at the start of the cull year.

The formula takes into account the possibility that a livestock owner might be using more than one valuation method to value the stock and might reduce the number on NSC or the cost price method between the start of the cull year and the cull date. When all the stock are on NSC or the cost price method, stock numbers are constant and all stock is culled, then the formula simplifies to just the sales proceeds plus compensation.

If there is an increase in livestock numbers for a class over the cull year, those additional stock are excluded from the spread through section EZ 4B(8)(b) which caps "number" at the number of livestock of that class on hand at the beginning of the cull

[10] For example, an owner might use the herd scheme in conjunction with NSC (the alternative valuation option).

year and valued in the previous year under either NSC or the cost price method.

Examples of the income and deduction spread calculations are provided in Tables 6 and 7.

### *Person ceasing business (section EZ 4B(4))*

Should a person cease carrying on the business in which they use the relevant livestock, section EZ 4B(4) requires any unallocated amount of spread income and deduction to be allocated to the cessation year.

In the case of the death of a sole trader, the person would effectively cease business once probate has been granted, but with a company, the death of a shareholder would not automatically trigger an allocation of the remaining spread. In the case of a look through company or a partnership, the owner or partner who has died would effectively cease their proportion of the business which would trigger an allocation of their proportion of the remaining spread.

### *Notification (sections EZ 4B(14) to (16))*

Those taking up the spreading option need to notify Inland Revenue in writing. This can be done electronically.

Section EZ 4B(14) requires an election to be made by the date of filing the taxpayer's return of income for the 2020–21 income year, if the cull year is the 2020–21 income year or earlier, and by the date of filing their return for the cull year in any other case.

The additional compliance costs from this notification requirement would be small given the anticipated small number of farmers affected by Mycoplasma bovis. The amount of income and tax involved is significant for each affected taxpayer so knowing who has taken up this option will also be helpful from a compliance perspective.

The election is irrevocable, but under section EZ 4B(16) is treated as not being made if, at the end of the income year following the cull year, the number of mixed-age cows on hand that were valued under one of the cost schemes is less than seventy five percent of the equivalent pre-cull levels. This is to ensure that there has been material replacement of the culled stock.

### *Enabling switching from the Main Income Equalisation Account or Adverse Events Income Equalisation Account to the income spread*

*(Sections CZ 37, EH 1, EH 5, EH 13, EH 35, EH 36, EH 61, EZ 4B, EZ 80, EZ 81)*

As culls began in 2017, some Mycoplasma bovis-affected farmers will by now have made deposits into the Main Income Equalisation Scheme (MIES) or the now repealed Adverse Event Income Equalisation Scheme (AEIES), to mitigate the tax consequences created by the cull. The legislation gives Mycoplasma-bovis affected farmers that made such deposits the option of retrospectively switching to the proposed six-year income spread provided the tax effects of the relevant deposits are reversed and the election is made by the date of filing their return of income for the 2020–21 income year. The spread is likely to be better at mitigating the income effects as in many cases the deposits will have needed to be withdrawn after a year to fund the purchase of replacement stock.

Under normal circumstances, a deposit into the MIES or AEIES results in a deduction for the livestock owner, for the amount of the deposit, and a withdrawal of a MIES or AEIES deposit results in equivalent income. However, deposits in any one year cannot exceed net income. If deposits in a year exceed this maximum, the excess needs to be refunded.

This concept is built upon in the new legislation to achieve the necessary reversals of the tax effects of deposits made in relation to the income that is now to be spread. It also means that the tax effects of deposits in relation to other income are not reversed.

#### *Reversal of deduction for the deposit*

Specifically, a retrospective amendment to section EH 35 (meaning of main maximum deposit) ensures that the spread is included in the calculation of the maximum deposit and, therefore, automatically leads to a reversal of the earlier deductions for the deposit, to the extent the maximum deposit is then exceeded. A comparable change has been made to section EH 61 to include the spread in the meaning of adverse event maximum deposit.

#### *Reversal of income from withdrawal of deposit*

Any such excess deposit is refundable. This is separate from any earlier excess deposit that arose under the standard provisions (respectively, sections EH 8 and EH 42) that require Inland Revenue to refund amounts that exceed the maximum deposit. Sections EZ 80 and EZ 81 treat this refund as excluded income (and therefore as not taxable) to negate any income that would have arisen when the deposit was withdrawn – see section EZ 80 (6)(b) and EZ 81(6)(b) in conjunction with section CZ 37(2).

Sections EZ 80(8) and EZ 81(8) stipulate that section EZ 80 and EZ 81 respectively override sections EH 8 and EH 42. This override is necessary to distinguish when Inland Revenue needs to repay any additional excess deposits arising from the spread,

[11] Section EC 2 provides a deduction at the beginning of the cull year for the value of stock on hand at the end of the preceding income year.

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from any other excess deposit situation. Sections EH 8 and EH 42 envisage the automatic refund of an excess deposit soon after the end of the accounting year. They were therefore considered to be impracticable for an election to spread the income which is made retrospectively and may involve amounts that have already been refunded under other provisions.

To the extent that the excess deposit has not already been withdrawn, sections EZ 80(2) and EZ 81(2) require Inland Revenue to pay it out as soon as practicable after the election to use the spread is made. Practicably, the revised income tax returns outlining the spread amount will be necessary for Inland Revenue to calculate any remaining deposit amounts that need to be repaid.

Refunds are to first come from the deposits made for the accounting year in which the excess arose. In many cases an excess amount will likely have already been refunded through a standard withdrawal request, to pay for replacement livestock. Therefore, if there are insufficient remaining deposit amounts to fully refund the excess deposit, sections EZ 80(5) and EZ 81(5) provide ordering rules (starting with the earliest refunded deposits) to determine which, and how much, of the deposits for that accounting year that have been already refunded under other provisions (sections EH 13 and EH 15 but not EH 8), are instead treated as being refunded under sections EZ 80 and EZ 81. This means that those refunds change from being income to being excluded income.



*Treatment of interest*

Any interest paid or payable on the deposits, under sections EH 6 (interest on deposits in main income equalisation account) and EH 40 (interest on deposits in adverse event equalisation account), will still stand and be income. Interest on any excess deposits is calculated to the date the election is made (see sections EZ 80(7) and EZ 81(7) which respectively modify sections EH 6 and EH 40 to achieve this).

**Example 61**

A livestock owner deposits $200,000 into their MIES account in their 2018–19 accounting year. As the maximum deposit that they could make at that stage was $120,000, $80,000 was refunded under section EH 8 (and is excluded income).

With the passage of the new legislation, the person decides to take up the income spread option for the 2018–19 accounting year. This reduces their maximum deposit amount to $0, in which case Inland Revenue now needs to refund a further $120,000 (which is also treated as excluded income, and no deduction can be claimed for that deposit amount). $100,000 of deposits for 2018–19 have already been withdrawn (ignoring the $80,000 refunded under section EH 8). Those withdrawals are now treated as refunds under new section EZ 80. The remaining $20,000 not already withdrawn is also refunded under section EZ 80.

Interest on the $20,000 is still payable as those funds have been in the scheme for more than one year. The $100,000 withdrawn earlier did not meet this standard timing test to qualify for any interest.

**Example 62**

A livestock owner deposits $150,000 into their MIES account in their 2018–19 accounting year, the maximum deposit that they could make. This comprises $100,000 for the additional net income arising from the cull of their herd in that year, plus $50,000 in relation to other income.

With the passage of the new legislation, the person decides to take up the income spread option for the 2018–19 accounting year. This reduces their maximum deposit amount to $50,000. As none of the $150,000 deposited for that year has been withdrawn, under section EZ 80 Inland Revenue now needs to refund $100,000 (which is treated as excluded income, and no deduction can be claimed that deposit amount).

Under section EH 6, interest is payable on the full $150,000. Interest is payable on the $100,000 up to the date of the election. Interest is payable on the remaining $50,000 up until the deposit is refunded, either because it has been withdrawn or the maximum deposit period has expired (whichever is earlier). The maximum deposit period ends five years after the end of the accounting year for which the deposit was made.

*Consequential changes*

Consequential changes have been made to sections EH 1, EH 5, EH 13, EH 36, YA 1 and the former EZ 80 (now EZ 82) to update them for the new provisions.

*Already filed income tax returns*

Since the spread applies from the 2017–18 income year, taxpayers who take up the spread for a past year, can now request that the Commissioner of Inland Revenue amend their relevant past assessments, under section 113 of the Tax Administration Act

1994. A request can be made by emailing Mbovis@ird.govt.nz, and should include the year of the cull, the amounts to be spread over the six years, and details on how this has been calculated.

Previously, up to the enactment of the legislation, Inland Revenue had been allowing instalment arrangements to be entered into in relation to the tax due for the 2018–19 income year, to match the proposed spread.

**Table 6: Income spread**

| Opening numbers for cull year | | | | | | Cull numbers | | Income spread | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Total for class | Valued in cost | Held in herd scheme A – B | Held for breeding | Breeding in NSC D – C | Number culled | Valued in NSC E + F – A | Spread based on smaller of E or G | Cull proceeds per class | Co per |
| | A | B | C | D | E | F | G | H | I | |
| R1 heifers cows | 0 | | | | | | | | | |
| R2 heifers (AVO in use) | 20 | 5 | 15 | 20 | 5 | 19 | 4 | 4 | $15,200 | $ |
| MA cows | 100 | 100 | 0 | 100 | 100 | 80 | 80 | 80 | $95,000 | $5 |
| Breeding bulls | 0 | | | | | | | | | |
| | | | | | | | | | | |

Presumed that when the alternative valuation option (AVO) is in use, the herd scheme animals are the breeding or replacement animals.

**Table 7: Deduction spread**

| | Spread based on smaller of E or G | Last year NSC per class | Spread H × M |
|---|---|---|---|
| | H | M | N |
| R1 heifers | 0 | | |
| R2 heifers | 4 | $845 | $3,380 |
| MA cows | 80 | $925 | $74,000 |
| Breeding bulls | 0 | | |
| | **Total income spread** | **$77,380** | |

# Research and development

## Amendment to definition of eligible R&D expenditure

*(Section LY 5 of the Income Tax Act 2007)*

This amendment modifies section LY 5 of the Income Tax Act 2007, which contains the rules regarding what expenditure is eligible for the R&D tax credit, to clarify that expenditure must be closely connected with conducting an R&D activity to be eligible for the R&D tax credit.

### Background

Section LY 5(1), as previously written, defined R&D expenditure as being eligible to the extent to which it was:

- incurred on an eligible R&D activity in the relevant income year
- described in schedule 21B, part A (which lists the categories of expenditure that are eligible for R&D tax credits), and
- not described in schedule 21B, part B (which lists the categories of expenditure that are ineligible for R&D tax credits).

These tests did not specify how closely the expenditure had to be connected to an R&D activity to be eligible. To ensure that expenditure claimed has sufficient nexus with the eligible R&D being conducted, the amendment clarifies that expenditure is only eligible if it is *directly related to, required for,* and *integral to* the R&D taking place.

### Application date

This amendment applies from the beginning of the R&D tax credit regime, which is the 2019–20 income year. The amendment is a simple clarification that expenditure must be directly connected with R&D to be eligible and is not intended as a change in policy, or to change the way the law currently operates. It should therefore not affect R&D tax credit claims already filed and should provide future claimants with more explicit legislative direction regarding what expenditure may be eligible for the credit.

### Key features

The amendment adds new tests to the definition of eligible R&D expenditure for the R&D tax incentive, as prescribed in section LY 5 of the Income Tax Act 2007, to clarify that only expenditure directly connected with an eligible R&D activity is eligible. The amendment does this by adding in the following requirements, so that expenditure is only eligible if it is:

- **directly related to** conducting an R&D activity
- **required for** conducting an R&D activity, and
- **integral to** conducting an R&D activity.

The existing requirement that expenditure must be listed in schedule 21B, part A and not in schedule 21B, part B also applies.

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

### Detailed analysis

The amendment to section LY 5(1)(a) inserts a requirement that expenditure must be directly related to, required for, and integral to an eligible R&D activity to be eligible for the credit. These are in addition to the existing requirements in the section that expenditure must be listed in schedule 21B, part A and not described by schedule 21B, part B.

#### *Directly relates to (new section LY 5(1)(a)(i))*

The "directly relates to" requirement clarifies that expenditure must have a direct connection to an R&D activity to be eligible. A person must make a reasonable assessment of whether their expenditure has a sufficiently close connection to R&D to be eligible. If a person's expenditure relates to an R&D activity, but also relates to another purpose, the person must apportion the expenditure accordingly.

This requirement is intended to ensure that expenditure that is too remote from the R&D activity to which it relates is not eligible for the credit. Requiring expenditure to directly relate to an R&D activity clarifies the policy intent, which is that only expenditure that closely relates to an R&D activity should be eligible.

**Example 63: Expenditure must directly relate to R&D to be eligible for the credit**

LiamCo operates a mixed-use facility in Auckland, where fifty percent of the facility is devoted to R&D, while the other fifty percent is used for HR for LiamCo's operations across New Zealand.

LiamCo has an ongoing contract with a cleaning company to clean its Auckland facility. LiamCo's payments to the cleaning company would be eligible expenditure where they relate to cleaning the R&D area of the facility (while used for eligible R&D), because they directly relate to performing eligible R&D. However, the costs of cleaning the HR work area would not be eligible, even though HR spends some time supporting R&D staff, because these costs have no direct connection with performing R&D.

### *Required for and integral to (new section LY 5(1)(a)(ii) and (iii))*

The "required for" requirement clarifies that expenditure is only eligible to the degree it is necessary to support an R&D activity. The "integral to" requirement clarifies that expenditure must be essential to an R&D activity to be eligible. That is, the activity could not be performed or completed without the expenditure.

#### *Similarities with supporting activity limb*

These two requirements are taken from the definition of supporting R&D activity in section LY 2(3)(a). A supporting R&D activity is an activity that contributes to and is necessary for a core R&D activity (a core R&D activity is one that resolves scientific or technological uncertainty, via a systematic method, in order to produce new knowledge or things). The policy intent is that supporting activities must be very closely connected to a core activity in order to be eligible, and the tests required by the supporting R&D activity definition are designed to necessitate this close connection.

The policy intent for R&D expenditure is likewise that it must be closely connected with an eligible R&D activity to be eligible for the credit. Replicating part of the supporting R&D activity tests for the definition of eligible R&D expenditure clarifies that there must be a close connection between expenditure and an R&D activity for the expenditure to be eligible. This ensures the legislation matches the policy intent.

**Example 64: Expenditure must be required for and integral to the R&D**

To the extent that their duties relate to eligible R&D, expenditure on the salaries of staff at LiamCo's Auckland facility is eligible for the credit, as it is required for and integral to the R&D taking place. This includes the salaries of LiamCo's R&D staff, but also the salaries of the HR staff inasmuch as their duties relate to the R&D staff, as this expenditure is considered required for and integral to R&D (it relates to the performance of R&D and the R&D could not be performed without it).

However, the HR staff at the Auckland facility also perform HR duties for LiamCo's operations nationwide. The salaries of the HR staff cannot be claimed to the extent that their duties do not relate to R&D staff, as this expenditure is not required for R&D.

In addition to their salaries, staff at the facility receive a number of employee benefits, such as discounted gym subscriptions and on-site childcare facilities. These benefits are optional and are not factored into an employee's remuneration package. While some R&D staff may use these facilities, they are not integral to the R&D taking place; R&D could still be performed even if these benefits were not provided. Expenditure on these benefits is therefore not eligible.

#### *"Only or main purpose" test not included*

Not all of the supporting activity tests are included in the amended eligible expenditure definition in section LY 5. In particular, the "only or main purpose" requirement has not been included, as this test would go beyond the policy intent by requiring that expenditure be incurred only or mainly for the purpose of supporting an R&D activity to be eligible.

For example, a business does R&D in a lab, which forms part of a larger complex that also includes non-R&D facilities. The R&D portion of the total complex is twenty five percent. The policy intent is that twenty five percent of the rent be eligible for the credit; however, an "only or main purpose" test may completely exclude the rent. Therefore, the "only or main purpose" has not been included in the amendment.

#### *Businesses not obligated to minimise expenditure*

As with the supporting R&D activity tests, the new "required for" and "integral to" expenditure tests do not obligate a business to adopt the cheapest possible approach to its R&D. For instance, one business may want the highest possible quality for materials and equipment used in R&D, while another may be satisfied with a lower standard. In both cases the expenditure required for and integral to the R&D activity is eligible.

Similarly, businesses may go about their research in different ways. Expenditure that is required for an approach that a business has chosen is not disqualified simply because another business might have chosen a cheaper option.

**Example 65: Business not obligated to minimise expenditure**

Loud Co is performing eligible R&D to develop new drilling equipment for use in constructing tunnels. Their equipment emits noise at a volume damaging to human hearing, so, to protect its employees' (and future customers') health and safety, Loud Co incorporates noise-reducing technologies into the design of its drilling equipment.

At the same time, Equally Loud Co is performing R&D on similar equipment. Rather than altering the design of the equipment, Equally Loud Co addresses the problem more cheaply by buying noise-cancelling earmuffs for all of its employees working on the drill.

Both Loud Co's expenditure on reducing the noise of the drill and Equally Loud Co's expenditure on earmuffs are eligible for the credit. It does not matter that Loud Co could have taken a cheaper approach to solve the issue.

### *Existing requirements in section LY 5(1)(a) and (b) still apply*

#### *Schedule 21B, part A*

To be eligible, expenditure must be described in schedule 21B, part A, which provides a list of expenditure that may be eligible for the R&D tax credit (section LY 5(1)(a)). This requirement is not affected by the new amendment and continues to apply as before.

#### *Schedule 21B, part B*

If expenditure is described in schedule 21B, part B, it is not eligible for the R&D tax credit (section LY 5(1)(b)). This requirement is also not affected by the new amendment and continues to apply as before.

#### *"To the extent" test still applies*

The amendment removes the "to the extent" test (which ensures that expenditure is only eligible to the extent to which it is incurred on an R&D activity) from LY 5(1)(a). However, the test still applies to R&D expenditure because it is explicitly referred to in each of the clauses in schedule 21B, part A. Each of the clauses in this schedule stipulates that expenditure in that category is only eligible to the extent to which this expenditure relates to performing an R&D activity.

**Example 66: Eligible R&D expenditure under the new requirements**

GeneriCo is a company whose main business activity is performing R&D. It files its supplementary return for the 2020–21 income year.

GeneriCo can claim the costs of employees performing eligible R&D, as well as costs for other staff to the extent that their duties are required for and integral to performing R&D. For instance, GeneriCo can claim the cost of HR staff to the extent that they are supporting R&D staff, cleaning staff to the extent that they are cleaning facilities used for R&D, and payroll staff to the extent that they are paying R&D staff.

However, GeneriCo cannot claim expenditure with a less direct connection to R&D. For instance, it cannot claim the cost of payroll staff to the extent that they are paying HR staff who are supporting R&D staff, or cleaning staff to the extent that they are cleaning the offices of payroll staff who are paying R&D staff, and so on. This is because these costs do not directly relate to an R&D activity.

GeneriCo can claim rent, utilities, insurance, and other expenses necessary to operate its R&D-performing facility in Christchurch, to the extent that the expenses relate to the performance of eligible R&D activities. However, GeneriCo cannot claim the costs of its on-site cafeteria or grounds maintenance costs at the facility. These costs are not required for or integral to the performance of R&D – R&D could still take place at the facility even in the absence of these costs.

***Variation of facts: Under the previous expenditure rules***

The legislation previously required that expenditure be on an activity but gave no direction as to how closely the expenditure must be connected to the activity. Without the clarification provided by this amendment, this could allow GeneriCo to claim costs that are only loosely connected with R&D, contrary to the policy intent (which is that only expenditure that closely relates to and is reasonably necessary for performing R&D should be eligible).

For instance, GeneriCo might interpret the law in a way that allows it to claim the full cost of its staff for the credit; as GeneriCo's main business is performing R&D, all staff costs could be considered as necessary to support the performance of R&D activities. Likewise, as they are part of the costs of a facility used solely for R&D activities, GeneriCo might interpret the law in a way that allows it to claim the costs of the staff cafeteria or maintaining the grounds at its Christchurch facility.

## Exclusions in relation to miners

*(Schedule 21, parts A and B, and schedule 21B, part B of the Income Tax Act 2007)*

This amendment clarifies the treatment of capital assets used in the petroleum and mineral mining industries for the purposes of the tax credit regime and aligns it with the existing treatment of depreciable assets used in other industries.

### Background

The intent is that the upfront cost of capital assets is not generally eligible for the R&D tax credit. This is achieved through a number of expenditure exclusions in schedule 21B part B of the Act (which lists categories of ineligible expenditure) that target various types of expenditure on depreciable property.

Most industries use the depreciation rules when amortising their assets for tax purposes, and their assets are therefore caught by the exclusions, as intended. However, assets used in the petroleum and mineral mining industries have their own tax treatments, set out in subparts DT and DU (respectively) of the Act. As these tax treatments are not technically depreciation, assets used in the mining industry are therefore not considered depreciable and are thus not covered by the existing expenditure exclusions in schedule 21B part B that relate to depreciable property. A taxpayer can thus claim the full upfront cost of these assets for the credit, contrary to the policy intent.

To ensure that the upfront costs of assets used in the mining industry are not inappropriately eligible for the credit, the amendment adds a new clause to schedule 21B part B that specifically excludes the cost of these assets from being eligible.

### Key features

The amendment adds a new expenditure exclusion that excludes assets used in the petroleum and mineral mining industries, using language which aligns with the petroleum and mining tax regimes that already exist in the Income Tax Act 2007 ("the Act"). It achieves this by excluding expenditure or loss by a "petroleum miner" or "mineral miner" (as defined in section YA 1 of the Act). The new exclusion includes exceptions for labour costs that contribute to core R&D and for prototypes (parallel to the treatment of tangible depreciable property).

To ensure the exclusion covers the same range of industries as the existing activity exclusion on prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy, miners of "minerals" (as defined in section YA 1 of the Act)

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and geothermal energy are explicitly covered by the exclusion. As its intent is covered by the new exclusion, the amendments also repeal the existing activity exclusion.

### Application date

The amendment applies from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

### Detailed analysis

The amendment adds a new clause, clause 3B, to schedule 21B part B of the Act, which lists categories of excluded expenditure for the R&D tax credit. Clause 3B excludes expenditure or loss incurred by a petroleum miner, mineral miner, or a person who would be a mineral miner of geothermal energy and "minerals" (in the broader sense defined in section YA 1 of the Act).

Assets used in petroleum and mineral mining have their own tax regimes in the Act (subparts DT and DU). These regimes centre on the terms "petroleum miner" and "mineral miner," as defined in the Act. These terms are linked to a number of expenditure-related defined terms, such as "mining development expenditure" and "petroleum development expenditure," which provide for the alternative tax treatment of assets created and used by miners when undertaking mining activities. Anchoring the clause to the definitions of a petroleum miner or mineral miner thus excludes all expenditure that falls within these expenditure-related terms.

The petroleum and mineral miner definitions, and the expenditure-related terms that depend on them, only affect a taxpayer in their capacity as a miner. Any R&D activities performed by a business involved in mining that meet the other legislative requirements could therefore potentially be claimed for the credit, so long as it is not performed by the business in their capacity as a miner. This is in line with the policy intent, which is to exclude the cost of assets used in the mining industries from the tax credit while still allowing a credit for R&D performed in these industries.

As its intent and function is similar to existing exclusions on tangible depreciable property, clause 3B contains similar exceptions for labour costs that contribute to core R&D and for prototypes only used in R&D (refer to *Amendment to tangible depreciable property exclusion*, for a detailed analysis of how these exceptions work). This brings the treatment of expenditure on assets in the mining industries fully into line with the treatment of expenditure on depreciable tangible property in other industries.

The mining regimes in the Act include terminology that covers the intent of clause 5 of schedule 21 parts A and B (which excludes "prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy" as an eligible activity). The amendments accordingly repeal clause 5 of schedule 21 parts A and B.

However, the term "mineral miner" and the terms associated with it in the Act (for example, "mining prospecting expenditure," "mining exploration expenditure") refer only to "listed industrial minerals," rather than minerals in the broader sense. The definition of "listed industrial minerals" in the Act does not cover some minerals intended to be covered by the exclusion, such as coal. Geothermal energy, which is also covered by the present exclusion, would not be covered. To achieve the policy intent, clause 3B also deems miners of "minerals" (as defined in the Act) and geothermal energy to be "miners".

## Amendment to tangible depreciable property exclusion

*(Schedule 21B, part B of the Income Tax Act 2007)*

Schedule 21B, part B, clause 3 renders expenditure or loss that contributes to the cost of tangible depreciable property ineligible for the credit, other than expenditure or loss on developing prototypes. An amendment to clause 3 ensures the exception for expenditure or loss on prototypes is working as intended, while also allowing expenditure or loss in relation to labour on core R&D activities to be eligible (regardless of whether the property is a prototype).

### Background

Schedule 21B, part B, clause 3 excludes expenditure or loss that contributes to the cost of tangible depreciable property. An exception exists for expenditure that contributes to the cost of property intended for use solely in performing an R&D activity. This prototype exception is intended to capture expenditure required to produce items created by and solely used in core R&D activities, such as prototypes. Expenditure on tangible depreciable property that meets this test is still eligible for the tax credit.

This amendment changes the exclusion in two ways. The first change amends the prototype exception. The second allows certain labour costs to be eligible, even if they contribute to the cost of tangible depreciable property.

#### *Prototype exception*

The policy intent of the prototype exception is to allow expenditure or loss on items of tangible depreciable property created through R&D and used solely in R&D throughout their lifetime to be eligible. However, as previously worded, the exception may have included a greater range of expenditure than was intended.

The amendment brings the legislation in line with the intent by requiring, in addition to the requirement that the property must only be used in performing R&D, that the property must only be intended for use in performing R&D in the future, and that creating the property must involve a core R&D activity.

### *Labour cost carve-in*

The amendment also allows labour-related expenditure or loss on an item of tangible depreciable property to be eligible for the tax credit, regardless of whether it meets the above tests, to the extent to which it relates to performing core R&D activity. This means that a business can claim expenditure on employees or on contracted labour that contributes to the cost of an item of tangible depreciable property for the tax credit, even where the item of property is not intended as a prototype, to the extent that the employees or contractors are performing a core R&D activity. Usually this means an identifiable separate activity incidental to the creation of a larger item of tangible depreciable property.

This is consistent with the existing inclusion for labour costs for R&D undertaken in commercial production environments and recognises that it should be easier to identify whether labour costs directly relate to R&D compared with non-labour costs, such as electricity costs. The amendment allows more genuine R&D costs to be eligible while still ensuring any fiscal risk posed by R&D projects involving significant tangible depreciable assets is minimised.

## Key features

This amendment makes two changes to the existing exclusion on expenditure or loss that contributes to the cost of tangible depreciable property (schedule 21B, part B, clause 3 of the Income Tax Act 2007).

First, it clarifies the scope of the exception for expenditure that contributes to the cost of property intended for use as a prototype ("prototype exception"), by adding further requirements that:

- the property must only be intended for use in performing R&D in the future, and
- creating the property must involve a core R&D activity.

This ensures that the provision operates consistently with the policy intent, which is for expenditure on tangible depreciable property to be ineligible unless it is on a prototype (property that is developed through R&D and is only used in R&D).

Second, it allows expenditure/loss on labour in relation to core R&D to be eligible for the credit, despite the exclusion for costs that contribute to tangible depreciable property ("labour cost carve-in").

## Application date

The amendment applies from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

## Detailed analysis

### *Clarifying the prototype exception*

The amendment adds further tests into the clause that ensure the prototype exception is better targeted towards the concept of a prototype. In addition to the requirement that an item of property is only used in R&D, these tests require that the property's sole intended future use is in performing R&D, and that the creation of the item involves a core R&D activity:

- **Sole intended future use is in performing R&D** means that a person's intent must be that the item of property will only ever be used in performing R&D activities, and never be used for any other purpose.
- **Creation involves a core R&D activity** means that, for expenditure or loss on an item of property to be eligible, the expenditure or loss must also be incurred on performing a core R&D activity (that is, the creation of the item involves resolving a scientific or technological uncertainty via a systematic method).

For expenditure or loss on an item of tangible depreciable property to be eligible, all three tests must be met.

### *New exception for labour costs on core R&D activity*

The amendment also allows expenditure or loss on an item of tangible depreciable property to be eligible for the tax credit, regardless of whether it meets the above tests, to the extent to which it relates to labour costs on core R&D activity. Labour expenditure can be claimed regardless of whether it relates to employees or to contracted labour.

Expenditure or loss on labour for an item of tangible depreciable property is ineligible to the extent to which the costs do not relate to performing a core R&D activity (unless the item of property meets the tests required by the prototype exception).

**Example 67: Tangible depreciable property exclusion and labour costs**

Claire's Construction is experimenting with new construction materials that would allow the construction of lighter yet sturdier bridges. The construction of their first bridge involves some eligible R&D as it requires the resolution of scientific or technological uncertainty. Assuming the R&D is successful, Claire's Construction intends that the bridge be used for commercial transport once it is complete.

Claire's Construction contracts a local university to provide scientific expertise to help resolve the uncertainty. The university's scientists work alongside engineers who are directly employed by Claire's Construction. The company also hires workers to build the bridge, who are variously employed or contracted.

The cost of the scientists and engineers working to resolve the scientific or technological uncertainty involved in creating the bridge is eligible expenditure for the tax credit (as these costs relate to a core activity). However, Claire's Construction cannot claim the cost of the workers building the bridge (as building the bridge is a supporting activity), nor any of the costs of materials or equipment.

## Other amendments to the schedule of excluded expenditure

*(Schedule 21B, part B of the Income Tax Act 2007)*

The Act makes a number of other amendments to schedule 21B, part B of the Income Tax Act 2007 clarifying what expenditure is excluded from the R&D tax credit.

### Key features

The Act makes several additions or changes to the categories of expenditure ineligible for the R&D tax credit set out in schedule 21B, part B. These are:

- Amending the exclusion on expenditure to acquire depreciable property (clause 2) to clarify that "acquiring" depreciable property, for the purposes of the exclusion, does not include making depreciable property.
- Amending the exclusions on expenditure to acquire depreciable property (clause 2) and on expenditure that contributes to the cost of depreciable tangible property (clause 3) to exclude expenditure or loss on property which would have been depreciable in the absence of an election to treat it as non-depreciable under section EE 8 of the Income Tax Act 2007.
- Changing the word "purchase" in the existing exclusion on expenditure to purchase land (clause 10) to "acquire".
- Changing the exclusion on professional fees incurred in determining a person's entitlement to the tax credit (clause 13) to also cover in-house expenditure incurred in determining a person's entitlement.
- Inserting new clause 13B, which excludes expenditure or loss incurred in performing corporate governance activities.
- Inserting new clause 20B, which excludes expenditure or loss incurred in decommissioning.
- Inserting new clause 20C, which excludes expenditure or loss incurred in remediating land.
- Changing the exclusion on expenditure or loss supported by or related to a government grant (clause 21) to allow amounts not directly supported by other forms of government funding to be claimed for the credit.

### Application date

The amendments apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

### Detailed analysis

#### *Clarifying that expenditure to make depreciable property can be eligible for the credit (clause 2)*

An amendment to clause 2, which excludes expenditure or loss to acquire items of depreciable property, clarifies that this exclusion does not apply to expenditure or loss to make depreciable property. The policy intent is that expenditure on the upfront cost of large capital assets generally be ineligible for the credit. Instead, it is intended that depreciation loss on these assets over time be eligible (to the extent the assets are used in R&D), similar to the tax treatment of these assets.

As R&D can involve the creation of a capital asset, the original intent of clause 2 was to exclude expenditure on acquiring these assets through any means other than making them. It was intended that expenditure on making depreciable property be generally eligible, subject to the other exclusions in schedule 21B part B. However, the Income Tax Act 2007 defines "acquire" to include "make" in relation to depreciable property. Under the previous wording, taxpayers were thus prevented from claiming the tax credit for any costs of making depreciable property, giving the exclusion unintended overreach.

#### *Treatment of items of property where election made under section EE 8 (clauses 2 and 3)*

Amendments to clause 2 (which excludes expenditure to acquire depreciable property) and clause 3 (which excludes certain expenditure that contributes to the cost of depreciable tangible property) clarify that these exclusions also apply to expenditure or loss on acquiring an item of property that would have been depreciable in the absence of an election under section EE 8 of the Income Tax Act 2007. The policy intent is that expenditure on the upfront cost of large capital assets generally be ineligible for the credit. Instead, it is intended that depreciation loss on these assets over time be eligible (to the extent the assets are used in R&D), similar to the tax treatment of these assets.

Section EE 8 allows a taxpayer to elect that an item of property be treated as non-depreciable property (where, in the absence of this election, it would otherwise be depreciable property) upon acquisition or, in limited circumstances, a change in use. This could potentially allow taxpayers to bypass the exclusions for the upfront cost of depreciable property and claim the full upfront cost of their property as eligible expenditure, contrary to the policy intent. The amendments ensure the legislation better satisfies the policy intent by aligning the treatment of depreciable property and property that would have been depreciable absent an election under section EE 8.

#### *Changing "purchase" to "acquire" (clause 10)*

Clause 10 excludes expenditure to purchase land. It is not appropriate to give an R&D tax credit for land acquired for use in R&D for two reasons. The first is that it is difficult to apportion what cost of the land relates to R&D, given the land could be used for non-R&D purposes later. The second reason is that land generally increases in value and therefore can be sold to recoup the cost.

This amendment broadens the scope of clause 10 so that it excludes expenditure to acquire land, rather than merely to purchase it. This is consistent with the policy intent of the original exclusion, which is intended to exclude expenditure on obtaining land regardless of the method used to obtain it.

### *Excluding in-house costs on determining tax credit entitlement (clause 13)*

Clause 13 excludes professional fees incurred in determining a person's entitlement, or lack of entitlement, to an R&D tax credit. This exclusion covers fees paid to determine the eligibility of a person, activity, or amount of expenditure, such as amounts paid to an accounting firm to prepare a person's R&D claim.

The amendment broadens the scope of clause 13 to cover all expenditure or loss incurred in determining a person's entitlement to the tax credit by replacing the words "professional fees" with "expenditure or loss." This is intended to exclude in-house expenditure on determining entitlements, as well as the fees currently targeted by the exclusion. These amounts should be ineligible under current legislation because they do not directly relate to R&D (they do not relate to resolving scientific or technological uncertainty), but the amendment to clause 13 provides explicit legislative guidance that these costs are not eligible for the R&D tax credit.

### *Exclusion of expenditure on corporate governance activities (new clause 13B)*

New clause 13B excludes expenditure or loss on performing corporate governance activities. These costs should already be ineligible under current legislation, but the new exclusion provides certainty and clarity to firms that they cannot claim these costs. These amounts are excluded because they do not directly relate to R&D. They are costs that have to be incurred regardless of whether R&D takes place.

### *Exclusion of decommissioning expenditure (new clause 20B)*

New clause 20B excludes expenditure on decommissioning. This exclusion is intended to cover expenditure involved in doing the following to assets (including land):

- dismantling, demolishing, disposing of, removing, or abandoning an asset
- preventing access to an asset
- converting an asset so that it can be used to conduct a different activity (unless it is being converted for use in R&D), and
- otherwise decommissioning an asset.

The exclusion is intended to apply to assets (including land) such as:

- structures
- plant and machinery, and
- any improvements or alterations to land.

Note that the above lists are not exhaustive.

This expenditure, in and of itself, should largely already be excluded from the credit as it is unlikely to relate to resolving scientific or technological uncertainty. The intent of this exclusion is to clarify that expenditure on decommissioning is not eligible for the credit.

Note that the exclusion only relates to expenditure on the act of decommissioning itself. Expenditure on R&D relating to decommissioning is potentially eligible for the credit, providing it meets the other eligibility criteria, is an identifiable separate activity, and is incidental to the decommissioning activity.

### *Exclusion of expenditure on remediating land (new clause 20C)*

New clause 20C excludes expenditure on remediating land. This exclusion is intended to cover the costs of restoring or remedying a site or area of land ("site"), where a person's activities on the site have resulted in changes to the site. This also includes any monitoring or maintenance activities that relate to restoring/remedying a site.

This expenditure, in and of itself, should largely already be excluded from the credit as it is unlikely to relate to resolving scientific or technological uncertainty. The new clause clarifies this by explicitly excluding expenditure on remediating land from the credit.

Note again that the exclusion only relates to expenditure on the act of remediating land itself. Expenditure on R&D relating to remediation could still be eligible for the credit, providing it meets the other eligibility criteria, is an identifiable separate activity, and is incidental to the decommissioning activity.

***Amending the exclusion of expenditure related to a government grant (clause 21)***

Clause 21 excludes expenditure or loss that is related to a grant made by the Crown or a local authority. This is a broad exclusion introduced to avoid "double-dipping" by preventing businesses from claiming multiple sources of government funding for expenditure relating to the same R&D activity. An amendment in the Act clarifies the scope of the exclusion to allow more expenditure unsupported by any other funding mechanism to be claimed for the credit, while maintaining the anti-double-dipping provision.

The broader policy intent of the tax credit is to incentivise and support businesses to increase their expenditure on R&D. However, as previously written, the exclusion applied very broadly, so that (for example) expenditure that relates to R&D funded by a Project Grant but is not directly funded by the grant, and beyond the specified co-funding, was excluded from the credit. This expenditure was thus supported by neither the Grant nor the credit, contrary to the intent of the credit.

Under a Project Grant, businesses can receive funding for up to 40% of a project's estimated cost (and are required to contribute 60% as co-funding). However, the terms of the funding agreement specify that the business must spend any additional funding required to complete the project beyond the required 60% co-funding. This means that any additional expenditure by the business on the project is considered to be incurred in connection with expenditure that has already been subsidised through the grant and was therefore considered ineligible for the RDTI under schedule 21B, part B, clause 21 as previously written.

**Example 68: Current practice**

Company A undertakes R&D project X and applies for a Project Grant. At the time of application, the company estimates that Project X will cost $500k. Company A's application is approved, and it receives funding from Callaghan Innovation of $200k (which is 40% of 500k). The company is required by its Project Grant funding agreement to complete the agreed R&D project and spend a minimum of $300k on top of the $200k funded by the grant.

After starting the project, Company A discovers that it will need to spend an additional $700k on the project. The $700k of additional expenditure is considered ineligible for the RDTI under schedule 21B, part B, clause 21 because it relates to expenditure supported by a Project Grant.

The amendment narrows the scope of clause 21 so that it does not cover amounts over and above the estimated cost of the project (as specified in the Project Grant contract), allowing these amounts to be claimed for the credit provided they meet the other criteria. It also removes the words "or otherwise related to" from the exclusion, allowing for other amounts that are not directly supported by a government grant to be claimed.

## Criteria and methodologies application due date change

*(Section 68CC of the Tax Administration Act 1994)*

This amendment brings forward the due date for submitting an application for criteria and methodologies (CAM) approval to six months before the end of a person's income year.

### Background

From the 2020–21 income year, businesses must obtain either general approval or criteria and methodologies (CAM) approval. Under general approval, a business must apply for approval of each of its core and supporting R&D activities. Businesses which expect to spend more than $2m on R&D in a given year can opt out of general approval and into CAM approval. Under CAM approval, a business instead applies for approval of the criteria and methodologies it uses to determine the eligibility of its R&D activities and expenditure.

Under the previous legislation, CAM approval applications were due after the end of the income year. The amendment changes the due date for applying for CAM approvals to six months before the end of the first income year to which a CAM relates (CAM approvals can be obtained for up to three income years). So, for a standard balance date (31 March) claimant in the 2021–22 income year, their year-end would be 31 March 2022, and their CAM approval application would be due on 30 September 2021 under the proposed new due date. This amendment does not require that the CAM approval process be completed by the above due date, only submitted.

This earlier due date ensures businesses have the correct R&D processes and methodologies in place when their R&D is actually occurring (during the relevant income year). This reduces the need for businesses to have to retrospectively amend their processes and methodologies to ensure their R&D claims are correct. In addition, an earlier due date means businesses have more time to seek general approval should their CAM approval application be declined (or only cover part of their R&D). This is important, because without general or CAM approval, a person is not eligible for the R&D tax credit regime from the 2020–21 income year.

**Example 69: Applying for CAM approval under the new rules**

Widgets-R-Us, a large company with a major R&D arm, is considering applying for the R&D tax incentive in the 2021–22 income year. Its balance date is 30 June. As Widgets-R-Us undertakes a wide variety of R&D projects, it elects to apply for CAM approval for the 2021–22, 2022–23, and 2023–24 income years (rather than seeking general approval for each project). The due date for applying for CAM approval is six months before the end of the first income year to which the CAM relates. As Widgets-R-Us's balance date for the 2021–22 income year is 30 June 2022, its application is due on 31 December 2021.

The company submits its CAM application on 21 December 2021. The application takes six weeks to process and is completed on 1 February 2022. Most of Widgets-R-Us's R&D projects are included in the CAM approval; however, the core team is not satisfied with the company's systems for identifying eligible expenditure in two of its projects. These projects are not covered by the CAM approval. The core team advises Widgets-R-Us to apply for general approval for both projects.

The due date for applying for general approval for the 2021–22 income year is unchanged; applications are due on or before the 7th day of the 2nd month after the end of the first income year. For Widgets-R-Us, this is 7 August 2022. The company applies for general approval for both projects before the due date.

***Variation of facts: Under the previous legislation***

Under the previous legislation, CAM approval applications were due on or before the 7th day of the 2nd month after the end of the first income year to which the CAM relates. As Widgets-R-Us's balance date for the 2021–22 income year is 30 June 2022, its application would be due on 7 August 2022. The company submits its application on 28 July. As above, the CAM takes six weeks to approve (it is approved on 8 September 2022), and two projects are not covered.

The due date for applying for general approval is still 7 August 2022. Widgets-R-Us cannot apply for general approval for the two projects not covered by its CAM approval in time. The company cannot claim the credit for these projects in the 2021–22 income year.

The amendment also contains a discretion for the Commissioner to accept and approve applications after the new due date, where the applicant has had a change in their balance date for the first income year to which the CAM relates. This ensures that taxpayers who have a transitional tax year due to a change in their balance date are not rendered unable to apply for CAM approval in a timely manner due to their balance date being brought forward.

The amendment applies prospectively from the 2021–22 income year (from 1 April 2021 for most claimants). This ensures that taxpayers (particularly those with early balance dates) intending to apply for CAM approval for the 2020–21 income year have sufficient time to plan for the new due date.

### Application date

The amendment applies from the 2021–22 income year (1 April 2021 for most taxpayers).

### Key features

The amendment brings forward the due date for applying for CAM approval applications in section 68CC(3) of the Tax Administration Act 1994, so that applications must be submitted on or before the last day of the 6th month before the end of the first income year to which the CAM applies (30 September for most taxpayers). Applications submitted after that date will not be considered for the relevant income year.

However, the amendment also provides the Commissioner with discretion to accept an application at a later time of her choosing where the applicant has changed the end date of their income year due to a change in their balance date.

## More time to consider requests to increase R&D claims

*(Section 108(1E) of the Tax Administration Act 1994)*

This amendment provides the Commissioner with more time to consider section 113 requests to increase claims in a taxpayer's favour. Previously, the legislation imposed a time bar that prevents the Commissioner from considering requests if more than a year has passed since a taxpayer's income tax return due date for the relevant year.

### Background

A person can only file a request to increase their R&D tax credit claim once for each R&D tax credit claim they make (section 113E of the Tax Administration Act 1994), whether through a section 113 request or a notice of proposed adjustment (NOPA). A time bar prevents the Commissioner from increasing a person's R&D tax credit claim if the person fails to make the request to increase their claim within a year of their income tax return due date (section 108(1E)).

As previously drafted, the legislation required a section 113 request to increase an R&D tax credit claim to be initiated **and processed** within a year of the relevant taxpayer's income tax return due date. This is contrary to the policy intent, which is simply that the person must initiate the disputes process within that timeframe. By requiring the request to be processed within that timeframe, the Commissioner may not have enough time to fully consider requests.

An amendment in the Act removes the requirement that the request be fully processed within that timeframe, while still requiring the request be initiated within a year of the relevant taxpayer's income tax return due date. This makes the time bar which applies to section 113 requests consistent with the rules that apply for NOPAs, which were amended by the Taxation (KiwiSaver, Student Loans and Remedial Matters) Act 2020 in a similar way. The amendment ensures the Commissioner has enough time to consider requests consistent with the policy intent.

### Key features

Section 108(1E) of the Tax Administration Act 1994 is amended to allow the Commissioner to adjust a person's R&D tax credit claim upwards if the person has made a section 113 request within a year of their income tax return due date. Provided a request is initiated within this timeframe, the Commissioner can consider the request.

### Application date

The amendment applies from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).



## Ability to transfer tax refunds to an amount borrowed under the Small Business Cashflow (Loan) Scheme

*(Section 3 of the Tax Administration Act 1994)*

An amendment is made to the definition of "tax" in the Tax Administration Act 1994 to ensure that tax refunds owed to a recipient of a loan under the Small Business Cashflow (Loan) Scheme (SBCS) can be transferred by Inland Revenue to their outstanding loan balance at their request.

### Background

The Small Business Cashflow (Loan) Scheme (SBCS) opened for applications on 12 May 2020 as a response to the economic impacts of COVID-19. Borrowers are able to access a loan of up to $100,000, with the amount depending on the number of full-time-equivalent employees employed by the business or organisation.

Previously, if a borrower was owed a tax refund, they were unable to request that Inland Revenue transfer this amount toward paying down their SBCS balance. This is because a loan under the SBCS was not included in the definition of "tax" for the purpose of Part 10B of the Tax Administration Act 1994, where transfers of excess tax can be made to another tax type or to another amount due. This meant that tax refunds had to be made to the borrower's bank account, at which point the borrower had to make a manual repayment to repay their loan under the SBCS.

### Key features

The Act provides for an amendment to section 3 of the Tax Administration Act 1994 to allow Inland Revenue to transfer a tax refund owed to an SBCS recipient to their outstanding SBCS balance at the recipient's request.

### Application date

The amendments apply from the date the Act received Royal assent.

### Detailed analysis

The Act amends the Tax Administration Act 1994.

#### *Section 3 of the Tax Administration Act 1994*

The definition of "tax" in section 3 of the Tax Administration Act 1994 is amended for the purpose of Part 10B to include an amount payable in relation to a loan made under the SBCS. The amendment allows Inland Revenue to transfer a tax refund owed to an SBCS loan recipient to their outstanding SBCS balance at the recipient's request. This simplifies the process for a loan recipient who wants to use a tax refund they are owed to pay down their SBCS loan balance.

The purpose of the amendment is to reduce compliance costs for loan recipients who want to offset a tax refund against their SBCS balance. Instead of a loan recipient receiving a refund before using it to make a manual repayment of their loan, the recipient may choose for a tax refund to be directly transferred to their outstanding SBCS balance. This amendment does not give Inland Revenue authority to make a transfer without the recipient's permission.



## Changes to the PIE schedular income year-end adjustment rules

*(Sections BC 7, DB 53, HM 36B, HM 52, HM 56, LA 6, LS 3, LS 4 and YA 1 (residual income tax) of the Income Tax Act 2007)*

Amendments have been made to the way in which the portfolio investment entity (PIE) year-end process works to clarify the rules, and to simplify and future proof the calculations.

### Background

The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 introduced changes to allow for overpaid tax on PIE income of individuals to be refunded from the 2020/21 tax year. This is achieved through a year-end square-up comparing the amount of tax paid on PIE income during the year (by PIEs on behalf of their investors) with the amount of tax that should have been paid on a person's PIE income for the tax year. This year-end square-up addresses any over- or underpayment of tax on PIE income during the tax year. Any resulting refund due or tax payable is added to the person's end of year tax position and would either be refunded, payable, or would reduce the person's tax payable or reduce the person's tax refund.

These current amendments clarify the year-end adjustment process and better integrate it into existing income tax legislation and processes.

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

### Key features

The key changes are as follows:

- The year-end adjustment calculation formula described in legislation is replaced with an outline of what the Commissioner needs to take into account when calculating the adjustment.
- PIE losses and loss tax credits attributable to a natural person investor are included when calculating the individual's PIE schedular tax adjustment.
- Only taxpayers who have used the incorrect prescribed investor rate (PIR) or who have changed their PIR during the year will have additional tax to pay or a refund from a PIE schedular tax adjustment.
- Clarification that the year-end PIE schedular tax adjustment:
  - applies only to natural person investors who are resident in New Zealand, and
  - does not apply to a natural person who derives PIE income as beneficiary income from a trust that is not a PIE.
- Multi-rate PIE income is taxable income for the purposes of the calculation of the PIE schedular tax adjustment only. This limits the removal of PIE income from excluded income.
- The PIE schedular tax adjustment will form part of an investor's residual income tax for provisional tax purposes.

### Application date

The amendments apply retrospectively from 1 April 2020, when the new year-end PIE tax adjustments came into effect.

### Detailed analysis

#### *PIE schedular income year-end adjustment calculation*

The year-end adjustment calculation formula described in subsections HM 36B(2) and (3) was overly prescriptive. This risked preventing the ability to include some types of attributed tax credits in the calculation for the benefit of the investor both in the 2020–21 year or in the future as more detailed information can be supplied by fund managers.

The prescriptive formula is changed to an outline of what the Commissioner needs to consider when calculating the adjustment. The recommended amendments are designed to future-proof the calculation and enable the Commissioner to incorporate any potential improved data reporting around credits in the future.

A PIE schedular tax adjustment is only required where a natural person investor resident in New Zealand has had tax deducted from their PIE income using an incorrect prescribed investor rate (PIR). This could occur when an incorrect PIR is provided by the investor, where they have changed their PIR during the year, or where a PIE has not applied the correct PIR or applied a zero rate to some or all of the PIE income. This change eliminates the charging of small amounts of tax payable to investors due to the timing of the calculation process.

**Example 70**

Tim is an investor in the B&E PIE. Tim started the year on a 17.5% PIR, however, after filing his tax return for the prior year he works out that his PIR for the year should be 28% but he fails to change his PIR with the B&E PIE. At the end of the year the B&E PIE undertakes a tax calculation using the following information:

| | **Amount** |
|---|---|
| PIE income | $20,000 |
| Tax on that @ 17.5% | $3,500 |
| Tax to pay | $3,500 |

The B&E PIE redeems some of Tim's units and pays the PIE tax liability.

At the end of the year Inland Revenue performs the PIE tax adjustment for Tim's PIE income from the B&E PIE using the following information and Tim's correct PIR:

| | **Amount** |
|---|---|
| PIE income | $20,000 |
| Tax on that @ 28% | $5,600 |
| *Less:* | |
| PIE tax paid | $3,500 |
| Tax to pay | $2,100 |

Tim will have additional tax to pay of $2,100 to bring his PIE tax for the year up to the correct PIR. As Tim used an incorrect PIR and tax was deducted using that incorrect PIR during the year this amount will be charged to him.

The PIE schedular tax adjustment is now included as part of residual income tax, which forms the basis for any provisional tax liability. This amendment reduces complexity for taxpayers and Inland Revenue's systems in that the tax liability for the year will be the same as their residual income tax liability on which provisional tax is calculated.

**Example 71**

Noel is an investor in a KiwiSaver fund administered by Spoons Funds Limited (Spoons). When Noel opened his fund in the 2023–24 income year he gave Spoons his PIR at 10.5% thinking that he would get a good timing advantage from having his funds taxed at a lower rate than his correct PIR of 28%.

Noel is self-employed and he is a provisional taxpayer with residual income tax (before PIE schedular tax adjustment) in the 2023–24 income year of $26,000. Inland Revenue adds his PIE adjustment of $6,000 to his income tax liability for the year and his residual income tax for the 2023–24 income year will be $32,000 on which his 2024–25 provisional tax will be based.

**Example 72**

Eddie, an employee of The Lost Cat Cattery Limited, is an investor in a PIE fund administered by Pioneer Phunds Limited (Pioneer). Eddie figures that it will be great timing advantage to delay paying as much PIE tax on his investment as possible and gives Pioneer a PIR of 10.5% even though he should be on the 28% PIR. Inland Revenue has notified Eddie that he is on an incorrect PIR but he does not notify the PIE.

At the end of the year Inland Revenue calculates his PIE schedular tax adjustment as $5,300 which he will have to pay but it will also mean that Eddie will be a provisional taxpayer for that year. He will be liable to pay provisional tax in the following year even though the rest of his income is taxed at source.

However, it is likely that cases such as the example of Eddie will be reduced, as Inland Revenue will be notifying investors that they are on an incorrect PIR to enable them to correct this and reduce the exposure to provisional tax liabilities.

*PIE losses and loss tax credits are incorporated when calculating a person's PIE schedular tax adjustment*

PIE schedular tax adjustments calculated under section HM 36B only referred to attributed PIE income. This amendment clarifies that attributed losses and resulting tax credits are included when calculating the PIE schedular tax adjustment.

The amendment will ensure that a natural person investor, who is resident in New Zealand, that is attributed a loss that has or is entitled to have a tax credit calculated on the loss using their prescribed investor rate (PIR), can also receive an adjustment where the rate used is not the investor's PIR.

*Clarification of whom the PIE schedular tax adjustment rules apply to*

Specific rules apply to non-resident investors in a multi-rate PIE and to trustees of a trust investing in a multi-rate PIE. The new year-end PIE schedular tax adjustment rules were not intended to make changes to these rules.

The amendments clarify that the new year-end adjustment only applies to natural person investors who are resident in New Zealand, and that the new year-end adjustment rules do not apply to a person who is an investor in a multi-rate PIE and derives income as a beneficiary of a trust that is not a PIE.

*Limiting the removal of the excluded income status for multi-rate PIE income*

Prior to the new PIE schedular tax adjustment rules being introduced, income from a multi-rate PIE was largely excluded income of a natural person, meaning this income did not flow through to the person's income tax assessment. To better incorporate the new year-end adjustment process into existing income tax processes, this excluded income status was removed entirely, meaning attributed income from a locked-in PIE (such as KiwiSaver) was included in a taxpayer's PIE taxable income.

The excluded income status is reinstated for multi-rate PIE income attributed to a natural person who is resident in New Zealand except for the calculation of the PIE schedular tax adjustment. This avoids any unintended flow-on consequences that treating the adjustment as non-excluded income might have for loss offsets and any added complications for Working for Families tax credits, student loans, and child support.

**Example 73**

Iris works for Ghost Girl Comics Limited as an illustrator. She has a student loan obligation which is deducted from her salary each fortnight. She is also a member of KiwiSaver and has her fund held by One Step Ahead Funds Limited (OSA). When Iris started in KiwiSaver she made a mistake in calculating her PIR and gave OSA a PIR of 10.5% when she should have been on 17.5%.

At the end of the year Inland Revenue calculates a PIE schedular tax adjustment for Iris and because she was on an incorrect PIR she has additional tax to pay of $346.50. Although this amount is included in her income tax liability for the year it will be excluded income for the purposes of calculating her liability to repay her student loan.

## Changing the due dates for locked-in PIEs

*(Sections 25E, 25J, 25K and 61 of the Tax Administration Act 1994)*

The amendment brings forward the date to 15 May by which multi-rate portfolio investment entities (PIEs) that are a superannuation fund or retirement savings scheme are required to file detailed income information for their investors.

### Background

Existing rules provide for a year-end square-up of the tax on income from multi-rate PIEs for natural persons. This PIE tax square-up happens alongside the year-end process for income tax. The outcome of the square-up is applied to the person's end-of-year income tax position, resulting in one overall tax refund or bill, if any. However, currently the due date for filing of PIE information is not standardised which can result in delays in squaring up taxpayers PIE tax.

### Key features

The amendment brings forward the filing due date by which multi-rate PIEs that are a superannuation fund or retirement savings scheme are required to file detailed income information for their investors to 15 May, to align with that of other multi-rate PIEs and enable the year-end square-up.

### Application date

This amendment applies retrospectively from the 2020–21 income year to align with the application date of the new PIE rules. The first filing due date under the change is 15 May 2021.

### Detailed analysis

For individuals who only have reportable income, (income that Inland Revenue receives regular information about, typically from third party payers such as employers), the year-end process for tax on PIE income is an automated process at the same time as the auto-calculation process for income tax.

Section 25K of the Tax Administration Act 1994 has been amended to require multi-rate PIEs that are a superannuation fund or retirement savings scheme (for example, a locked-in fund) to file the detailed income information for their investors by 15 May each year (previously 30 June), to align with other, non-locked-in funds.

This avoids delays to the year-end income tax automatic calculation process for a large number of individuals under the new PIE tax square-up.

## PIE investor interest exemption for lines trusts

*(Schedule 29 of the Income Tax Act 2007)*

The Income Tax Act 2007 has been amended to allow lines trusts, commonly known as energy consumer trusts, to own up to one hundred percent of a PIE without the PIE breaching its minimum number of investor or maximum investor interest requirements.

### Background

Generally, an entity can only own up to 20 percent of a PIE and there must be at least 20 investors in a PIE. These restrictions ensure that PIEs are widely held, so a single investor cannot dominate the actions of a PIE. However, an exception exists for certain entities which invest on behalf of large groups, communities, or the general public, and which are, or can be considered equivalent to, widely held. Examples include other PIEs, local authorities, and the New Zealand Superannuation Fund.

Energy consumer trusts were established by vesting orders under the Energy Companies Act 1992 or by the Southland Electricity Act 1993. These trusts are defined in the Income Tax Act 2007 as "lines trusts." The trusts invest for the benefit of electricity customers and communities in their local area and can therefore be considered widely held.

### Key features

Under section HM 14, an investor class (group of investors) in a PIE must include 20 or more persons and, under section HM 15, no investor can hold more than 20 percent of the total investor interests in that class. Section HM 21 overrides these requirements for entities listed in schedule 29 of the Income Tax Act 2007.

Lines trusts have been added to schedule 29, part A. This means lines trusts can own up to 100 percent of a PIE without the PIE breaching the minimum number of investor or maximum investor interest requirements.

### Application date

The application date is 30 March 2021, the date of royal assent.

## GST credit and debit notes

*(Section 25 of the Goods and Services Tax Act 1985)*

Two amendments have been made to ensure that a supplier that issues a credit note to correct a previous mistake in a GST return receives similar outcomes to a supplier that applies to the Commissioner to amend the original GST return. All section references are to the Goods and Services Tax Act 1985 unless otherwise stated.

### Clarifying that credit and debit notes can be used to correct the GST treatment of a supply

#### Background

A GST-registered supplier that incorrectly charged GST or charged the wrong amount of GST (such as 15% on a zero-rated supply) will often issue a credit note to correct this error.

For example, if the invoice was for $100 on an exempt or zero-rated supply plus $15 of GST that was incorrectly charged, it is a common commercial practice to issue a credit note for the full value of the original invoice ($115), and then issue a new invoice for the correct amount ($100).

This method is used for many reasons, including that it is more practical and provides a better audit trail. It also involves fewer compliance and administrative costs than alternatives for correcting the GST, such as the supplier asking the Commissioner of Inland Revenue under section 113 of the Tax Administration Act 1994 to amend the GST return in which the supply occurred.

Suppliers issuing a credit note in situations whereby GST was incorrectly charged generally used section 25(1)(b) which applies when the amount of consideration of the supply was altered. However, it was not clear that this provision was intended to be used for issuing a credit note in these situations and therefore whether it would provide for the correct amount of adjustment to be made in a subsequent GST return.

#### Key features

New section 25(1)(ab) has been inserted to provide a general provision which clarifies that a credit or debit note can be issued for any supply of goods or services where an incorrect GST treatment was applied to the supply. This includes scenarios such as:

- Zero-rated supplies mistakenly charged at 15%.
- Exempt or non-taxable supplies mistakenly charged at 15%.
- Standard-rated supplies mistakenly treated as exempt, non-taxable or zero-rated supplies.
- Standard-rated supplies charged at the wrong rate (for example, 12.5% or 10%) instead of 15%

Where a supplier uses new section 25(1)(ab) to issue a credit or debit note, the resulting GST adjustment provided for under section 25(2) is intended to be the same amount of adjustment that would have been provided if the supplier had instead applied to the Commissioner to amend the original GST return.

Some consequential amendments have been made to simplify the GST legislation. This is because some previous provisions in section 25 allowed credit notes to be issued in specific circumstances where the GST treatment was incorrect. These provisions became redundant as a result of the new general provision which applies to any circumstance where the GST treatment was incorrect. Accordingly, the former section 25(1)(ab) has been replaced, and sections 25(1)(aab) and 25(1)(abb) have been repealed as the new section 25(1)(ab) has made them redundant.

#### Application date

New section 25(1)(ab) applies from 1 April 2012 as it is expected to align with existing commercial practices whereby suppliers have issued credit and debit notes to correct errors they made regarding the GST treatment of their supplies. The retrospective application date provides taxpayers with certainty that these practices are correct and do not need to be adjusted.

### Time limit for issuing a GST credit note for a supply made in an earlier period

#### Background

An amendment has been made to ensure that the time limits on amending an earlier GST return are effective. This is achieved by inserting new time limits on issuing a credit note.

### Key features

New section 25(3)(f) sets three potential time limits for issuing a credit note for a supply made in an earlier period.

Two of the time limits in sections 25(3)(f)(iii) and (ii) are consistent with the time limits for GST refunds which would apply if the supplier had instead applied to the Commissioner to amend the original GST return which included the supply to which the credit note relates.

Section 25(3)(f)(i) retains an existing time limit (that was previously in the former section 25(3)(f)), for issuing a credit note in relation to certain supplies of land. This time limit is seven years since the date of settlement and applies where the supplier failed to zero-rate the land, even though that supply qualified for zero-rating under section 11(1)(mb).

### Detailed analysis

#### *Time limits for credit notes align with the corresponding time limits for GST refunds*

Section 25(3)(f)(iii) provides a four-year time limit for issuing a credit note that relates to a supply which was included in a previous GST return. This time limit is consistent with the usual time limits for GST refunds referred to in section 45(1), (2) or (3) of the GST Act.

Under section 45(4) of the GST Act an extra four years may be available to adjust a GST return to correct an overpayment of tax that resulted from a clear mistake or simple oversight. This effectively provides an eight-year time bar in these circumstances. Section 25(3)(f)(ii) provides the same additional time limit for issuing a credit note. This means the total of eight years is only available when the overpayment of tax, which the credit note is being issued to correct, was due to the result of a clear mistake or simple oversight.

The above time limits are measured from the end of the taxable period for the earlier return.

#### *Time limit for issuing credit notes relating to a zero-rated supply of land*

Section 25(3)(f)(i) retains an existing time limit (that was previously in the former section 25(3)(f)), for issuing a credit note in relation to certain supplies of land.

Section 25(3)(f)(i) provides a seven-year time limit for credit notes issued to correct errors whereby a supply of land met the requirements for qualifying for the business-to-business compulsory zero-rating rule in section 11(1)(mb), but had an incorrect GST treatment applied at the time of supply. The seven-year time limit is measured from the date of settlement of the land transfer.

For a supply of land that was included in an earlier GST return and should have been zero-rated but was not, then two of the three time subparagraphs described in section 25(3)(f) may need to be compared to determine if the earliest of these two time limits may have expired. The earliest time limit would usually be four years from the end of the taxable period in which the supply of land was incorrectly included in a GST return (in cases where the requirements of both subparagraphs (i) and (iii) are met). Alternatively, it could be seven years from the date of settlement, if the incorrect GST treatment was due to a clear mistake or simple oversight of the supplier (in cases where the requirements of both subparagraphs (i) and (ii) are met).

### Application date

New section 25(1)(f) applies from 4 June 2020, which was the date the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill was introduced.

### GST on outbound mobile roaming services

*(Sections 2(1), 8(7), 8(8B), 11AB and 51 of the Goods and Services Tax Act 1985)*

The Goods and Services Act 1985 (the "GST Act") has been amended to impose GST (at the standard rate of 15%) on the consumption of outbound mobile roaming services used by a person with a New Zealand registered mobile device while they are outside New Zealand.

Additionally, inbound mobile roaming services used by a non-resident in New Zealand would be either zero-rated or not subject to GST.

### Background

Under the previous GST rules for cross-border supplies of telecommunications services for mobile roaming services, introduced in 2003, the location of the person who initiates the supply from a telecommunications supplier was used as a proxy to determine the place of consumption of these services.

Essentially, outbound mobile roaming services used by a New Zealand resident travelling overseas would be either zero-rated or not subject to GST. Conversely, inbound mobile roaming services used by non-residents travelling in New Zealand may be subject to GST at 15%. However, a special registration rule for non-resident telecommunication suppliers meant inbound mobile roaming services would not generally be subject to GST in New Zealand.

In 2016, the Organisation for Economic Co-operation and Development finalised the *International VAT/GST Guidelines*[12] (the "Guidelines"), a set of internationally agreed standards and recommended approaches to address the issues that arise from the uncoordinated application of national VAT systems in relation to international trade.

The Guidelines help determine the place of consumption of cross-border remote services and intangibles. The Guidelines state that where necessary, the consumer's usual place of residence can be used as a proxy for determining the place of consumption.

The Guidelines use a broad definition of what constitutes a remote service, including supplies of telecommunication services. The United Kingdom and the European Union already apply VAT on mobile roaming services consistent with these Guidelines.



## Key features

The amendments have added a definition to the GST Act for mobile roaming services and what constitutes outbound mobile roaming services and inbound mobile roaming services.

### *Definition of mobile roaming services*

These are mobile telecommunication services supplied to a person's mobile device while they are outside the country of their usual mobile network, using the country code of the subscriber identity module (SIM card) used within their mobile device.

### *Outbound mobile roaming services*

These are mobile roaming services used by a person whose usual mobile network is in New Zealand. These services are subject to GST at the standard rate of 15%.

### *Inbound mobile roaming services*

These are mobile roaming services used by a person who is in New Zealand and whose usual mobile network is outside New Zealand. These services supplied to non-residents are either zero-rated (if supplied by a resident) or treated as being made outside New Zealand and therefore not subject to GST (if supplied by a non-resident).

## Application date

The amendments will come into force on 1 April 2022.

## Detailed analysis

### *Definition of mobile roaming services*

Section 2(1) defines mobile roaming services as mobile telecommunication services supplied to a person's mobile device who is outside the country of their usual mobile network as determined by the country code of the subscriber identity module for the person's mobile device.

There is no overlap between the remote services rules and the new mobile roaming services rules. This is because section 8(5) of the GST Act states that sections relating to the remote services rules do not apply to telecommunication services. The amendments have, in effect, modified the definition of telecommunications services by creating new rules for both outbound and inbound mobile roaming services.

If a person is travelling overseas and uses a local SIM card in their mobile device, then they would not be consuming mobile roaming services. This is because their usual mobile network would be determined by the country code of the SIM card in their mobile device – which in this situation is the country they are travelling in.

**Example 74: Local SIM card**

Matthew is an Australian resident on holiday in New Zealand, and he purchases a New Zealand SIM card to use in his mobile device. Because the country code of the SIM is New Zealand, then New Zealand is considered to be the country of Matthew's usual mobile network. So, Matthew is not using mobile roaming services.

[12] OECD (2017), International VAT/GST Guidelines, OECD Publishing, Paris, **https://doi.org/10.1787/9789264271401-en**.

The definition of mobile roaming services also includes services supplied to enable a person to receive mobile telecommunication services when they are outside the country of their usual mobile network. This includes roaming deals offered by telecommunications suppliers that enable their customers to continue to use their regular mobile plan while the customer is overseas for a flat daily or weekly fee.

**Example 75: Services to enable mobile roaming**

Kiwiphone is a New Zealand telecommunications supplier that allows its customers to continue using their regular mobile plan while travelling overseas for a fee of $5 per day. This service is an outbound mobile roaming service as it enables Kiwiphone's customers to receive mobile telecommunications services while outside New Zealand.

### *Outbound mobile roaming services*

Section 2(1) defines outbound mobile roaming services as mobile roaming services received by a person whose usual mobile network is in New Zealand. In addition:

- New section 11AB(2) prevents the zero-rating provision in paragraph (1)(b) from applying to outbound mobile roaming services.
- New section 8(8B) treats supplies by non-residents of outbound mobile roaming services as being made in New Zealand.

**Example 76: Outbound mobile roaming services**

Benji is a New Zealand resident visiting his friend Amin in the town of Smithtown, New York. While there he uses his mobile phone (with his NZ SIM card) for calls, texts and data. Benji's SIM has a New Zealand country code, which means that while he's overseas he is using outbound mobile roaming services.

### *Inbound roaming services*

Section 2(1) defines inbound mobile roaming services as mobile roaming services received by a person who is in New Zealand and whose usual mobile network is outside New Zealand. In addition:

- New section 11AB(1)(c) adds a zero-rating provision for inbound mobile roaming services supplied to a non-resident.
- Section 8(7) is amended by shifting the existing subsection to (a) and adding paragraph (b) to treat inbound mobile roaming services supplied to non-residents by a non-resident as being made outside New Zealand, and therefore, not subject to GST.

**Example 77: Inbound mobile roaming services**

Graeme is a Scottish resident visiting New Zealand. While in New Zealand he uses his mobile phone to make calls. Graeme's SIM card in his mobile phone has a British country code, which means that while he is in New Zealand he is using inbound mobile roaming services.

### *Miscellaneous*

Section 51(1)(e) has been repealed. The amendments described above have consequently made this provision unnecessary as inbound mobile roaming services supplied by a non-resident to non-residents travelling in New Zealand are no longer treated as being made in New Zealand.

## Income Tax treatment of leases subject to NZ IFRS 16

*(Sections CC 14, DB 51C, EJ 10, EJ 10B, EW 15I, YA 1 (NZIAS 17, NZ IFRS 16, lease) of the Income Tax Act 2007)*

The Income Tax Act has been changed to allow taxpayers with certain leases accounted for under NZ IFRS 16 to choose to more closely follow their accounting treatment for tax purposes.

The tax changes result from the replacement of the previous accounting standard for leases, New Zealand Equivalent to International Accounting Standard 17 Leases (NZ IAS 17), with New Zealand Equivalent to International Financial Reporting Standard 16 Leases (NZ IFRS 16). NZ IFRS 16 applies to income years starting on or after 1 January 2019.

### Background

A lease involves one person (known as the lessor) who owns (or otherwise holds) an asset providing it to another person (known as the lessee) to use in exchange for payment over the term of the lease. For entities with NZ IFRS reporting obligations, the accounting treatment was previously determined under NZ IAS 17. This standard has been replaced by NZ IFRS 16 for years starting on or after 1 January 2019; although, it is also possible to apply the standard before this and Inland Revenue is aware that some taxpayers have done so.

Under NZ IAS 17, there was a difference in the accounting treatment between operating and finance leases for both lessors and lessees. NZ IAS 17 defined the distinction as follows:

> *A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.*

For lessees, NZ IFRS 16 removes the distinction between operating and finance leases for accounting purposes. Under NZ IFRS 16, lessees are required to account for all leases by recognising an asset on their balance sheet, being the right to use the leased asset for the lease term, and a lease liability, representing the obligation to pay rentals.

NZ IFRS 16 also changes the timing of accounting expenditure for lessees compared to the previous treatment of operating leases; but total deductions are unchanged over the life of the lease. This can be shown in the following simplified example for a five-year lease, that was an operating lease under NZ IAS 17, with $100,000 per year of lease payments and a 3.7237%[13] discount rate:

| Year | NZIAS 17 Expenses | IFRS 16 Expenses |
|---|---|---|
| 1 | 100,000 | 106,439 |
| 2 | 100,000 | 103,337 |
| 3 | 100,000 | 100,120 |
| 4 | 100,000 | 96,783 |
| 5 | 100,000 | 93,322 |
| **Total** | **500,000** | **500,000** |

NZ IFRS 16 does not significantly change the accounting treatment of leases for the lessor. The lessor will continue to differentiate between operating leases and finance lease for accounting and will reflect leased assets on their balance sheet for operating leases.

There are no changes to the tax treatment of lessors. Nor are there any changes to the tax treatment of leases for taxpayers that do not have NZ IFRS reporting obligations.

The Income Tax Act 2007 requires a different tax treatment for operating and finance leases. The tax definitions of operating and finance leases are similar but not identical to the accounting definitions. The existing tax definitions have been maintained.

### Key features

Taxpayers who follow NZ IFRS 16 for their leases as a lessee are now able to make a one-off choice, on a lease-by-lease basis, to more closely follow their accounting treatment for tax. For the purpose of this bulletin making this choice is referred to as applying NZ IFRS 16 for tax and the date of this election is referred to as the tax transition date.

[13] This interest rate has been chosen as a representative rate as it was the NZ dollar five-year BBB+ rate on a particular day when officials were considering this project. This rate is used consistently in all NZ IFRS 16 examples in this bulletin. The actual interest rate is determined for each individual lease, based on its specific terms and features, following the requirements set by NZ IFRS 16.

Income and expenditure arising from a lease are calculated under new section EJ 10B which applies only when the taxpayer has elected to apply NZ IFRS 16 for tax to that lease under section EJ 10B(1)(d). Expenditure is deductible under section DB 51C and income is assessable under section CC 14. Most amounts calculated under EJ 10B are expected to be expenditure, but income can arise in some circumstances, such as when an impairment adjustment from a previous year is reversed through profit and loss for accounting purposes.

NZ IFRS 16 will apply for tax purposes for all IFRS leases. IFRS leases are operating leases of personal property that meet the criteria to be an IFRS lease in section EJ 10B(1). The criteria include that:

- the person applies NZ IFRS 16 for accounting and has chosen to apply NZ IFRS 16 for tax for that lease
- the lessor and lessee are not associated, and
- the asset is not subleased to another person.

NZ IFRS 16 spreads certain expenditure and provisions related to a lease in way that results in the timing of recognition of this expenditure for accounting purposes being significantly different to when it would be incurred for tax purposes. Section EJ 10B(3) to (5) requires or allows adjustments to ensure this expenditure is deductible for tax at a similar time to when it would be deductible for a taxpayer not applying NZ IFRS 16 for tax.

An exception to this in section EJ 10B(2) are short-term, low-value leases which have an initial right of use asset of $100,000 or less and a term of four years or less initially and immediately after any extension. No adjustments are required or allowed for these leases and the tax deduction will always mirror the NZ IFRS 16 treatment.

When an IFRS lease ends, either because the lease itself ends or because it no longer qualifies to be an IFRS lease, section EJ 10B(6) and (7) requires a wash-up to ensure total deductions over the term of the lease match those that would have been deductible for a taxpayer not applying NZ IFRS 16 for tax. This also applies to short-term, low value leases.

Section EJ 10B(8) and (9) include transitional adjustments for certain leases when NZ IFRS 16 applies for tax after the original commencement of the lease.

### Application date

The amendments apply for balance dates commencing on or after 1 January 2019 to align with the application date of NZ IFRS 16.

### Detailed analysis

#### *Updates to the tax definition of finance leases and operating leases*

The definition of finance lease in section YA 1 of the Income Tax Act 2007 which previously referred to NZ IAS 17 has been updated to refer to NZ IFRS 16.

No changes have been made to the existing boundary between finance leases and operating leases for tax purposes.

#### *Finance leases and the yield to maturity method*

Section EW 15I previously allowed a person who had a tax finance lease that was classified as an operating lease under NZ IAS 17 to apply the yield to maturity method. NZ IFRS 16 has removed the accounting distinction between operating and finance leases for lessees. However, the yield to maturity method will continue to be available for these leases by applying section EW 15E.

Section EW 15I has been updated to refer to NZ IFRS 16 rather than NZ IAS 17 as a lessor applying NZ IFRS 16 may still have a tax finance lease that is classified as an operating lease for accounting.

#### *Lessors under tax operating leases for NZ IFRS taxpayers*

No changes have been made to the tax treatment of lessors.

#### *Lessees under tax operating leases for NZ IFRS taxpayers*

The changes for lessees are optional. NZ IFRS taxpayers who choose not to apply NZ IFRS 16 for tax for some or all of their qualifying tax operating leases will be able to continue to follow their existing treatment.

*Optional election*

A taxpayer who applies NZ IFRS 16 for accounting can make a one-off choice in section EJ 10B(1)(d) to apply NZ IFRS 16 for tax for each of their qualifying operating leases.

The election is made by calculating deductions under the new rules[14] in the income tax return for the income year the choice is made. No separate election is required. Once a taxpayer makes this choice for a particular lease, they will have to continue to follow this method for the lease in all future years where they follow NZ IFRS 16 for accounting purposes.

This election is available in any income year so that a taxpayer can choose to first apply NZ IFRS 16 for tax in a year subsequent to when they first apply NZ IFRS 16 for accounting or when they first applied NZ IFRS 16 for tax for other leases.

*Leases within the scope of the proposed rules*

A taxpayer choosing to apply NZ IFRS 16 for tax can choose to apply it to some or all of its new and existing leases from the start of the first year the election is made. Such leases are defined in section EJ 10B(1) as an IFRS lease.

However, a taxpayer must continue to follow their existing treatment for the following tax operating leases:

- a lease of real property
- a lease from an associated party, and
- a lease where the asset is subleased.

***Real property***

The Income Tax Act 2007 already treats all leases of real property as operating leases. This is because the definition of a finance lease in the Income Tax Act 2007 applies only to personal property lease assets, so a lease of real property cannot be a finance lease. The new rules also carve out real property, using the existing boundary. As a result, all leases of real property will continue to be subject to the standard operating lease treatment even when a taxpayer has chosen to apply NZ IFRS 16 for tax for other leases.

***Associated parties***

The different treatment between lessors and lessees under NZ IFRS 16 means that if a taxpayer could choose to apply NZ IFRS 16 for tax for an asset they leased from an associated party, their combined tax positions would result in a tax timing advantage compared to retaining the asset in the lessor. To prevent this, the standard tax treatment is retained for all operating leases from an associated party as such a lease will not meet section EJ 10B(1)(b).

Two unassociated parties might enter into an operating lease under the proposed rules and then subsequently become associated, for example because of a change in shareholding. At this point the lease would cease to qualify as an IFRS lease, and the tax treatment of that lease would revert to the standard treatment including a wash-up as described below.

***Subleases***

Under NZ IFRS 16, when an asset is subleased to a second person the asset in the first person's balance sheet changes from a right-of-use asset to a finance lease receivable where the sublease of the lessor is a finance lease for accounting. If the tax treatment followed the accounting treatment, a taxpayer would not be entitled to deductions for the amortisation of a right-of-use asset. To resolve this situation the standard tax treatment has been retained for all operating leases when the asset is subleased to another person as such a lease will not meet section EJ 10B(1)(c).

If an asset is subleased to another person part way through a lease term, the lease will cease to qualify as an IFRS lease, and the tax treatment of that lease would revert to the standard treatment and include a wash-up as described below. The exclusion of real property leases from the proposed rules is expected to significantly reduce the likelihood of this situation occurring.

*Leases that previously did not meet the definition of an IFRS lease*

A lessee will be required to make a transitional adjustment under section EJ 10B(8) and (9) in the first year they apply NZ IFRS 16 for tax for a lease in two circumstances:

- if it is the first year they apply NZ IFRS 16 for accounting and they adopted NZ IFRS 16 for accounting on a retrospective basis, or
- in any other year where in a previous year NZ IFRS 16 has been applied to a lease for accounting purposes but not tax purposes.

*Leases that do not fully follow NZ IFRS 16 for accounting*

A lessee that follows NZ IFRS 16 for accounting may have individual leases that are not accounted for on their balance sheet. Examples of this could include some short-term or low value leases[14]. The accounting treatment of these leases will still be in accordance with NZ IFRS 16 and any accounting expenditure recognised through the profit and loss account will be deductible. The accounting treatment for these specific leases is expected to be similar to the existing tax treatment.

[14] Notwithstanding the same terminology, the thresholds for this in NZ IFRS 16 are lower than the short-term, low-value leases which do not require tax adjustments as discussed elsewhere in this Bulletin.

*Adjustments*

The formula for calculating the deductible expenditure or assessable income for an IFRS lease in section EJ 10B(3) starts with the accounting amount. This is the total amount recognised through the profit and loss account for the IFRS lease for the income year. Net accounting expenditure this is treated as a positive amount and net accounting income is treated as a negative amount.

The new rules are not intended to significantly accelerate tax deductions compared to those available under the existing rules. Therefore, with the exception of short-term, low value leases, the tax adjustments to the accounting amount set out in Table 9 may be required.

**Table 9: Results of spreading and the proposed tax adjustments that may be required**

| If the spreading results in accounting deductions that are… | …then a tax adjustment is made |
|---|---|
| in advance of when the expenditure is incurred (for example, impairment or revaluation amounts, or make good costs) | • to ensure that tax deductions are only available in a similar period to when the expenditure is incurred. |
| later than when the expenditure is incurred (for example, certain direct or mobilisation costs) | • to ensure tax deductions are available in a similar period to when the expenditure is incurred, and<br>• it is optional, so that a taxpayer who would incur higher compliance costs in making the adjustment than the perceived value of that adjustment will not be required to do so. |

The formula in section EJ 10B(3) includes three adjustment amounts which are the add-back adjustment, impairment and revaluation adjustment and make-good and direct costs adjustment.

**Add-back adjustment** decreases the tax deduction by the total increase in impairment or revaluation adjustments for a lease when they are recorded or amended through profit and loss (and likewise increases the tax deduction if these impairment or revaluation adjustments are reversed through profit and loss). This is necessary as these impairment or revaluation adjustments do not reflect expenditure that has been incurred. These adjustments are referred to in paragraphs 33 and 35 of NZ IFRS 16. There is no equivalent adjustment for fair value movements referred to in paragraph 34 of NZ IFRS 16 as these relate to investment property which is excluded from the rules as it is real property.

**Impairment and revaluation adjustment** increases the tax deduction by the amount of the add-back adjustment spread in equal proportions over the remaining term of the lease, taking into account part-years in the remaining term by dividing the relevant number of days in the part-year by the total number of days in that year (and likewise decreases the tax deduction where the add-back adjustment increases the tax deduction). This is designed to approximate the accounting (and therefore, tax) deductions that would have been available had the impairment or revaluation adjustment not been made.

**Make-good and direct costs adjustment** realigns the tax impact of these costs that are required to be spread over the lease term under NZ IFRS 16 but are incurred at a single point (or points) for tax purposes. The adjustment decreases the tax deduction by the amount of make-good costs described in paragraph 24(d) and the amount of direct costs described in paragraph 24(c) of NZ IFRS 16. These are nominal amounts (that is, not discounted). The amounts are spread in equal proportions over the remaining term of the lease, taking into account part-years in the remaining term by dividing the relevant number of days in the part-year by the total number of days in that year. Make-good costs are the costs of restoring the leased asset and are spread over the term of the lease under NZ IFRS 16 but are tax deductible when they are incurred, which is typically at or near the end of the lease. A make-good cost adjustment is compulsory to prevent expenditure being deductible in advance of it being incurred. Direct costs are the costs of obtaining or setting up the leased asset and are spread over the term of the lease under NZ IFRS 16 but, in some circumstance where they are not required to be capitalised into the asset value, would be tax deductible when they are incurred, which is typically at or near the beginning of the lease. A direct cost adjustment is optional so that a taxpayer that would incur greater compliance costs in calculating the direct costs adjustment than they would benefit from making that adjustment can choose to continue following their accounting treatment.

An equal spread of either the impairment and revaluation adjustment or the make-good and direct costs adjustment may not exactly replicate the accounting spread of these adjustments but is intended to be easier for taxpayers to calculate and will total to the same amount over the term of the lease.

Section EJ 10B(5) allows a deduction for make good costs and direct costs when they are incurred. To ensure all direct costs incurred are deductible but not deductible twice, this will apply only when an adjustment has been made in the formula in section EJ 10B(3).

**Example 78: Impairment**

On 1 April 2022 A Co enters into a five-year equipment lease with payments of $100,000 at the end of each year. Its deductions are expected to be:

| Year ended 31 March | Accounting expenditure | Add-back adjustment | Impairment and revaluation adjustment | Make-good and direct costs adjustment | Tax deduction |
|---|---|---|---|---|---|
| 2023 | 106,439 | 0 | 0 | 0 | 106,439 |
| 2024 | 103,337 | 0 | 0 | 0 | 103,337 |
| 2025 | 100,120 | 0 | 0 | 0 | 100,120 |
| 2026 | 96,783 | 0 | 0 | 0 | 96,783 |
| 2027 | 93,322 | 0 | 0 | 0 | 93,322 |
| **Total** | **500,000** | **0** | **0** | **0** | **500,000** |

On 31 March 2024 A Co recognises that a change in their business model makes the equipment less valuable to them than it previously had been and records a $200,000 impairment charge so its deductions change to:

| Year ended 31 March | Accounting expenditure | Add-back adjustment | Impairment and revaluation adjustment | Make-good and direct costs adjustment | Tax deduction |
|---|---|---|---|---|---|
| 2023 | 106,439 | 0 | 0 | 0 | 106,439 |
| 2024 | 303,337 | 200,000 | 0 | 0 | 103,337 |
| 2025 | 33,453 | 0 | 66,667 | 0 | 100,120 |
| 2026 | 30,116 | 0 | 66,667 | 0 | 96,783 |
| 2027 | 26,655 | 0 | 66,667 | 0 | 93,322 |
| **Total** | **500,000** | **0** | **200,000** | **0** | **500,000** |

**Example 79: Make-good costs**

On 1 April 2022 A Co enters into a five-year equipment lease with payments of $100,000 at the end of each year. They also expect to have to spend $125,000 restoring the asset at the end of the lease. Its deductions are:

| Year ended 31 March | Accounting expenditure | Add-back adjustment | Impairment and revaluation adjustment | Make-good and direct costs adjustment | Tax deduction |
|---|---|---|---|---|---|
| 2023 | 131,139 | 0 | 0 | 25,000 | 106,139 |
| 2024 | 128,182 | 0 | 0 | 25,000 | 103,182 |
| 2025 | 125,114 | 0 | 0 | 25,000 | 100,114 |
| 2026 | 121,933 | 0 | 0 | 25,000 | 96,933 |
| 2027 | 118,633 | 0 | 0 | 25,000 | 93,633 |
| **Total** | **625,000** | **0** | **0** | **125,000** | **500,000** |

In addition, A Co is entitled to a deduction for any costs incurred in restoring the asset under section EJ 10B(5)(a).

### *Cumulative adjustments*

An impairment and revaluation adjustment and a make-good and direct costs adjustment must be carried forward into the remaining income years of the lease term when applying the formula in section EJ 10B(3) for each of those remaining income years. This means there may be more than one impairment and revaluation adjustment or make-good and direct costs adjustment in a year.

**Example 80: Cumulative adjustments**

A Co from the make-good example above enters into the same lease; however, on 1 April 2024 decides that the estimated make-good costs should be increased by $30,000 to $155,000. Its revised deductions are:

| Year ended 31 March | Accounting expenditure | Add-back adjustment | Impairment and revaluation adjustment | Make-good and direct costs adjustment | Tax deduction |
|---|---|---|---|---|---|
| 2023 | 131,139 | 25,000 | | 25,000 | 106,139 |
| 2024 | 128,182 | 25,000 | | 25,000 | 103,182 |
| 2025 | 135,077 | 25,000 | 10,000 | 35,000 | 100,077 |
| 2026 | 131,932 | 25,000 | 10,000 | 35,000 | 96,932 |
| 2027 | 128,671 | 25,000 | 10,000 | 35,000 | 93,671 |
| **Total** | **655,000** | **125,000** | **30,000** | **155,000** | **500,000** |

In addition, A Co is entitled to a deduction for any costs incurred in restoring the asset under section EJ 10B(5)(a).

*Lease term*

The impairment and revaluation adjustment and make-good and direct costs adjustment in section EJ 10B(4) are both required to be spread in equal proportions over the remaining income years of the lease term. NZ IFRS 16 requires a specific lease term for each lease but this can change over time, for example when an entity decides they will take up an option to extend a lease that they previously were not expected to do. The lease term referred to in these proposed adjustments is the lease term recognised by NZ IFRS 16 at the time of the initial adjustment, but this lease term is not updated if the lease term recognised by NZ IFRS 16 subsequently changes. By not having to change the tax adjustments to reflect the change in lease term compliance costs are expected to be minimised.

The consequence of this approach is if the lease term shortens the full amount of adjustments will not be made before the maturity of the lease so these differences will be covered by the wash-up calculation described below. Likewise, if the lease term extends, the full amount of adjustments will be made before the maturity of the lease so there may not be adjustments in the final years. In either case, on an individual year basis the tax adjustments will not match the accounting consequences arising from the change in lease term. However, over the full term of the lease these differences will net to zero.

**Example 81: Extended lease term**

A Co from the first make-good costs example above enters into the same lease. However, on 1 April 2025 it agrees with the lessor to extend the five year lease to seven years. Lease payments remain at $100,000 per year and make good costs are estimated to increase by $20,000 to $145,000 and they are now incurred in March 2029 instead of 2027. A Co's deductions are calculated as follows:

| Year ended 31 March | Accounting expenditure | Add-back adjustment | Impairment and revaluation adjustment | Make-good and direct costs adjustment | Tax deduction |
|---|---|---|---|---|---|
| 2023 | 131,139 | 25,000 | | 25,000 | 106,139 |
| 2024 | 128,182 | 25,000 | | 25,000 | 103,182 |
| 2025 | 125,114 | 25,000 | | 25,000 | 100,114 |
| 2026 | 119,821 | 25,000 | 5,000 | 30,000 | 89,821 |
| 2027 | 116,777 | 25,000 | 5,000 | 30,000 | 86,777 |
| 2028 | 113,621 | | 5,000 | 5,000 | 108,621 |
| 2029 | 110,346 | | 5,000 | 5,000 | 105,346 |
| **Total** | **845,000** | **125,000** | **20,000** | **145,000** | **700,000** |

In addition, A Co is entitled to a deduction for any costs incurred in restoring the asset under section EJ 10B(5)(a).

The amount calculated by applying the formula in section EJ 10B(3) can be positive or negative. A lessee is allowed a deduction for a positive amount and has income for a negative amount.

### *Short-term, low-value leases*

Under section EJ 10B(2) these adjustments are not required to be made for short-term, low-value leases. As a result, the tax deduction or income for a short-term, low value lease will equal the total amount recognised through the profit and loss account for the lease for the income year. Net accounting expenditure is treated as a positive amount and net accounting income is treated as a negative amount.

While not making adjustments may mean expenditure will be accelerated compared to an equivalent lease under the standard rules, the amount of this acceleration will be relatively small due to their short-term, low-value nature meaning the timing difference will be reversed within a small number of income years. Compliance costs will be reduced by not being required to make these adjustments. We expect that the majority of leases[15] entered into by lessees who apply IFRS 16 will fall within this category.

To qualify for section EJ 10B(2) the lease must be both short-term and low-value. A short-term lease is one with an initial lease term, or a remaining lease term immediately after any extension, of four years or less. A low-value lease is one with an initial right of use asset of $100,000 or less. If a single lease includes multiple assets (for example a fleet of cars under a single lease) each asset will be treated as a separate right of use asset and will meet this requirement as long as each right of use asset is less than $100,000, even if the total of all right of use assets under the lease exceeds this amount.

**Example 82: Short term lease with an extension**

A Co enters into a lease with an initial term of four years which is not expected to be extended. When the lease has one year to go A Co and the lessor agree that the lease will be extended by two further years. At the time the extension is entered into the lease now has three years remaining. As the lease never had more than four years remaining it will qualify as a short-term lease even though it will run for six years in total.

**Example 83: Low-value leases**

A Co enters into a lease for 10 cars with each having a right of use asset value of $50,000. As the lease does not include a right of use asset for an individual car of over $100,000 the lease will qualify as a low-value lease even though the total value of all right of use assets will be $500,000.

[15] By number of leases but possibly not by value of right-of-use assets or lease payments.

*Transitional adjustment*

Appendix C of NZ IFRS 16 sets out the accounting transition for entities applying NZ IFRS 16 for the first time. There are two possible transition approaches in paragraph C5:

- Applying NZ IFRS 16 retrospectively to each prior period's profit and loss account which will result in a movement (either positive or, more commonly, negative) to the entity's opening retained earnings in the year of transition, or
- Applying NZ IFRS 16 to the remaining lease term at the date of initial application of NZ IFRS 16 which will not affect the opening retained earnings in the year of transition.

Section EJ 10B(8) and (9) ensure the correct amount of tax deductions are available for any leases where the lessee transitions to applying NZ IFRS 16 for tax after they have already been subject to tax under the standard rules by requiring a transitional adjustment for tax. A transitional adjustment could be necessary when the taxpayer either:

- has applied NZ IFRS 16 retrospectively[16], or
- chooses to apply NZ IFRS 16 for tax for a lease for one or more years after they started accounting for the lease under NZ IFRS 16.

A transitional adjustment involves calculating the difference between NZ IFRS 16 accounting expenditure in prior years and tax deductions under the existing rules so that the difference can be recognised for tax. The transitional adjustment is calculated for each lease at the date of tax transition using the formula in section EJ 10B(8):

**Retrospective accounting expenditure –**
**retrospective tax adjustments – previous tax deductions**

Each of these terms is defined in section EJ 10B(9) and can be explained as follows:

**Retrospective accounting expenditure** is the total accounting expenditure or loss recognised under NZ IFRS 16 for the lease until the tax transition date, including amounts recognised retrospectively.

**Retrospective tax adjustments** is the total tax adjustments that would have been required if the entity had applied section EJ 10B for the years they accounted for the lease under NZ IFRS 16 until the tax transition date.

**Previous tax deductions** is the total tax deductions incurred under the existing rules for the years they accounted for the lease under NZ IFRS 16 until the tax transition date.

The transitional adjustment may be a positive or negative amount. A positive amount is treated deductible expenditure and a negative amount is treated as assessable income. In either case this should be spread in equal amounts over the tax transition year and the four subsequent years. This is in contrast to the impairment and make-good costs adjustments referred to above which should be allocated proportionately over the remaining lease term taking into account part years.

In many instances an existing lease will mature before the end of this five-year spreading period. Any undeducted expenditure or unreturned income should be incorporated into the wash-up calculation that is discussed below.

[16] The year of accounting transition and tax transition may be the same but if tax transition for a lease happens in a subsequent year the calculation of retrospective accounting expenditure for the transitional adjustment will also need to include the retained earnings impact in the years when the entity follows NZ IFRS 16 for accounting and not for tax.

**Example 84: Retrospective transition**

On 1 April 2017 A Co entered into a seven-year equipment lease with $100,000 annual payments. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. Its accounting entries for this lease are:

| Year ended 31 March | NZ IAS 17 accounting expenditure | IFRS 16 accounting expenditure | IFRS 16 retained earnings adjustment |
|---|---|---|---|
| 2018 | 100,000 | | |
| 2019 | 100,000 | | |
| 2020 | | 103,333 | 15,529 |
| 2021 | | 100,231 | |
| 2022 | | 97,014 | |
| 2023 | | 93,677 | |
| 2024 | | 90,216 | |
| **Total** | **200,000** | **484,471** | **15,529** |
| **Grand total** | | **700,000** | |

As there are no adjustments for impairment, revaluation or direct costs the total tax transitional adjustment is equal to the NZ IFRS 16 retained earnings amount of $15,529. When this is spread equally over five income years the tax transitional adjustment is $3,106 per year. A Co calculates its tax deductions as follows:

| Year ended 31 March | Tax deduction pre transitional adjustment | Tax transitional adjustment | Total tax deduction |
|---|---|---|---|
| 2018 | 100,000 | | 100,000 |
| 2019 | 100,000 | | 100,000 |
| 2020 | 103,333 | 3,106 | 106,439 |
| 2021 | 100,231 | 3,106 | 103,337 |
| 2022 | 97,014 | 3,106 | 100,120 |
| 2023 | 93,677 | 3,106 | 96,783 |
| 2024 | 90,216 | 3,106 | 93,322 |
| **Total** | **684,471** | **15,529** | **700,000** |

**Example 85: Retrospective transition with delayed tax transition**

On 1 April 2017 B Co entered into a seven-year equipment lease with $100,000 annual payments. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. Its accounting entries are identical to the A Co retrospective transition example above.

B Co chooses not to apply NZ IFRS 16 for tax for this lease in its year beginning 1 April 2019 and instead chooses to apply NZ IFRS 16 for tax in its year beginning 1 April 2020. Again, there are no adjustments for impairment, revaluation or direct costs so the total tax transitional adjustment is $18,862 which is calculated as follows:

| Year ended 31 March | Tax deduction | IFRS 16 accounting expenditure | IFRS 16 retained earnings adjustment |
|---|---|---|---|
| 2018 | 100,000 | | |
| 2019 | 100,000 | | |
| 2020 | 100,000 | 103,333 | 15,529 |
| **Total** | **300,000** | **103,333** | **15,529** |

When this is spread equally over five income years the tax transitional adjustment is $3,772 per year. B Co calculates its tax deductions as follows:

| Year ended 31 March | Tax deduction pre transitional adjustment | Tax transitional adjustment | Total tax deduction |
|---|---|---|---|
| 2018 | 100,000 | | 100,000 |
| 2019 | 100,000 | | 100,000 |
| 2020 | 100,000 | | 100,000 |
| 2021 | 100,231 | 3,772 | 104,003 |
| 2022 | 97,014 | 3,772 | 100,786 |
| 2023 | 93,677 | 3,772 | 97,449 |
| 2024 | 90,216 | 3,772 | 93,988 |
| **Total** | **681,138** | **15,089** | **696,228** |

As the fifth year transitional adjustment deduction is not available before the maturity of the lease this will be incorporated into the wash-up calculation (described below) so B Co will also get a wash-up deduction of $3,772 and total tax deductions will be $700,000.

**Example 86: Non-retrospective transition**

On 1 April 2017 C Co entered into a seven-year equipment lease with $100,000 annual payments. It adopted NZ IFRS 16 without using the retrospective transition approach on 1 April 2019. There is no adjustment to the 1 April 2019 retained earnings and subsequent lease expenditure is calculated as though there was a five-year lease starting on 1 April 2019. No tax transitional adjustment is required. Its tax deduction is calculated as follows:

| Year ended 31 March | NZ IAS 17 accounting expenditure | IFRS 16 accounting expenditure | Tax deduction |
|---|---|---|---|
| 2018 | 100,000 | | 100,000 |
| 2019 | 100,000 | | 100,000 |
| 2020 | | 106,439 | 106,439 |
| 2021 | | 103,337 | 103,337 |
| 2022 | | 100,120 | 100,120 |
| 2023 | | 96,783 | 96,783 |
| 2024 | | 93,322 | 93,322 |
| **Total** | **200,000** | **500,000** | **700,000** |

**Example 87: Non-retrospective delayed transition**

On 1 April 2017 D Co entered into a seven-year equipment lease with $100,000 annual payments. It adopted NZ IFRS 16 without using the retrospective transition approach on 1 April 2019. Its accounting expenditure is identical to the C Co example above. However, D Co chooses not to apply NZ IFRS 16 for tax for this lease in its year beginning 1 April 2019 and instead chooses to apply NZ IFRS 16 for tax in its year beginning 1 April 2020.

Again, there are no adjustments for impairment, revaluation or direct costs so the total tax transitional adjustment is $6,439 which is calculated as follows:

| Year ended 31 March | Tax deduction | Accounting expenditure |
|---|---|---|
| 2018 | 100,000 | 100,000 |
| 2019 | 100,000 | 100,000 |
| 2020 | 100,000 | 106,439 |
| **Total** | **$300,000** | **$306,439** |

When this is spread equally over 5 income years the tax transitional adjustment is $1,288 per year. D Co calculates its tax deductions as follows:

| Year ended 31 March | Tax deduction pre transitional adjustment | Tax transitional adjustment | Total tax deduction |
|---|---|---|---|
| 2018 | 100,000 | | 100,000 |
| 2019 | 100,000 | | 100,000 |
| 2020 | 100,000 | | 100,000 |
| 2021 | 103,337 | 1,288 | 104,625 |
| 2022 | 100,120 | 1,288 | 101,408 |
| 2023 | 96,783 | 1,288 | 98,071 |
| 2024 | 93,322 | 1,288 | 94,610 |
| **Total** | **693,561** | **5,151** | **698,713** |

As the fifth-year transitional adjustment deduction is not available before the maturity of the lease this will be incorporated into the wash-up calculation (described below) so B Co will also get a wash-up deduction of $1,288 and total tax deductions will be $700,000.

*Wash-up*

When a taxpayer ceases to be a lessee to an IFRS lease, either because the lease ceases to meet the IFRS lease requirements in section EJ 10B(1) or because it ends, section EJ 10B(6) and (7) require a wash-up to ensure total deductions match what would have been available under the existing tax treatment. This adjustment is conceptually similar to a base price adjustment under the financial arrangements rules.

The lease will cease to be an IFRS lease when:

- the lease matures
- the lessee and lessor have become associated
- the asset has been subleased to another person, or
- the lessee ceases to follow NZ IFRS 16 for accounting.

This wash-up is typically expected to be zero when a lease runs for its full term being accounted for under NZ IFRS 16 or when it runs for its full term with at least five years accounted for under NZ IFRS 16 so that the transitional adjustment spreading period in section EJ 10B(8) is exhausted. If a lease existed before NZ IFRS 16 was adopted the wash-up for a lease that runs for its full term will typically be equal to any undeducted expenditure or unreturned income under the transitional adjustment.

The wash-up adjustment is calculated for each lease using the formula in section EJ 10B(6):

**IFRS deductions – IFRS income – expenditure**

Each of these terms is defined in section EJ 10B(7) and can be explained as follows:

> **IFRS deductions** is the total amount deducted for tax for the lease for all income years including the year in which the lease ceases to be an IFRS lease but excluding the wash-up adjustment. This may include deductions in years when section EJ 10B was not applied.
>
> **IFRS income** is the total amount of income returned for tax for the lease for all income years including the year in which the lease ceases to be an IFRS lease but excluding the wash-up adjustment. This may include income in years when section EJ 10B was not applied.
>
> **Expenditure** is the total expenditure incurred since entering into the lease until the wash-up date ignoring section EJ 10B.

The wash-up adjustment may be a positive amount or a negative amount. A positive amount is treated as assessable income and a negative amount is treated as deductible expenditure. We note the legislation, as enacted in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021, incorrectly states the person has a deduction for a positive amount and has income for a negative amount. We will seek to have this corrected at the first available opportunity.

**Example 88: Full-term wash-up**

On 1 April 2017 A Co entered into a five-year equipment lease with $100,000 annual payments. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. Its deductions excluding the wash-up calculation are calculated as follows:

| Year ended 31 March | NZ IAS 17 accounting deduction | IFRS 16 accounting deduction | IFRS 16 retained earnings adjustment | Tax deduction excluding transitional adjustment | Tax transitional adjustment | Total tax deduction |
|---|---|---|---|---|---|---|
| 2018 | 100,000 | | | 100,000 | | 100,000 |
| 2019 | 100,000 | | | 100,000 | | 100,000 |
| 2020 | | 100,120 | 9,775 | 100,120 | 1,955 | 102,075 |
| 2021 | | 96,783 | | 96,783 | 1,955 | 98,738 |
| 2022 | | 93,322 | | 93,322 | 1,955 | 95,277 |
| **Total** | **200,000** | **290,225** | **9,775** | **490,225** | **5,865** | **496,090** |

A Co calculates its wash-up as:

IFRS deductions = $496,090

IFRS income = $0

Expenditure = $500,000

$496,090 – $0 – $500,000 = –$3,910

A Co has an additional deduction available in the year ended 31 March 2022 of $3,910. This amount is equal to the two remaining years of transitional adjustment that were yet to be claimed when the lease matured.

**Example 89: Part-term wash-up example**

On 1 April 2019 A Co entered into a five-year equipment lease with $100,000 annual payments. On 31 March 2022 they agree with the lessor to terminate the lease early with no further payments owing. Its deductions are:

| Year ended 31 March | Payments | Accounting expenditure and tax deduction |
|---|---|---|
| 2020 | 100,000 | 106,439 |
| 2021 | 100,000 | 103,337 |
| 2022 | 100,000 | 100,120 |
| **Total** | **300,000** | **309,895** |

A Co calculates its wash-up as:

IFRS deductions = $309,895

IFRS income = $0

Expenditure = $300,000

$309,895 – $0 – $300,000 = $9,895

A Co has additional income in the year ended 31 March 2022 of $9,895. This is the amount its deductions in the 2020-2022 years exceeded the expenditure it incurred ignoring section EJ 10B.

## Overseas donee status

*(Schedule 32 of the Income Tax Act 2007)*

The following charities have been granted donee status from the 2020–21 and later income years:

- Active Hearts Foundation
- Kiwilink
- Shimshal Trust

### Background

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

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

### Application dates

The new insertions apply from the 2020-21 and later income years.

## Portability of Australian unclaimed superannuation money

*(Section YA 1 (Definitions) of the Income Tax Act 2007 and sections 93 and 93B of the KiwiSaver Act 2006)*

The amendments will enable the direct transfer of previously unclaimed Australian superannuation funds held by the Australian Tax Office (ATO) to KiwiSaver accounts.

### Background

Under Australian law, money held by Australian superannuation schemes that becomes unclaimed must be transferred to the ATO. New Zealanders are currently only able to transfer reclaimed money from the ATO to a complying Australian superannuation scheme. This amendment will enable the transfer of New Zealanders' reclaimed money directly from the ATO to KiwiSaver schemes.

### Key Features

Currently, New Zealanders wanting to repatriate their lost Australian superannuation funds must first transfer them from the ATO to a complying Australian scheme before it can be transferred to a KiwiSaver account. The proposed amendments to the Income Tax Act 2007 and KiwiSaver Act 2006 will enable New Zealanders to directly repatriate their lost savings from the ATO to their KiwiSaver accounts.

### Application date

The amendments will apply from the earlier of:

- the day specified in the diplomatic notes exchanged by the Governments of Australia and New Zealand, or
- the day that is one year from the amendment Act receiving Royal assent.

## Temporary loss carry-back remedial – loss grouping

*(Section IZ 8 of the Income Tax Act 2007)*

### Background

Section IZ 8 of the Income Tax Act 2007 contains the temporary loss carry-back rules. The rules allow a company with net losses in the 2019–20 or 2020–21 income years to carry losses back to offset taxable income in the immediately preceding income year, in order to receive a tax refund.

### Key features

The purpose of this remedial amendment is to ensure companies in non-wholly owned corporate groups are able to use the loss carry-back. A non-wholly owned corporate group ("group") is a group of companies that have at least 66%, but less than 100%, common ownership.

Under previous rules, to be eligible for the loss carry-back, a company in a group was required to:

- have a net loss in the 2019–20 or 2020–21 income years (the "loss year"), and
- have taxable income in the income year immediately preceding the loss year (the "profit year").

If a company had losses in both the profit and loss years, then the company was not able to use the loss carry-back under the previous rules, even if another group member had taxable income in the profit year against which the losses could be offset. This outcome was contrary to the policy intent expressed in the COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Bill commentary.

The policy intent is for a company to be able to carry back and offset its losses against a group member's taxable income in the profit year, even if the company has losses in both the profit and loss years. This remedial amendment amends section IZ 8 of the Income Tax Act 2007, so that the legislation now satisfies the policy intent.

**Example 90**

Mippy Co and Snowy Co are 80% commonly owned. In 2018–19, Mippy Co has net income of $100,000 and Snowy Co has $50,000 of losses. Snowy Co decides to offset its $50,000 of losses against Mippy Co's income that year, so Mippy Co has taxable income of $50,000.

In 2019–20, Mippy Co has net income of $50,000 and Snowy Co has net losses of $75,000. After offsetting Snowy Co's losses against Mippy Co's net income,* Snowy Co still has $25,000 of losses remaining. It decides to use the temporary loss carry-back so that it can offset its remaining $25,000 of losses against Mippy Co's 2018–19 taxable income.

Snowy Co carries its remaining $25,000 of losses back to 2018–19, and offsets the losses against Mippy Co's 2018–19 taxable income of $50,000. Mippy Co receives a tax refund of $7,000 ($25,000 × 28%, which is the corporate tax rate). After using the loss carry-back, Mippy Co still has $25,000 of taxable income remaining in 2018–19. Snowy has $0 losses remaining in 2019–20 after using the loss carry-back.

| **2018–19 income year** | **Mippy Co** | **Snowy Co** |
|---|---|---|
| Net income/(loss)<br>*(before offsets and loss carry-back)* | $100,000 | ($50,000) |
| Taxable income/(loss)<br>*(after offsets but before loss carry-back)* | $50,000 | $0 |
| **2019–20 income year** | | |
| Net income/loss<br>*(before offsets and loss carry-back)* | $50,000 | ($75,000) |
| Taxable income/loss<br>*(after offsets but before loss carry-back)* | $0 | ($25,000) |
| **Temporary loss carry-back** | | |
| 2018–19 taxable income/(loss)<br>*(after loss carry-back)* | $25,000 | $0 |
| 2019–20 taxable income/(loss)<br>*(after loss carry-back)* | $0 | $0 |
| Amount refunded under loss carry-back | $7,000 | $0 |

* *In this example the two companies have chosen to offset losses within the group in the loss year before using the loss carry-back. This is not a requirement for groups that are not wholly owned.*

## Application date

This remedial amendment applies for the duration of the temporary loss carry-back scheme, so applies to two pairs of income years: the 2018–19/2019–20 and 2019–20/2020–21 profit/loss years.

## Other remedials

### Default RWT rate

*(Section 19 of the Taxation (Income Tax Rate and Other Amendments) Act 2020)*

When a payer of interest income has not received an elected rate from the recipient of the interest, the payer must withhold tax at the default resident withholding rate.

The Act amends the Taxation (Income Tax Rate and Other Amendments) Act 2020 to maintain the default RWT rate at 33% rather than increasing to 39% to align with the top marginal tax rate. This reflects that for the majority of interest recipients a 39% rate would result in over-withholding.

#### Application date

The amendment modifies section 19 of the Taxation (Income Tax Rate and Other Amendments) Act 2020 which applies from 1 October 2021.

### Domestic trust disclosure rules

*(Section 59BA of the Tax Administration Act 1994)*

The Act amends the domestic trust disclosure requirements to clarify the filing requirements, add several categories of excluded trusts and include the ability for the Commissioner to vary requirements for certain trusts or types of trusts.

#### Application date

The amendments modify section 59BA which applies from the 2021-22 income year.

#### Background

The Taxation (Income Tax Rate and Other Amendments) Act 2020 inserted increased disclosure requirements for domestic trusts to support compliance with the new 39% top tax rate and to assist the Commissioner in understanding and monitoring the use of structures and entities by trustees.

The increased disclosures include the requirement to provide details of settlements and distributions made over the year as well as to provide financial statements as part of their annual return.

The rules apply broadly to trusts, including estates, with some exceptions as set out in the new provisions.

#### Key features

The amendments clarify the filing requirements for trusts, including when the trustee is required to comply with the increased disclosure requirements.

The amendments also provide more excluded categories of trusts, recognising where the collection of additional disclosures is not necessary in light of the purpose of the disclosure rules.

A new provision gives the Commissioner of Inland Revenue the power to vary the increased disclosure requirements for certain classes of trustees. This provides an ongoing flexibility to respond to concerns where some data may be impractical or disproportionately costly for some trustees to provide when weighed against the purpose of collection.

#### Detailed analysis

***Domestic trust filing requirements***

An amendment to section 59BA(1) clarifies that all trustees of a trust who derive assessable income are required to provide a return of income for that income year.

Section 59BA(2) is amended to clarify the relationship between the requirement in subsection (1) and the additional disclosure requirements set out in subsection (2). Specifically, trusts which are listed in 59BA(3) are still required to complete a return of income where they derive assessable income. Being listed as a category of trust in 59BA(3) only exempts a trust from providing an annual return in the form set out in 59BA(2).

If a trust does not derive assessable income for a year, regardless of whether they are listed as an excluded type in 59BA(3), they are not required to provide a return of income.

### *Excluded trusts*

Section 59BA (3) is amended to designate additional types of trusts as excluded trusts for the purposes of the increased disclosure requirements.

The Taxation (Income Tax Rate and Other Amendments) Act 2020 exempted the following types of trusts from the increased disclosure requirements on the basis that they were at low risk of being used to avoid the 39% rate and/or existing information requirements already applied to these trusts:

- foreign trusts (these trusts are already subject to extensive disclosure requirements)
- non-active trusts (there are existing provisions in place to exempt non-active trusts from filing requirements; these are carried through for the new requirements)
- charitable trusts incorporated as a board under the 1957 Act (these trusts have existing requirements under other legislation)
- trusts eligible to be a Māori authority.

The Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021 introduces five additional exclusions. These trusts are considered to be generally of low risk of use in relation to avoiding the 39% tax rate as the trusts are generally widely-held and/or specific requirements apply around the use of the funds.

#### *Charitable trusts registered under the Charities Act 2005 (59BA(3)(c))*

This recognises that some charitable trusts are registered under the 2005 Act and not incorporated under the 1957 Act and resolves the discrepancy that exists if charitable trusts incorporated under the 1957 Act are excluded, and charitable trusts more recently registered under the 2005 Act are not.

#### *Widely held superannuation funds (59BA(3)(f))*

Widely-held superannuation funds, which includes KiwiSaver funds, must meet certain criteria including a certain number of investors and therefore are not the type of private trust that is the main focus of the increased disclosure requirements. This exclusion uses the existing definition of a widely held superannuation fund in YA 1 of the Income Tax Act 2007.

#### *Exempt employee share scheme trusts (59BA(3)(g))*

Exempt employee share schemes (ESS) are defined in YA 1 of the Income Tax Act 2007 and have several requirements they must meet to qualify. There are special rules for these types of ESS which are intended to reduce compliance costs for those schemes which are widely available to employees and where individual employees derive limited benefits under the scheme.

#### *Securitisation trusts (59BA(3)(h))*

Securitisation trusts or "debt funding special purpose vehicles" are defined in YA 1 of the Income Tax Act 2007. The Income Tax Act 2007 currently includes a regime for debt funding special purpose vehicles which exists to maintain tax neutrality for the treatment for these vehicles. Their exclusion from the trust disclosure rules recognises that securitisation trusts are set up to obtain better lending terms and that there is low risk of their use in accumulation of private wealth and avoidance of the 39% tax rate.

#### *Consumer energy trusts where trustees meet the definition of lines trust in YA 1 of the Income Tax Act 2007 (59BA(3)(i))*

Consumer energy trusts were established following the restructuring of the electricity sector under the Energy Companies Act 1992. They distribute to a large number of beneficiaries and often do not have their IRD numbers. They are widely held and therefore are excluded from the additional annual return requirements for trustees.

The term "lines trust" is defined in YA 1 and refers to trusts that had allocated to them and continue to hold, shares in energy companies as provided for under the Energy Companies Act 1992.

**Example 91: Helion Power Trust**

Helion Power Trust is a consumer energy trust which was established following the restructure of the energy sector in the 1990s. They meet the definition of a lines trust established under the Energy Companies Act 1992 and are excluded from the additional disclosure requirements in section 59BA(2).

Helion Power does not need to comply with the increased disclosure requirements in section 59BA(2), which includes identifying details of any new settlements, distributions and financial statement information. However, as Helion Power derive income, they will still be required to report this income to Inland Revenue and file a tax return.

*Ability for the Commissioner to vary requirements for trusts*

New section 59BA(5) allows the Commissioner to vary the disclosure requirements set out in section 59BA(2).

This is intended to ensure there is sufficient flexibility to account for situations where there are types of trusts which may be reasonably unable to meet some of the disclosure requirements, and/or the particular requirements are not necessary given the characteristics of the trust and therefore impose undue compliance costs.

This is intended to be similar to the flexibility allocated to the Commissioner for other filing requirements, such as employment income information.



## Remedial amendments to the Commissioner's information gathering powers

*(Sections 17B -17C, 17E, 17H, 20, 20B, 20D, 20F of the Tax Administration Act 1994)*

The Taxation (Annual Rates for 2020– 21, Feasibility Expenditure, and Remedial Matters) Act 2021 included remedial amendments to the Commissioner's information gathering powers. These amendments were technical in nature and ensured that the sections operate in line with policy intent. Section 17GB is intended to operate similarly to the Commissioner's existing power in 17B (with the exception that information obtained under 17GB is not available for use in proceedings against the person).

### Background

Section 17GB of the Tax Administration Act 1994 was introduced in the Taxation (Income Tax Rate and Other Amendments) Act 2020 to clarify that the Commissioner's power to collect information extended to information required for policy development purposes.

The amendments in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 update the information gathering provisions in the Tax Administration Act 1994 to include relevant cross-references to this new information collection provision.

### Key features

- Sections 17B, 17C, 17E and 17H relate to the operation of 17GB as an information gathering provision and clarifies the Commissioner's powers in relation to documents and ability to seek a court order if a person is non-compliant with an information requisition.
- Sections 20, 20B, 20D and 20F ensure that information collected under section 17GB is subject to privilege for legal practitioners and tax advice confidentiality.

### Application date

The amendments apply retrospectively from 7 December 2020.

## Confirming Housing New Zealand Build Limited subject to income tax

*(Schedule 36, Part A of the Income Tax Act 2007)*

Housing New Zealand Build Limited, a subsidiary of Kāinga Ora – Homes and Communities, has been added to the schedule of state enterprises in the Income Tax Act 2007, to confirm that it is subject to income tax.

### Background

The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 updated the list of state enterprises in schedule 36 of the Income Tax Act 2007 to replace Housing Zealand Corporation with Kāinga – Homes and Communities. This change simply reflected that Kāinga Ora had absorbed the functions of Housing Zealand Corporation and like the Corporation, is subject to income tax. In the absence of being listed in schedule 36, Kāinga Ora, as a statutory entity, would be exempt from income tax.

Interpretative advice indicated that Kāinga Ora's subsidiaries should also be listed in schedule 36. Kāinga Ora's main subsidiary, Housing New Zealand Limited, is already listed in schedule 36.

### Key features

An amendment to schedule 36 has been made to confirm that Kāinga Ora's subsidiary, Housing New Zealand Build Limited, is subject to income tax. This is not a change in tax status as the company is already being treated as taxable.

### Application date

The amendment to schedule 36 applies from 23 May 2018, when Housing New Zealand Build Limited was incorporated.

## Remedial amendments: investment income withholding and reporting rules for custodial institutions

*(Sections RE 10C of the Income Tax Act 2007 and 25MB of the Tax Administration Act 1994)*

Amendments have been made to the investment income reporting and withholding rules for custodial institutions.

### Background

Custodial institutions act as a conduit between the payer of investment income and the ultimate owner of that income. Provisions which modernised and clarified the withholding and reporting obligations were introduced by the Taxation (KiwiSaver, Student Loans and Remedial Matters) Act 2020. The changes aimed to enable the pre-population of tax returns and to ensure that taxpayers' tax obligations and social policy entitlements are calculated more accurately during the year.

Clarifications were required to ensure that sections RE 10C and 25MB reflect the original policy intent.



### Key features

The definition of a "custodial institution" has been amended, so that sections RE 10C(6)(b) and 25MB(7)(b) do not distinguish between resident and non-resident custodians. Custodians which operate their New Zealand business by way of a fixed establishment in New Zealand are now able to access the relaxations available to custodians which operate through a local entity, in line with the original policy intent.

A further amendment has been made to section RE 10C(3) to clarify that custodial institutions' obligations to withhold include non-resident withholding tax (NRWT) when paying or transferring investment income to the end investor. The exclusion of NRWT was inadvertent, and custodians should withhold RWT or NRWT as applicable.

### Application date

The amendments to sections RE 10C and 25MB apply from 1 April 2020, being the date those sections originally came into force.

## Beneficiaries as settlors

*(Section HC 27 of the Income Tax Act 2007)*

The Income Tax Act 2007 has been amended to ensure that if, at the end of an income year, a beneficiary of a trust is owed more than $25,000 by the trustee and interest has not been paid on this amount at the prescribed or market rate, then the beneficiary will become a settlor of the trust.

### Background

Section HC 27(2) provides that a person who transfers value to a trust is a settlor. A beneficiary can become a settlor when money is paid out to them but is retained in their current account with the trust. This is because they "transfer value" to the trust by leaving money in the trust interest-free.

A recent legislative amendment to section HC 27(6) aimed to ensure that beneficiaries with current account balances below $25,000, or on which the prescribed or market rate of interest has been paid, do not become settlors. This was a taxpayer-friendly amendment, ensuring that beneficiaries with modest current account balances do not because settlors. Being a settlor has implications in numerous areas, such as social assistance and student loan repayment obligations.

It has become apparent that this amendment may be ineffective because, from a legal point of view, a beneficiary's knowledge as to the way the trustee is using the money is required for a transfer of value to occur. Therefore, a beneficiary could be owed any amount by the trust but not be a settlor if the beneficiary had no knowledge of the debt.

### Key features

New section HC 27(2)(bb) clarifies that a beneficiary that is owed money by a trust will always become a settlor if they do not meet the requirements of subsection (6) (which is that the amount owed to the beneficiary is $25,000 or less or the beneficiary is paid interest on the amount at a rate equal to the prescribed or market interest rate). As such, a beneficiary that is owed more than $25,000 on which interest has not been paid at the prescribed or market rate will become a settlor of the trust, regardless of knowledge.

### Application date

1 April 2020.

## Settlor trust migrating to New Zealand

*(Sections HC 10, HC 30(4)(ab), (b), (4B), HC 33(5)((b), (c), (d)(ii))*

The amendments apply for a settlor of a trust that has migrated to New Zealand and wish to distribute an amount to a beneficiary as exempt income. The amendments apply if the trustee has satisfied their New Zealand tax obligations for world-wide trustee income in either of the following circumstances:

- for an assessment of tax on world-wide trustee income arising under a voluntary disclosure, or
- for an assessment of tax on world-wide trustee income arising under a retrospective election to pay tax on world-wide trustee income.

### Background

A settlor of a foreign trust that migrates to New Zealand may elect to pay New Zealand tax on worldwide trustee income from a specified date. The main benefit of making this election is that there is no additional layer of tax when the tax-paid trustee income is distributed to a beneficiary.

If this election is not made by a certain time (the election expiry date), distributions from the trust to a beneficiary from amounts derived by the trustee after the election expiry date may be taxed at 45%. However, this outcome was not consistent with the situation of a trustee choosing to pay New Zealand tax on past period's trustee world-wide trustee income after being assessed for amended tax positions for prior years under either:

- the voluntary disclosure rules, or
- an election to pay tax on world-wide trustee income under section HC 33.

#### *Voluntary disclosure*

The voluntary disclosure rules permit the Commissioner to assess tax on past incorrect tax positions that have been voluntarily disclosed to Inland Revenue. A purpose of the voluntary disclosure rules is to allow the trustee to "put right" their past tax position, subject to appropriate penalties and use-of-money interest being imposed.

Under the voluntary disclosure process, New Zealand income tax (including penalties and interest) has been assessed and paid for the earlier period or periods to which the voluntary disclosure relates.

In this circumstance, the intent of the voluntary disclosure rules (as they relate to a distribution from a trust) is that a distribution to a beneficiary from an amount derived by the trustee during these periods would be exempt from tax for the beneficiary. However, prior to these amendments, it was possible that such a distribution could still be taxed at 45%.

#### *An election under section HC 33*

Recent amendments to the Income Tax Act 2007 clarified that an election may be made to pay tax on worldwide trustee income retrospectively for up to four earlier years. Prior to this amendment; the law was unclear on whether this election could be made retrospectively. This earlier amendment was also to allow the trustee to "put right" their past tax position, subject to appropriate penalties and use-of-money interest being imposed.

In this circumstance, the intent of the retrospective election rules (as they relate to a distribution from a trust) is that a distribution to a beneficiary from an amount derived by the trustee during these periods would be exempt from tax for the beneficiary. However, prior to these amendments, it was possible that such a distribution could still be taxed at 45%.

### Key features

The amendments apply for a trust of which a settlor has migrated to New Zealand and:

- an election to pay tax on world-wide trustee income was not made within a prescribed period (the election expiry period), and
- has subsequently taken steps under either the voluntary disclosure rules or the voluntary election rules to pay tax on world-wide trustee income for past years after the election expiry period has ended.

#### *Voluntary disclosure*

The amendment in sections HC 10 and HC 30(4)(ab) and (4B) ensure the law works as intended for a distribution to a beneficiary from amounts derived by a trustee during the periods to which a voluntary disclosure relates.

The amendments apply to a trust of which a settlor has migrated to New Zealand for which all the following apply.

- No election had been made to pay tax on world-wide trustee income within the election expiry period.
- A subsequent voluntary disclosure has been made to pay tax on world-wide trustee income of that trust.
- The amendments result in this trust being treated as a complying trust for distributions from amounts derived by the trustee during the periods to which the voluntary disclosure relates subject to:
  - the application of the ordering rules in section HC 16, which require distributions to be made on a first-in-first-out basis, after taking into account whether the distribution is from income, capital gain, or corpus, and
  - the trustee having fully satisfied their New Zealand income tax obligation for these periods.



#### *Voluntary election*

It is clear that a trust of which a settlor has migrated to New Zealand within the previous four years may make a retrospective election to pay New Zealand tax on up to four years of earlier worldwide trustee income. However, it was unclear if this election results in an additional layer of tax when this trustee income is distributed to beneficiaries.

The amendments to section HC 30(4), (4B) and HC 33 ensure that a retrospective election for a trust can result in that trust being treated as a complying trust for distributions from amounts derived by the trustee during the periods to which the retrospective election relates subject to:

- the ordering rules, which require distributions to be made on a first-in-first-out basis, after taking into account whether the distribution is from income, capital gain, or corpus; and
- the trustee having fully satisfied their New Zealand income tax obligation for these periods.

### Application date(s)

The amendments apply as follows:

- for a voluntary disclosure made on, before or after 23 March 2020, and
- for an election made under section HC 33, from 23 March 2020.

## Nominee treatment for trustee of exempt employee share scheme

*(Sections CE 6 and CD 43)*

Section CE 6 of the Income Tax Act 2007 ("the Act") is amended to clarify that a trustee of an exempt employee share scheme can be treated as a nominee of the company providing the scheme.

Section CD 43 of the Act is also amended to clarify that consideration received by a company for the issue of shares as a result of the application of section CE 6 is included in "subscriptions" for calculating available subscribed capital (ASC).

### Background

Under section CE 6, if a trustee carries out activities related to a company's employee share scheme, and shares or related rights are issued or transferred under the scheme, the trustee is treated as the nominee of the company to the extent of those share scheme activities. As a nominee, the trustee acts for the company and is therefore treated the same way the company would be treated if the company were carrying out the share scheme activities. This prevents tax being triggered where shares and other rights are passed between the trustee and company in legal terms, but there is no substance to the transactions because the trustee is performing the role of the company itself.

Under the wording of section CE 6 prior to this amendment, a trustee was only treated as a nominee to the extent to which its activities related to an "employee share scheme". An "exempt employee share scheme" is not an "employee share scheme" (section CE 7(b)(i)).

There was no policy reason why, in this context, a trustee of an exempt employee share scheme should not be treated the same way for tax purposes as the trustee of an employee share scheme. The only difference between taxable schemes and exempt schemes is that exempt schemes allow the employer to grant tax exempt share scheme benefits. This should not have a bearing on the tax treatment of a trustee administering the scheme on the company's behalf. Therefore, it was proposed that section CE 6 be amended to extend nominee treatment to trustees of exempt employee share schemes.

The proposal to amend section CE 6 drew attention to an existing issue relating to ASC (the amount of capital received by a company in exchange for the allocation of shares). It was unclear whether the definition of "subscriptions" in section CD 43(2)(b) – which is used in the formula for calculating ASC – included consideration for the issue of shares received by a trustee that was being treated as a nominee under section CE 6. Not including such consideration in subscriptions would lead to an incorrect calculation of ASC. Consequently, it was proposed that section CD 43(2)(b) be amended to clarify that consideration received by a company for the issue of shares as a result of the application of section CE 6 is included in the definition of "subscriptions" for ASC.

### Application date

30 March 2021.

## Disposal of company's own shares by employee share scheme trustee

*(Section CW 58 of the Income Tax Act 2007)*

Section CW 58 of the Income Tax Act 2007 is amended to clarify that if a trustee of an employee share scheme, while acting as a nominee for the company offering the scheme under section CE 6, disposes of shares the company holds in itself ("treasury stock"), any income the trustee derives from the disposal is exempt.

### Background

Under section CW 58, if a company disposes of its own shares, having acquired them without cancelling them, any income the company derives from that disposal is exempt. This is because the disposal is a partial transfer of ownership of the company to shareholders, not a sale that produces any economic gain or loss.

A company that offers an employee share scheme may nominate a trustee to carry out activities related to the share scheme, such as holding shares on trust for employees, transferring shares to employees, or reacquiring shares from employees where the company wishes to hold them as treasury stock. As a nominee of the company under section CE 6, the trustee effectively acts as the company, and should therefore be treated in that capacity the same way the company would be treated.

Since income derived by a company from disposing of its own shares is exempt, income derived by a trustee from disposing of the company's shares while acting in its capacity as nominee of the company should also be exempt. However, prior to this amendment, the wording of section CW 58 did not explicitly contemplate the possibility of a trustee nominee. Consequently, the section was interpretable as not exempting that trustee income.

To resolve this ambiguity, it was proposed that CW 58 include a reference to section CE 6.

### Application date

30 March 2021.

## Use of pre-consolidation imputation credits

*(Sections OB 52, OP 22 and Tables O2 and O19)*

This amendment aligns the use of pre-consolidation imputation credits by a consolidated imputation group (CIG) to the first-in first-out method for:

- pre-amalgamation imputation credits are used by an amalgamated company
- imputation credits used by an individual company.

### Background

Prior to this amendment, the Commissioner's view and practice was that section OP 22 and its corresponding provisions in earlier legislation always required a CIG to exhaust all its group imputation credits before it could draw on the pre-consolidation credits of the individual group companies. *Tax Information Bulletin Vol 16, No 1 (February 2004)* explained this policy.

This view has been contested by stakeholders from the private sector, who have argued that:

- the general legislative framework for individual companies requires imputation credits to be used on a first-in first-out (FIFO) basis
- imputation credits of an amalgamated company include the pre-amalgamation credits of amalgamating companies and these are used on a FIFO basis, and
- there is no policy reason to depart from this principle when addressing the use of pre-consolidation imputation credits by a CIG, provided shareholder continuity has been maintained.

### Key features

The amendments apply when:

- a consolidated imputation group has an imputation debit (for example, a group company is paying a dividend and wishes to attach imputation credits to that dividend)
- a group company has a credit balance in its imputation credit account (ICA) consisting of pre-consolidation imputation credits, and
- the group company's credit balance existed before the debit to the group ICA arose.

Under the amended rules, the consolidated imputation group may elect to transfer some or all of the credit balance from a group company's ICA to the group's ICA. This election is made by a nominated company recording the amount of the credit balance transferred as a debit in the group company's ICA (under section OB 52), and as a credit in the group's ICA.

Three requirements must be satisfied for the credit transfer to be made:

- The consolidated imputation group and the group company must meet the shareholder continuity requirements for the carrying forward of imputation credits until the end of the day on which the debit arises in the group ICA (section OA 8).
- Credits of the group and all group companies must be used to reduce the debit in the order in which the credits arose (FIFO).
- The amount of credits that can be transferred from group companies to the group is limited to the amount of the imputation debit to the group's ICA.

### Application date

The proposed amendment applies for the 2008–09 and later income years.

## Compulsory zero-rating of transfers of commercial land leases

*(Section 11(8D) of the Goods and Services Tax Act 1985)*

Several remedial amendments have been made to the zero-rating rules that apply to transfers of leases of commercial land. All section references are to the Goods and Services Tax Act 1985 unless otherwise stated.

### Background

The GST Act zero-rates certain supplies of land between GST registered persons (such as businesses). The zero-rating of land rules may also apply when a registered person transfers a lease to another registered person, including when the lease is transferred as part of the sale of a business, as a lease represents an interest in land.

### Key features

The remedial amendments slightly expand the scope of the zero-rating of land provisions, so they better align with current taxpayer practices by:

- ensuring that zero-rating applies to all assignments or surrenders of a lease that would meet the criteria for zero-rating had the land been sold, instead of leased
- clarifying that, if a business sale includes a zero-rated supply relating to a land lease, any business assets that are transferred as part of that same supply or arrangement should also be zero-rated, and
- expanding the scope of section 11(8D)(c), so that in addition to applying to lease surrenders, this provision may also apply when a lease is cancelled, prior to a new lease being arranged for the purchaser of a business.

### Application date

The remedial amendments apply retrospectively from 30 June 2014, being the date that the relevant provisions of section 11(8D) originally came into force under the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

However, as there may be instances where the relevant supplies were standard-rated rather than zero-rated, a savings provision preserves tax positions taken under the former section 11(8D), prior to the remedial amendments being enacted.

### Detailed analysis

#### *Assignments or surrenders of a commercial land lease*

Section 11(8D)(a) ensures that lease assignments and surrenders are subject to compulsory zero-rating if they meet the requirements of section 11(1)(mb).

Section 11(8D)(a) was amended in 2017, by inserting the words "and paragraph (b) does not apply" at the end of paragraph (a). This addition significantly changed the scope of section 11(8D)(a). The change was unintended and was not referred to in any of the guidance materials. The unintended effect of the 2017 change was that only assignments or surrenders of leases that involved making a non-regular payment that exceeded 25 percent of the total consideration agreed under the lease agreement (the test in section 11(8D)(b)) would be zero-rated.

The remedial amendment deletes the reference to "and paragraph (b) does not apply" in section 11(8D)(a). This achieves the original policy intent which is that all assignments or surrenders of a lease agreement for land that meet the criteria in section 11(1)(mb) should be zero-rated.

#### *Zero-rating business assets that are also transferred as part of the same arrangement*

When a registered person sells a business which includes land and other assets to another registered person, the zero-rating of land rules will zero-rate both the supply of land and the other business assets. This is achieved by section 11(1)(mb) referring to "the supply wholly or partly consists of land". Alternatively, the sale of the business may be zero-rated as a going concern under section 11(1)(m).

Because the transfer of a commercial land lease could be economically equivalent to a transfer of land, they should produce similar GST outcomes. This would mean any business assets that are transferred as part of the same overall arrangement as the transfer of a lease should also be zero-rated supplies.

Remedial amendments have been made to sections 11(8D)(a), (ab), (b) and (c) to clarify that, in the context of business sales, that involve a zero-rated supply relating to land leases under these provisions, any business assets that are transferred as part of that same supply or arrangement should also be zero-rated.

#### *Lease cancellations*

Section 11(8D)(c) applies in the context of a business sale to zero-rate the service of arranging a new lease for the purchaser of the business, when the old lease has been surrendered by the lessee.

Under the remedial amendment, section 11(8D)(c) has been expanded so it also applies to a similar scenario when the lessor has cancelled the lease (for example because the previous lessee failed to pay rent) but there is an arrangement as part of the business sale for the lessor and purchaser of the business to enter a new lease agreement. Accordingly, this provision may apply regardless of whether the old lease was surrendered by the original lessee or cancelled by the lessor

## Clarifying that cash dividends are derived on a cash basis

*(Section CD 1 of the Income Tax Act 2007)*

This is a minor amendment to clarify that income is allocated to the income year in which the person receives the dividend if it is a cash dividend.

### Background

This issue was raised in a Question We've Been Asked which asked: "when is income from a cash dividend paid on ordinary shares derived?" The draft answer was that for shareholders accounting for tax on an accrual basis, the dividend will be derived when a debt in their favour is established. When the draft was sent out for public comment, feedback was that the draft answer was not in line with general practice.

Currently, dividends paid in money are assessable on a cash or accrual basis (depending on which best reflects the taxpayer's income). Many submitters considered that dividends paid in money should only be assessable on a cash basis. Allowing such dividends to be derived on a cash basis would simplify filing, reduce compliance costs, and better align with other legal requirements.

This amendment adds an additional subsection to section CD 1 of the Income Tax Act 2007. The new section states the income is allocated to the income year in which the person receives the dividend if the dividend is a dividend other than a non-cash dividend. This does not change when the dividend is derived, but it does change when the income is allocated.

### Key features

Dividends paid in money are assessable on a cash basis and not on an accrual basis.

### Application date

The amendment applies from the 2020–21 income year.

## Non-resident contractors' tax

*(Section RD 24(1) of the Income Tax Act 2007)*

Clarifying that when a non-resident contractor seeks an exemption from income tax in respect of a payment, they must show that the amount derived from that payment is not "assessable income".

### Background

This amendment relates to non-resident contractors who perform or supply services or property in New Zealand, such as someone who travels to New Zealand to provide IT services on a short-term basis to a local company. However, due to their limited links to New Zealand, there is a risk of revenue loss – the contractor may not be aware of, or comply with, New Zealand tax laws. For that reason, income received by contractors is ordinarily subject to PAYE.

A contractor may apply to the Commissioner for an exemption from PAYE under section RD 24 of the Income Tax Act 2007, as long as one or more conditions are met. Under section RD 24(1)(a) the contractor must show that the payment is not "income" and therefore no tax is payable on it. Typically, this will be because a double tax agreement exempts the payment from tax.

Arguably, a payment will be income even if it is not subject to tax. The previous formulation of the test required the contractor to demonstrate that the "income derived" was not "subject to income tax". The change to "income" was unintended. This change will clarify that Inland Revenue does not seek to withhold tax from payments to contractors if no tax is ultimately due.

### Key features

Section RD 24(1)(a) is amended to confirms that the correct test for an exemption from income tax for a non-resident contractor is "assessable income".

### Application date

This amendment applies from the date of the enactment.

## Restricted transfer pricing remedials

*(Sections GC 16 and GC 18 of the Income Tax Act 2007)*

The following three amendments have been made to the restricted transfer pricing rules.

- Providing the same one or two notch credit rating decrease when the group credit rating is calculated for a group where no member has long-term senior unsecured debt with a third party as is allowed for a group which does have such third-party debt.
- Preventing cross border related borrowing that is not from an associated person from being used to justify an exotic feature of cross-border related borrowing.
- Introducing a second method to allow cross-border related borrowing with terms over five years based on the average term of all third-party debt within the group.

### Key features

Section GC 16(10)(ab) has been amended to include a reduction of one or two notches based on the equivalent reduction in existing section GC 16(10)(a).

There are 12 references to "associated persons" in section GC 18(5), (7), (8) and (9). Each of these references has been amended so that, in these provisions, all cross-border related borrowing is treated consistently, regardless of whether the borrower and lender are associated. These changes do not affect which loans are covered by the restricted transfer pricing rules, only the amount of the arm's length consideration for such loans.

Section GC 18(4) determines when the term of a loan greater than five years can be adjusted. This section has been replaced to include an additional criterion where no adjustment is required.

### Application date

These amendments apply for balance dates starting on or after 1 July 2019 to align with the original introduction of the restricted transfer pricing rules. A savings provision applies for taxpayers that have filed a return based on the original third party test for exotic features calculation before the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedials Matters) Bill was introduced on 4 June 2020.

### Detailed analysis

#### *Group credit rating*

Section GC 16(10)(ab) was introduced by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 to allow the group credit rating to be calculated by a group with no long-term senior unsecured debt with third parties.

The equivalent provision for groups with such third party debt is section GC 16(10)(a). That paragraph reduces the deemed credit rating of the borrower by one or two notches below the credit rating of the identified worldwide group member. It was always intended that equivalent reductions would be included in section GC 16(10)(ab). This intention has now been achieved.

#### *Third party test for exotic features*

Section GC 18(3) provides a list of borrower-friendly features that cannot be taken into account when pricing cross-border related borrowing. However, there is an exception to this restriction so that these features can be taken into account if they are also present in significant third party debt. If a feature is present in significant third party debt this supports there being a commercial reason for the feature's existence.

However, the definition of a cross-border related borrowing includes loans made by some lenders that are not associated with the borrower. The definition of cross-border related borrowing is in section GC 6(3B). Associated persons are covered by section GC 6(3B)(a)(i) but there are additional categories in section GC 6(3B)(a)(ii) to (iv).

The consequence of the previous law is that a cross-border related borrowing that is not from an associated lender is included in the category of loans from non-associates that determine whether exotic terms can be taken into account in pricing that cross-border related borrowing. This created two issues when a group had lending that was cross-border related borrowing from an unassociated person:

- The features of that loan partially or fully determined the appropriate features of that same loan.
- The features of a loan within the control of people controlling the borrower were included within a third-party test to determine appropriate exotic features.

Twelve instances of "associated persons" in section GC 18(5), (7), (8) and (9) have been updated so that, for the purposes of the third party test, all cross-border related borrowing is treated consistently.

#### *Terms greater than five years*

Section GC 18 prevents terms of greater than five years from being included in pricing cross-border related borrowing unless the New Zealand group or the worldwide group has significant third-party debt with a term that is equal to or greater than the term of the cross-border related borrowing. These rules were explained on page 24 of the BEPS interest limitation special report and page 113 of *Tax Information Bulletin* Volume 31, No 3, April 2019.

The threshold fraction calculates third-party debt with a term over five years as a proportion of total third-party debt. This was intended to require a group to price its cross-border related borrowing on the basis that the term profile of that borrowing was no longer than the term profile of its third-party funding. For example, if a group had 50% of its third party funding with a term of two years and 50% of its third party funding with a term of 10 years it could also have 50% of its cross-border related borrowing with a term of 10 years. While the rules operate appropriately when a group structures its cross-border related borrowing in this way, groups may prefer to have a single cross-border related borrowing rather than splitting it into below five-year and above five-year components. For example, instead of the two loans above they could have a single loan with a term of six years for the same average maturity. Under the original test, when a group has a single cross-border related borrowing with a term greater than five years it would only satisfy the threshold term if it has no third-party debt with a term less than five years.

An alternative approach has been added to section GC 18(4), for borrowers who are not insuring or lending persons or their associates. This allows a cross-border related borrowing to have a term of greater than five years taken into account without having to satisfy the threshold term provided:

- the term is less than the weighted average of the term of all third party debt; and
- cross border related borrowing is less than four times third party debt.

## Thin capitalisation remedials

*(Sections FE 2, FE 6, FE 12, and GC 16 of the Income Tax Act 2007)*

The following four amendments have been made to (or consequential to) the thin capitalisation rules.

- A reduction in scope of what trusts are covered by the thin capitalisation rules.
- A new interest apportionment formula for taxpayers owned by a group of unassociated investors acting together.
- An amendment to the debt percentage calculation so it operates correctly when non-debt liabilities are higher than total assets.
- An updated cross reference in section FE 12(2).



### Key features

Section FE 2(1)(d)(i) has been repealed and replaced by new section FE 2(1)(cd). These changes have also made section FE 2(4)(b) redundant so it has also been repealed.

The existing interest apportionment formula in section FE 6(2) has now been renamed the "general formula". A new interest apportionment formula has been introduced in section FE 6(3B) for excess debt entities with a worldwide group given by section FE 31D. Section FE 6(3)(e)(iiib) has been repealed as this situation is now covered by the formula in section FE 6(3B) rather than the general formula.

Section FE 12(3), which is the debt percentage formula, has been replaced. The replacement section applies the same formula but specifies that the debt percentage is zero if non-debt liabilities are greater than group assets. Consequential changes are made to the two interest apportionment formulas in section GC 6(2) and (3B) as well as the restricted transfer pricing rules in section GC 16(3)(c) and (4)(b).

### Application date

The trust scope reduction amendment applies from 1 April 2015 to align with the original amendment that increased the scope of trusts covered by the thin capitalisation rules. The interest apportionment formula applies to income years starting after 30 March 2021 which is the enactment date of the Taxation (Annual Rates for 2020-21, Feasibility Expenditure and Remedial Matters) Act 2021. The debt percentage calculation amendment applies to income years starting on or after 1 July 2018 to align with the previous changes to this formula that could have enabled the percentage to go negative.

### Detailed analysis

#### *Trust scope*

A variety of trusts were brought within the thin capitalisation rules by changes that applied from 1 April 2015. One of these provisions was intended to cover a group of associated residents and non-residents that settled at least 50% of a trust. However, it was drafted to include all trusts settled by a New Zealand resident if that resident was associated with any non-resident. The broad scope of this provision necessitated a carve-out for trusts where the only associated non-resident was a relative of the New Zealand resident settlor and that non-resident relative had not themselves settled on the trust.

Even with the carve-out, this approach brought many trusts with only New Zealand resident settlors within the scope of the thin capitalisation rules, including a number that may not have been aware of this requirement and accordingly would not have been compliant with the thin capitalisation rules.

Accordingly, this provision has now been replaced. The new approach will bring these trusts into the thin capitalisation rules only if they have been settled by a non-resident and the non-resident and any New Zealand resident associates have settled at least 50% of the trust.

This new approach means the previous carve-out in section FE 2(4)(b) is redundant so has been repealed. A trust that was previously excluded from the thin capitalisation rules only because the associated non-resident was a relative of the New Zealand resident settlor and the non-resident had not settled on the trust would no longer be included within new section FE 2(1)(cd) as no non-resident would have made a settlement on the trust.

There are no changes to the other provisions in section FE 2(1) so a trust, or other person, that was previously brought within the thin capitalisation rules under one or more other subsections will continue to be subject to the rules.

*Interest apportionment formula*

Since the extension of the thin capitalisation rules to groups controlled by a non-resident owning body from 1 April 2015 the thin capitalisation limit for these groups has been the greater of a 60% debt percentage including related party debt or a percentage[17] of their debt percentage excluding related party debt. The principle is that the thin capitalisation rules should not limit deductibility of interest paid by such groups to unrelated lenders.

If the thin capitalisation debt percentage threshold is breached income is derived by applying what is now known as the "general formula" in section FE 6(2). This formula essentially calculates the proportion of allowable debt then multiplies this proportion by total deductible interest. While this works correctly for the usual case where there is no distinction between debt owed to related parties and unrelated parties, when it was applied to a group controlled by a non-resident owning body it assumed that the interest rate on both related party debt and unrelated party debt was identical.

This will often not be the case, for example, because the related party debt and debt with unrelated parties was entered into at different times. In these circumstances, interest that should be deductible (because it is paid to unrelated lenders) could have been disallowed (if the rate of interest on unrelated party debt exceeded that on related party debt) or interest that should have been disallowed (because it is paid to related lenders and the 60% debt threshold is exceeded) could remain deductible.

A new formula has been introduced that generates an amount of income to the extent interest is paid to related parties on debt that is above the 60% threshold:

$$(\text{related interest} - \text{mismatch} + \text{FRD2}) \times \frac{\text{total debt} - \text{concession}}{\text{total debt}} \times \text{group debt comparison factor}$$

This formula essentially multiplies pre-thin capitalisation deductible related party interest by the proportion of total debt not eligible for the on-lending concession and by the proportion of related party debt that is deductible under the thin capitalisation rules.

The individual terms in the formula can be described as:

- **related interest** is the equivalent of **total deduction** in existing section FE 6(3)(a) except it is limited to debt with counterparties that would be excluded from the worldwide group under existing section FE 18(3B).
- **FRD2** is the equivalent of **FRD** in existing section FE 6(3)(ab) except it is limited to fixed-rate foreign equity or fixed-rate shares that would be excluded from the worldwide group under existing section FE 18(3B) if that section applied to fixed rate foreign equity or fixed-rate shares instead of just financial arrangements.
- **mismatch**, **total debt** and **concession** are identical to their equivalent term in existing section FE 6(3)(aba), (b) and (c) respectively.
- **group debt comparison factor** is:
  - 1 if the New Zealand or worldwide group has a debt percentage of zero, that is, in this case income derived is equal to the total related interest after adjusting for mismatch, FRD2 and the on-lending concession; or
  - The amount given by the following formula:

$$\frac{(\text{New Zealand group debt percentage} - \text{threshold amount})}{(\text{New Zealand group debt percentage} - \text{worldwide group debt percentage})}$$

The individual terms in this formula can be described as:

- **New Zealand group debt percentage** is not a defined term but is identical to the **group debt percentage** term in section FE 6(3)(d).
- **threshold amount is defined in section FE 6(3E) as the greater of 60% and the worldwide group debt percentage**
- **worldwide group debt percentage** is also not a defined term but is the debt percentage for debt with counterparties that would not be excluded under existing section FE 18(3B).

[17] This percentage was originally 110% but was reduced to 100% by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 with effect from income years beginning on or after 1 July 2018.

There are therefore three possible outcomes of the group debt comparison factor:

1. If the group does not have a debt percentage (that is, non-debt liabilities are greater than total assets) an amount equal to all related interest (after adjusting for mismatch, FRD2 and the on-lending concession) is income.
2. If the worldwide group debt percentage is greater than, or equal to, 60% an amount equal to all related interest (after adjusting for mismatch, FRD2 and the on-lending concession) is income.
3. If the worldwide group debt percentage is less than 60% an amount equal to related interest (after adjusting for mismatch, FRD2 the on-lending concession) that takes the total debt percentage above the 60% threshold is income.

The group debt comparison factor has been introduced to cover the situation of negative debt percentages. Equivalent changes have also been made to the general formula. This is explained in more detail below.

*Negative debt percentages*

The denominator in the debt percentage formula in section FE 12(3) was amended by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 to deduct non-debt liabilities from group assets. In the common scenario where non-debt liabilities are smaller than group assets this means that a group's debt percentage has increased.

However, it is possible for non-debt liabilities to be larger than group assets. As non-debt liabilities are usually a subset of total liabilities this scenario can only occur when a group is insolvent. In this scenario the denominator of the debt percentage calculation went negative creating a negative debt percentage. The effect of a negative debt percentage on interest apportionment under thin capitalisation or the high BEPS risk test in the restricted transfer pricing rules was not clear before the current amendment.

Section FE 12(3) has been amended to confirm that a group with non-debt liabilities larger than group assets has a debt percentage of zero. A group with no debt will also have a debt percentage of zero; however, will not be affected by, or have to consider, the thin capitalisation rules or the restricted transfer pricing rules.

Consequential amendments have been made to a number of sections to ensure the effect of a zero debt percentage flows through correctly.

*Thin capitalisation general formula*

Previously the general formula for interest apportionment in section FE 6(2) included the terms "(group debt percentage – threshold amount) ÷ group debt percentage". This has been replaced by the term "group debt factor" which is defined in section FE 6(3)(c). For the most common case, where a group has a positive debt percentage, the outcome of the revised formula will be identical to the previous formula. If the group has a debt percentage of zero it will derive income equal to its entire interest expense after adjusting for the other items already included in the general formula.

*Thin capitalisation formula in section FE 6(3B)*

The formula in section FE 6(3B) includes the group debt comparison factor. This is the equivalent of the group debt percentage in the general formula. The operation of this term and the formula is explained in the interest apportionment formula section above.

*High BEPS risk in restricted transfer pricing*

Adjustments to terms in cross border related pricing under section GC 16 can be required when an entity is a high BEPS risk[18]. One of the criteria that can cause an entity to be high BEPS risk in section GC 16(3)(c) and GC 16(4)(b) is when its thin capitalisation debt percentage is 40% or more. Section GC 16(3)(c) and GC 16(4)(b) have been amended so that an entity is also a high BEPS risk if it has a debt percentage equal to zero. As noted above, an entity with no debt would also meet this criterion; however, it will not have any arrangements subject to the restricted transfer pricing rules so this will have no effect.

*Updated cross reference*

Section FE 12(2) sets the requirements for a worldwide group when the debt percentage of the New Zealand group is more than 60% as described in section FE 5(1)(a) or 75% as described in section FE 5(1)(b). The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 introduced section FE 5(1)(ab) for worldwide groups given by section FE 31D. However, it did not update the reference in section FE 12(2). Section FE 12(2) has been updated by replacing the reference to section FE 5(1)(a) with a reference to section FE 5(1)(a) and (ab) so the worldwide group requirements apply correctly to these groups.

[18] The term High BEPS risk is not used in legislation but was used in the development of the restricted transfer pricing rules and the guidance to that legislation. It is used in this Bulletin in the same context.

## NRFAI deferral calculation formula consequential amendment

*(Section RF 2C of the Income Tax Act 2007)*

### Background

The non-resident financial arrangement income (NRFAI) rules address situations where there is a sufficient degree of deferral between deductions and payments under a financial arrangement between associated parties so that non-resident withholding tax should be imposed on an accrual basis, rather than a cash basis. This ensures there is better matching between deductions for the borrower and the imposition of non-resident withholding tax.

The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 inserted the "hybrid deduction" item in the NRFAI deferral calculation formula in section RF 2C(4) of the Income Tax Act 2007. This amendment ensured that expenditure for which a deduction is denied under the hybrid mismatch rules in subpart FH of the Income Tax Act 2007, is not taken into account in determining whether a loan gives rise to NRFAI. However, as a consequence of this change it is possible for the NRFAI deferral calculation formula to produce an undefined outcome. This would occur if a borrower is denied deductions for all of their relevant expenditure by the hybrid mismatch rules, resulting in a zero denominator in the NRFAI deferral calculation formula.

### Key features

To address the risk of an undefined outcome under the NRFAI calculation, section RF 2C(6)(a) has been amended to specify that the item "accumulated accruals" is equal to the item "hybrid deductions".

### Application date

The amendment applies for income years beginning on or after 1 July 2018.

## Spreading of fertiliser costs

*(Section EJ 3(5) of the Income Tax Act 2007)*

This is a minor amendment clarifying the notification requirements for taxpayers who wish to spread their fertiliser expenditure under section EJ 3(5) of the Income Tax Act 2007.

### Background

Under section EJ 3 of the Income Tax Act 2007 a taxpayer who carries on the business of farming or agriculture and has incurred deductible expenditure in acquiring fertiliser or lime has the option to spread that expenditure over one to four income years.

The proposed amendment provides the notice requirements of section EJ 3(5) will be considered satisfied when the taxpayer files their tax return on that basis.

### Key features

This amendment clarifies that a taxpayer can notify their election to spread fertiliser expenditure under section EJ 3 of the Income Tax Act 2007 by filing their tax return on that basis.

### Application date

The amendment applies for the 2020-21 and later income years.

## Application of the minors' income tax exemption to minor beneficiary income

*(Section CW 55BB of the Income Tax Act 2007)*

The Income Tax Act has been amended to provide that income derived by a minor beneficiary does not qualify for the income tax exemption in section CW 55BB.

### Background

Section CW 55BB provides school children with an income tax exemption on up to $2,340 of income. This is a compliance cost measure preventing them from having to a file a return. The exemption is not intended to apply where there is someone in a position to pay tax on behalf of the child – for example, it does not apply where tax has been withheld at source such as on investment income or salary and wages.

Beneficiary income up to $1,000 paid to a minor is taxed at the beneficiary's tax rate. Previously, this $1,000 distribution was eligible to be exempt under CW 55BB. This was contrary to the policy intent as the trustee can pay tax on behalf of the beneficiary.

### Key features

New section CW 55BB(2)(a)(iiib) provides that income derived by a beneficiary of a trust who is a minor does not qualify for the income tax exemption in section CW 55BB (the minors' income tax exemption).

### Application date

The amendment applies from the 2012-13 income year. A savings provision applies for people who took a tax position relying on the previous law in a return filed before 4 June 2020 (the date the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill was introduced into Parliament).

## New Zealand superannuation or veteran's pension recipients tax write off limitation

*(Schedule 8, Part B 1(a) of the Tax Administration Act 1994)*

The amendment clarifies the limit of the amount of tax that can be written off to $50 for recipients of New Zealand superannuation or veteran's pensions using a tailored tax code and the tax liability is incurred through the auto calculation process.

### Background

The new end-of-year auto calculation rules allow taxpayers that only receive New Zealand superannuation or veteran's pension income, and consequently have a tax liability (for example, through the under deduction of PAYE from these gross amounts) to have this tax liability written-off. This includes where the taxpayer has used a tailored tax code. For example, a taxpayer may have tax losses carried forward that reduces their overall taxable income and have applied for and received a tailored tax code to reflect that.

The policy intent of these rules is that anyone using a tailored tax code should be entitled to a tax liability write-off that is limited in the same way as other taxpayers whose tax to pay is calculated using auto calc. This is because a tailored tax code is based on an estimate of their income to be earned within a year.

### Application date

The amendment applies from the 2020–21 income year.

## Removal of the three-yearly parental tax credit review

*(Section MF 7(4) of the Income Tax Act 2007)*

The amendment has removed the requirement to review the rate of parental tax credit (PTC) every three years, as PTC is not available for babies born on or after 1 July 2018.

### Background

Section MF 7(4) required the Minister of Revenue, in consultation with the Minister for Social Development, to review the amounts of in-work tax credit and PTC by 30 June. The first review was in 2008 and each subsequent review is at three-year intervals.

The government stopped paying PTC for babies born on or after 1 July 2018 when it put in place the new Best Start tax credit. PTC can now only be claimed in submitting or finalising returns for previous tax years. Inland Revenue may also amend a person's entitlement if fraud or mistakes are discovered in past years' returns. The payment for those years would be the amount that applied then. It is extremely unlikely these amounts will be retrospectively changed. Therefore, the need to review the amount of PTC is now redundant.

### Application date

The amendment applied from 30 March 2021, being the date of enactment.

## Bringing employer KiwiSaver contributions into the penalties and use-of-money-interest regimes

*(Sections 3(1), 4A(3)(bc), 120B(bb), 157(10) of the Tax Administration Act 1994)*

Amendments have been made to the Tax Administration Act 1994 ("Act") in response to legislative changes to the operation of KiwiSaver.

### Background

From 1 April 2020 the government began to pay compulsory and voluntary employer KiwiSaver contributions to KiwiSaver scheme providers before the employer had paid the amounts to Inland Revenue.

However, voluntary employer contributions were not subject to the same penalties, debt collection mechanisms which applied to compulsory employer contributions.

The amendments ensure that the same penalties and debt collection mechanisms apply to both voluntary and compulsory employer KiwiSaver contributions. The amendments also update a number of existing cross-references in the Act.

### Key features

Voluntary employer KiwiSaver contributions are brought within the penalties and recoveries regimes. Both compulsory and voluntary employer KiwiSaver contributions are brought within the of money interest regime.

### Application date

The amendments applied from 30 March 2021.

### Detailed analysis

#### *Bringing voluntary KiwiSaver contributions within the penalties regime*

The amendment brings voluntary employer KiwiSaver contributions within the penalties regime in Part 9 of the Act.

The definition of "tax" in section 3(1) of the Act has been amended. The amendment replaces the specific reference to "compulsory employer contribution[s]" with the more generic "KiwiSaver Act 2006 employer contributions" in section 3(1)(a)(iii)(CC) so that it includes both compulsory and voluntary employer KiwiSaver contributions.

Additionally, in order to not imply the exclusion of voluntary employer KiwiSaver contributions, paragraph 3(1)(a)(viii) of the definition has been repealed.

#### *Bringing voluntary employer KiwiSaver contributions within the PAYE deduction rules*

The amendment is designed to ensure that the PAYE administration provisions of the Act apply to voluntary employer KiwiSaver contributions.

Section 4A(3) of the Act extends the PAYE withholding and deduction rules to a range of deductions prescribed under other pieces of legislation. While section 4A(3)(bc) includes compulsory employer KiwiSaver contributions, it did not mention voluntary employer KiwiSaver contributions.

The amendment replaces the reference to "compulsory employer contributions" with the more generic "KiwiSaver Act 2006 employer contributions".

#### *Bringing voluntary employer KiwiSaver contributions within the recoveries rules*

The recoveries provision in section 157 of the Act allows the Commissioner to make deductions from any amounts payable to a taxpayer who has overdue income tax. Section 157(10) includes its own definition of "income tax".

Previously, paragraph (h) of this definition included compulsory employer contributions, but not voluntary employer contributions. The amendment adds "KiwiSaver Act 2006 employer contributions" to the definition, thus extending it to include voluntary employer KiwiSaver contributions.

#### *Bringing voluntary and compulsory employer KiwiSaver contributions within the use of money interest regime*

Part 7 of the Act contains the UOMI rules, but section 120B(bb) specifically excluded unpaid compulsory employer KiwiSaver contributions.

The amendment to section 120B(bb) repeals this exclusion. This, coupled with the amendment to the definition of "tax" (above), brings compulsory and voluntary employer KiwiSaver contributions under the UOMI regime.

#### *Minor cross-referencing error corrected*

The definition of "tax" in section 3(1)(a)(iii)(CD) of the Act has been amended by replacing the reference to section "101I(5) of the KiwiSaver Act 2006" with section "141(5) of the KiwiSaver Act 2006".

The reason for this amendment is that section 101I was repealed on 1 December 2014 by section 90 of the Financial Markets (Repeals and Amendments) Act 2013. The equivalent section is now section 141(5) of the KiwiSaver Act 2006.

Sections 4A(3)(a)(bc), 120B(bb) and the definition of "income tax" in 157(10) of the Act have been similarly amended as these also referred to section 101I(5) of the KiwiSaver Act 2006.

## Amending the definition of "deferrable tax"

*(Section 3 of the Tax Administration Act 1994)*

The amendment alters the definition of "deferrable tax" to include consequential amendments from an amended assessment.

### Background

When a taxpayer has a dispute with Inland Revenue, they are only required to pay a proportion of the tax owing until the dispute is settled. This amendment provides for the situation where an amendment to the liability of one taxpayer affects an associated taxpayer which was not provided for previously.

For example, a company may have part of its expenditure disallowed as a deduction, which alters the amount of a loss offset made to another company in the same group. Prior to this amendment both entities had to object or challenge the assessments.

### Key features

This amendment alters the definition of deferrable tax to include consequential amendments resulting from an amended assessment that is in the disputes process.

### Application date

The amendment applies from 30 March 2021.

## Clarifying the definition of "initial provisional tax liability"

*(Section YA 1 of the Income Tax Act 2007)*

This is a minor amendment correcting an error made in the definition of "initial provisional tax liability" when the provisional tax threshold was changed from $2,500 to $5,000.

### Background

The provisional tax threshold increased from $2,500 to $5,000 following amendments contained in the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020. To do this, all references to the old threshold of $2,500 were changed to $5,000.

In doing this, a change was made to the definition of "initial provisional tax liability" in section YA 1 of the Income Tax Act 2007, which could adversely affect some taxpayers. This amendment adds a transitional provision to the definition of "initial provisional tax liability", so that taxpayers who were over the old threshold but were not over the new threshold do not become initial provisional taxpayers again.

An "initial provisional tax liability" applies to a taxpayer who has not been required to pay provisional tax in the previous four years because their residual income tax is beneath the threshold for paying provisional tax.

### Key features

The transitional provision provides that a person who, in the previous four years, had residual income tax of more than $2,500 but not more than $5,000 does not have an initial provisional tax liability.

### Application date

The amendment applies from 1 April 2020.

## Restricting the ability to challenge a tax position

*(Sections 89D and 89DA of the Tax Administration Act 1994)*

The amendment restricts the ability of a taxpayer to challenge a tax position to ensure taxpayers cannot circumvent the four-month time limit for challenging an assessment by making a voluntary disclosure.

### Background

Previously, it was arguable that taxpayers could circumvent the time limit for challenging an assessment by making a voluntary disclosure for a particular item, which could allow them to reopen the entire original assessment circumventing the four-month time limit for challenging an assessment.

Section 89D of the Tax Administration Act 1994 outlines when a taxpayer can issue a notice of proposed adjustment (NOPA). Section 89D(1) stated:

*If the Commissioner-*

*(a) Issues a notice of assessment to a taxpayer; and*

*(b) Has not previously issued a notice of proposed adjustment to the taxpayer in respect of the assessment, whether or not in breach of section 89C,-*

*The taxpayer may, subject to subsection (2), issue a notice of proposed adjustment in respect of the assessment except to the extent to which the assessment takes into account amounts arising under subpart HB of the Income Tax Act 2007.*

This arguably meant that if a taxpayer issues a voluntary disclosure and then receives a notice of assessment when they have not previously been issued a NOPA, they could then issue a NOPA for the entire return even if they are outside the four-month time limit for issuing a NOPA.

A similar rule was contained in section 89DA.

**Example 92**

Kstew Winers Limited (KWL) is a company that specialises in the sale of cheap imported wine. KWL files its 2020 tax return and receives an assessment on 20 April 2021. KWL has four months to object to or challenge the assessment, which expires on 24 August 2021.

On 6 October 2021 KWL makes a voluntary disclosure for the 2020 tax return indicating it had overclaimed expenses of $5,000 relating to personal air travel to Paris. The Commissioner accepts the voluntary disclosure and issues an amended assessment on 4 February 2022. On 11 March KWL files a notice of proposed adjustment to the Commissioner's assessment arguing that some unrelated income is not taxable as it was a capital gain.

By making the voluntary disclosure KWL has been able to extend the four-month challenge time limit for its original tax return.

The amendment means that if a taxpayer issues a NOPA for an assessment from a voluntary disclosure they are limited to the issues raised in the voluntary disclosure, which is identical to the position that applies to the Commissioner in section 138B(1) of the Tax Administration Act 1994.

### Key features

This amendment restricts the ability of a taxpayer to challenge a tax position where the taxpayer makes a voluntary disclosure to issues raised in the voluntary disclosure, where the voluntary disclosure is issued outside the four-month challenge time limit.

### Application date

The amendment applies from the date of enactment.

## Aligning the definition of benefit

*(Section 11 of the Accident Compensation Act 2001)*

*(Sections CF 1, CW 33, LC 13, MA 8, MB 1, MC 6, MD 8, MD 11, MD 14, MF2, MG 3, MG 4, MZ 2, RD 5, RD 11, YA 1 of the Income Tax Act 2007)*

*(Sections 349, 350 and Schedule 2 of the Social Security Act 2018)*

*(Section 40 of the Student Loan Scheme Act 2011)*

*(Sections 24B, 80KK, 80KN, 80KP, 80KU, 225A of the Tax Administration Act 1994)*

The definition of a main benefit in the Acts administered by Inland Revenue has been aligned with that used in the Social Security Act 2018.

### Background

The tax Acts and the Social Security Act both contain lists of various benefit payments in their definition sections. However, the defined terms are different for the same list of payments.

Aligning the definitions between the Acts will reduce confusion and misunderstanding of the law.

### Key features

The amendments align the definition of a main benefit in the tax Acts with that used in the Social Security Act 2018. The amendments:

- add a new definition of main benefit in section YA 1 of the Income Tax Act 2007
- remove the definition of "specified living allowance" as it is redundant, and
- make consequential amendments.

### Application date

The amendment applied from 30 March 2021, being the date of enactment.

## Clarifying the Commissioner's power to take copies of documents

*(Sections 17C(1), 17(5))*

The amendment clarifies the Commissioner's powers to take copies and the like in relation to documents produced under various sections of the Tax Administration Act 1994 ("Act") also extends to documents produced in the course of the Commissioner's inquiries under section 17I of the Act.

### Application date

The amendments came into force from 30 March 2021.

### Key features

The amendment extends the Commissioner's powers under section 17C to take copies and the like in relation to documents provided under other sections of the Act to documents which are produced in the course of the Commissioner's inquiries under section 17I.

The amendment also makes minor changes to better reflect the interaction of the sections with one another.

### Background

The various information collection provisions in the Act were rewritten and consolidated as part of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019. As part of this exercise, section 17C was introduced to consolidate the various provisions relating to the ability of the Commissioner to take extracts from documents and the like.

Section 17I (which allows the Commissioner to conduct inquiries to obtain information) did not contain rules for taking extracts and the like and therefore was not included within the scope of section 17C.

### Detailed analysis

All section references are to the Tax Administration Act 1994.

Sections 17 to 17M primarily deal with information collection. These provide the Commissioner with broad and wide-ranging powers to obtain information in specific circumstances. For example:

- section 17B allows the Commissioner to require information or the production of documents
- section 17G allows the Commissioner to obtain information from large multinational groups; and
- section 17H permits the Commissioner to apply to the District Court for an order requiring the provision of information.

Operating in concert with these sections is section 17C(1). This section provides the Commissioner with the power to take extracts or copies of documents produced by a person under sections 17, 17B, 17G and 17H.

However, there is another section under which the Commissioner may require a person to produce documents. Section 17I allows the Commissioner to conduct inquiries in relation to a person's tax liability. Under this section, the Commissioner may require a person to produce documents in their position or control.

Unfortunately, section 17C(1) did not contain an explicit reference to section 17I. The absence of a reference to section 17I within section 17C(1) made it unclear whether the Commissioner had the same powers over documents produced under section 17I such that she is able to, for example, take extracts or copies of documents produced under section 17I in the same way as she is under sections 17, 17B, 17G and 17H.

The amendment to section 17C(1) addressed this issue by incorporating a specific reference to section 17I within section 17C(1). This makes it clear that the Commissioner is able to take extracts or copies of documents produced under section 17I.

#### *Minor amendments*

The amendment also makes minor changes to better reflect the interaction of the sections with one another. These are:

- replacement of the term "provided" with "produced" in section 17C(5);
- replacing the reference within section 17C(1) to section 17H with the more specific, section 17H(6); and
- repealing the reference within section 17C(1) to section 17G, as documents are not provided or produced under this section.

### Hybrid rules remedials

*(Sections FH 3, FH 7, FH 12, and GC 8 of the Income Tax Act 2007)*

The Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 contains a number of remedial changes to the hybrid and branch mismatch rules to ensure they apply as intended.

### Background

Subpart FH of the Income Tax Act 2007 contains the hybrid and branch mismatch rules, which seek to neutralise tax advantages from the different ways that countries treat financial instruments and entities for tax purposes. These rules were inserted into the Income Tax Act 2007 by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018, following a series of recommendations by the OECD through reports released in 2015 and 2017. Details of these rules can be found in *Tax Information Bulletin* Vol 31 No 3 April 2019.

Several remedial changes were identified as being necessary to ensure that the hybrid and branch mismatch rules did not result in over taxation.

### Application date

The amendments apply for income years beginning on or after 1 July 2018.

### Detailed analysis

#### *Non-resident group members' ability to group surplus assessable income*

Section FH 12 of the Income Tax Act 2007 allows a deduction for hybrid mismatch amounts to the extent that the person paying or deriving the amounts has income which is taxable in New Zealand and can be expected to also be taxed in the other country giving rise to the hybrid mismatch. This income can arise in a different income year from the year the hybrid mismatch amount is allowed. Further details of section FH 12 can be found in Tax Information Bulletin Vol 31 No 3 August 2019 from page 80.

The policy intent of the surplus assessable income (SAI) grouping mechanism in section FH 12(10) is to ensure that the right economic outcome is reached for the group as a whole (that is, if one group company has more SAI than it can use, it can make its SAI available to another wholly owned group member who has a hybrid or branch mismatch for which a deduction would otherwise be denied).

On enactment of the hybrid and branch mismatch rules, New Zealand-resident companies were able to group their SAI, but non-resident companies paying tax in New Zealand were not. As a consequence of this limitation, the SAI of a non-resident company could go unused, while another non-resident in the same group is denied New Zealand deductions (where the non-resident company's SAI could have otherwise been used to offset the denied deductions). This could result in over-taxation of the group as a whole.

To address this problem, section FH 12(10) was amended to remove the requirement that companies eligible to group SAI must be resident in New Zealand.

#### *Payments made within a consolidated group are to be included in SAI calculation*

The SAI calculation formula includes an "exempt" item, which covers exempt dividends between two New Zealand members of a 100% commonly owned group that are taxable to a foreign owner. The inclusion of these dividends in the formula is to reflect that the hybrid nature of an entity may cause a payment to be taxable in another jurisdiction, with no corresponding deduction for the payer in New Zealand.

This same hybridity issue can arise in relation to payments made within a New Zealand consolidated group. Such a payment will be excluded income in New Zealand and no deduction will be permitted for the payer. However, if the payee is fiscally transparent in another country, income may be recognised in that country in relation to the consolidated group transaction. Such a payment was not captured in the SAI calculation formula, despite the same income potentially being subject to tax in two jurisdictions: first in New Zealand to the consolidated group on recipient of a third-party payment, and second in the parent jurisdiction, as a regarded transaction between New Zealand companies in the same consolidated group.

To address this issue, the SAI calculation formula in section FH 12(4)(c) was amended to treat excluded income under section CX 60 (that is, payments made within a New Zealand consolidated group) the same way as exempt dividends within New Zealand wholly-owned groups.

To reflect that section FH 12(4)(c) no longer applied solely to exempt income, the item "exempt" is now referred to in the legislation as "deductionless".

### *Hybrid financial instrument rule application to income fully taxed in New Zealand*

The hybrid financial instrument rule in section FH 3 of the Income Tax Act 2007 does not deny a deduction for a payment where a country or territory outside New Zealand recognises the payment as ordinary income. However, it was identified that the section could still apply to deny a deduction where New Zealand taxes a payment received by the payee at the full applicable tax rate (generally where the payee is a non-resident with a New Zealand branch).

As there is no deduction/no-inclusion hybrid mismatch if a payment is taxed as ordinary income of the payee in New Zealand, this is not a situation that should be captured by the hybrid rules. Therefore, section FH 3 was amended so that the section does not apply to a payment taxed at a payee's full applicable rate in any country or territory, including New Zealand.

### *Transfer pricing deemed arm's length amount – exception to deductions denied under the hybrid rules*

Where inadequate consideration is received under a transfer pricing arrangement, section GC 8(1) of the Income Tax Act 2007 deems an arm's length amount to have been received by the payee for income and withholding tax purposes. Section GC 8(2) contains an exception to this rule, where the general rule in section GC 8(1) will not apply and the below arm's length consideration will stand. Generally, this is the case where the payer of the amount is subject to full New Zealand tax and the payee is not.

Section GC 8(2)(b) did not account for the hybrid rules, meaning section GC 8(1) could deem a taxpayer to have income taxable in New Zealand under the transfer pricing rules, in circumstances where the hybrid rules could then deny or limit deductions for expenses arising in relation to that income. This is an issue for interest-free loans, where if a deemed arm's length amount of interest were to be substituted under section GC 8(1), then the hybrid rules could apply to deny a deduction for the deemed amount (that is, non-resident withholding tax would be payable on a deemed interest payment, with the payment not being deductible to the payer). This is an unintended outcome.

In relation to interest-bearing loans, section GC 8(2) also did not take into account disallowances under the hybrid rules where, from a policy perspective, the focus of the rule is on deferring – not permanently denying – a deduction, as is the case under sections FH 5, FH 8 and FH 9 (in these cases, the interest may still be deductible in future if there is sufficient "surplus assessable income"). As a deduction may become available for the interest payment in these instances, the original policy rationale for section GC 8(2) outlined above would apply and section GC 8(1) should not apply.

Section GC 8(2)(b) was amended accordingly to address these two issues.

### *Reverse hybrid rule clarification on how it applies to hybrid entities and branches*

Under section FH 7 of the Income Tax Act 2007, deductions may be denied to hybrid entities in circumstances where the relevant income is received but is not taxable due to the application of exemptions (and not the non-recognition of income) in the recipient jurisdiction.

The intended scope of this provision is discussed in *Tax Information Bulletin* Vol 31 No 3 April 2019 (pages 66-68) and provides that the appropriate application of the rules depends on whether a branch or hybrid entity is involved in the transaction.

Section FH 7 is intended to deny a deduction for a payment in two separate situations:

- where the payment is not taxable because of a branch mismatch
- where the payment is not taxable because it is made to a reverse hybrid in another country.

A payment will be non-taxable because of a branch mismatch if paragraphs (a), (b)(i), (c), (d) and (e)(i) of section FH 7 are met. A payment will be non-taxable because it is made to a reverse hybrid if paragraphs (a), (b)(ii), (c), (d) and (e)(ii) of section FH 7 are met.

There were three issues with the section:

- As drafted, the section could apply if paragraphs (a), (b)(i), (c), (d) and (e)(ii) are met, or if paragraphs (a), (b)(ii), (c), (d) and (e)(i) are met. This was not intended.
- With respect to (b)(ii), it should only apply if the amount is treated under the law of the payee country as being income of a person who is in the same control group as the payer and is not the payee. If the income is income of the payee, the payment will not be to a reverse hybrid. However, the previous drafting of the subparagraph meant that it could have applied if the income was income of the payee.
- Also with respect to paragraph (b)(ii), it should be met if: (a), the person treated as deriving the income under the law of the payee country is a person in the payer's control group who is not the payee; or (b), the arrangement is a structured arrangement (regardless of whether or not that last mentioned person is in the same control group as the payer).

All three of these issues were dealt with by amendments to section FH 7.



## Restrictions on depreciation rates for depreciable property transferred to an associate

*(Section EE 40 of the Income Tax Act 2007)*

The Income Tax Act has been amended to allow a new owner of an asset to change depreciation rates where the depreciation rate has changed in legislation.

### Background

Non-residential buildings are depreciable at a rate of 1.5% or 2% from the 2020–21 income year, as opposed to the 0% that applied from the 2011–12 income year.

The depreciation rate applies where a person has acquired depreciable property from an associate is restricted by section EE 40 to the rate used by the associate. As a result, a purchaser who acquired a non-residential building from an associate would have been restricted to a 0% depreciation rate, rather than the allowable rate of 1.5% or 2%.

Section EE 40 is intended to ensure that the purchaser is unable to claim more depreciation for the item than the associated person would have been able to claim had they retained the item. However, it is not intended to limit a purchaser's use of a deprecation rate where the rate has been changed by legislation as this is a change clearly intended by Parliament.

### Key features

Section EE 40 has been amended to allow a new owner of an asset to change depreciation rates where the depreciation rate has changed in legislation.

### Application date

The amendment applies from the 2020-21 income year.

## Foreign trust registration and filing fees

*(Section 3 of the Tax Administration Act 1994)*

### Background

The foreign trust disclosure rules impose fees for both registering a foreign trust (section 59B of the Tax Administration Act 1994) and for filing its annual return (section 59D).

Technically, these fees are a "tax" under section 3(1), as they are payable to the Commissioner under a tax law and are not explicitly excluded from being a "tax". As a result, late payment penalties and use of money interest (UOMI) can automatically apply when these fees are not paid. However, it was never intended that these fees be "taxes" or for these fees to attract penalties and UOMI.

### Key features

The definition of "tax" in section 3 of the Tax Administration Act is amended to clarify that foreign trust registration and annual return filing fees are not taxes.

### Application date

The amendment applies from 21 February 2017, when the foreign trust disclosure rules came into force.

## Using passport numbers in the student loan customs information search

*(Section 208 of the Student Loan Scheme Act 2011)*

The amendment adds the passport number of student loan borrowers as information that may be shared between Inland Revenue and New Zealand Customs for the purposes of information matching.

### Background

A student loan borrower who is New Zealand based is entitled to an interest-free student loan and loan repayments are based on their income. Interest is payable on student loans for borrowers who are based overseas.

Inland Revenue undertakes an information match with Customs for the purposes of verifying whether a borrower is in New Zealand or overseas. This information allows Inland Revenue to ensure that borrowers are correctly treated as New Zealand or overseas-based, and to identify borrowers in serious default when they leave or enter New Zealand.

The legislation governing this match allows Inland Revenue to share the borrower's name, date of birth and IRD number with Customs. The legislation now allows Inland Revenue to improve the accuracy of this match by adding the borrower's passport number to this information.

### Key features

A borrower's passport number has been included as information the Commissioner may provide to the Chief Executive of Customs for the purposes of establishing an information-matching programme.

### Application date

The amendment applies from 1 October 2021 to align with planned system changes as part of Inland Revenue's Business Transformation Programme.

## Tax treatment of distributions on wind-up of an approved unit trust

*(Section HC 6(2)(ab) of the Income Tax Act 2007)*

The Income Tax Act 2007 has been amended so that all income distributed by an approved unit trust, including income derived in the year it is distributed, will be trustee income and taxed at 28%. This change will support the wind-up of Bonus Bonds.

### Background

Bonus Bonds is the only approved unit trust. It pays tax on trustee income at 28% and then pays prizes out of prior year after-tax earnings, as tax-free distributions to beneficiaries. Bonus Bonds has never distributed beneficiary income, so it has not needed to hold tax rate details for its beneficiaries.

On 26 August 2020 it was announced that Bonus Bonds would stop accepting new investments with the intention of being wound up. In the year it winds up, it will have to distribute income derived to beneficiaries including income derived in the same year.

The general treatment of trust distributions, which also previously applied to an approved unit trust, is that income is beneficiary income, and taxed at beneficiaries' marginal tax rates, if it is paid to a beneficiary in the income year it is derived or within a certain period after the end of the income year.

### Key features

New section HC 2(ab) excludes income derived by a trustee of an approved unit trust from being beneficiary income. Under existing section HC 7(1), income derived by a trustee of a trust that is not beneficiary income is trustee income.

As Bonus Bonds is the only approved unit trust this change will not affect any other trusts.

### Application date

The amendment applies from Bonus Bonds' income year starting on 1 April 2021.

### Adding the problem gambling levy to section 184(5) of the Tax Administration Act 1994

*(Section 184(5) of the Tax Administration Act 1994)*

#### Background

As tax types transition to Inland Revenue's new technology platform as part of its Business Transformation, Inland Revenue is able to direct credit refunds through section 184A of the Tax Administration Act 1994. However, the problem gambling levy did not fall within the definition of "tax" in section 184A(5).

The problem gambling levy is now included in the definition of "tax" in section 184A(5) of the Tax Administration Act 1994.

#### Application date

The amendment applies from the date of enactment.

## Maintenance items

#### Background

The proposed amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

The amendments in table 10 correct any of the following:

- ambiguities
- compilation issues
- cross-references
- drafting consistency, including the readers' aids – for example, the defined terms lists
- grammar
- consequential amendments arising from substantive rewrite amendments, and
- inconsistent use of terminology and definitions.

#### Application dates

Application dates for each proposed amendment are stated in table 10.

NEW LEGISLATION

## Detailed analysis

### Table 10: Maintenance amendments

| Enactment | Section | Amendment | Application date |
|---|---|---|---|
| **Income Tax Act 2007** | ED 3(3) | Correction of terminology | 2 November 2012 |
| | EE 40(10) | Correction to cross-reference | 1 April 2008 |
| | EL 2(5) | Correction of terminology | 1 April 2019 |
| | EL 3(b), (c) | Correction of terminology and correction to cross-reference | 1 April 2019 |
| | EW 15I | Correction to cross-reference | 1 January 2019 |
| | EX 21(6) | Correction of terminology, correct defined terms list | 2 November 2012 |
| | EX 28(c) | Correction of terminology, correct defined terms list | 2 November 2012 |
| | EY 5(2) | Correction of terminology | 1 July 2010 |
| | EY 7(1) | Correction of terminology, correct defined terms list | 1 July 2010 |
| | EY 11(8) | Correction of terminology, correct defined terms list | 2 November 2012 |
| | FE 22(3)(b) | Correction of grammar | 1 April 2008 |
| | GB 20(1)(a) | Correction of grammar | 1 April 2014 |
| | HC 24 | Correct defined terms list | 1 April 2009 |
| | RA 1(gc) | Correction to cross-reference | 1 July 2016 |
| | RC 5(8) | Correction of terminology | 2 November 2012 |
| | RE 2(5) | Correction of terminology, correct defined terms list | 1 April 2008 |
| | YA 1 "annual branch equivalent tax account return" | Correction to cross-reference | 1 July 2012 |
| | YA 1 "business premises" | Correction of terminology | Assent |
| | YA 1 "claim" | Correction of terminology | 2 November 2012 |
| | YA 1 "dispose" | Correction of cross-reference | 27 March 2021 |
| | YA 1 "dividend" in paragraph (e) | Correction of terminology | 1 April 2008 |
| | YA 1 "early life regime application day" | Correction of terminology | 1 July 2010 |
| **Tax Administration Act 1994** | 3 "deferrable tax" | Correction of terminology | Assent |
| | 3 "tax" | Correction to cross-reference | 1 April 2020 |
| | 139A | Correction to cross-reference | Assent |
| | 139AB | Correction to cross-reference | 18 March 2019 |
| | 157(10) | Correction to cross-reference and terminology | 1 April 2020 |
| **Student Loan Scheme Act 2011** | 34 "Australian complying superannuation scheme" | Correction of terminology | 1 April 2012 |
| **KiwiSaver Act 2006** | 4 "Kiwisaver status" | Correction of terminology | Assent |

# Taxation Administration (Direct Credit of Problem Gambling Levey Refunds) Order 2021

An Order in Council was made on 24 May 2021 to cover an amount of problem gambling levy that may be refunded by direct credit under section 184A of the Tax Administration Act 1994.

The provisions in sections 184A and 184B require tax refunds to be paid by direct credit to a bank account nominated by the taxpayer. Problem gambling levy is included to the definition of "tax" for the purpose of making refunds. Tax Administration (Problem Gambling Levy) Order 2021 mandates the direct credit of refunds of the problem gambling levy when TAB NZ, casino operators, gaming machine operators and the Lotteries Commission pay excess in error. Section 184A still allows the Commissioner to provide an exemption when direct crediting would cause undue hardship or is impracticable.

## Background

Compulsory direct crediting for income tax, gaming machine duty, casino duty, lottery duty, and totalisator duty was implemented when the administration of these tax products was moved to Inland Revenue's new technology platform (START). The intention is for all refunds for tax types administered by Inland Revenue to be refunded by direct credit. Implementing this is occurring progressively by issuing Orders in Councils as the various tax types and associated refunds have been shifted to the new technology platform.

## Application date

The Order in Council comes into effect on 25 June 2021.

# BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

## Product Ruling – BR Prd 21/03: Zap NZ Limited

This is a product ruling made under s 91F of the Tax Administration Act 1994.

### Name of person who applied for the Ruling

This Ruling has been applied for by Zap NZ Limited (ZNZL).

### Taxation Laws

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of ss 5(11E), 5(11EA), 5(11F) and 5(11G).

### The Arrangement to which this Ruling applies

The Arrangement is the provision of the ZNZL digital gift card and loyalty scheme. Under the scheme, customers purchase Zap, which can be redeemed by Zap Holders for goods or services supplied by Participating Retailers.

Further details of the Arrangement are set out in the paragraphs below.

#### Background

1. ZNZL has created a digital gift card and loyalty scheme that is powered by blockchain technology. ZNZL has also developed the Zap App, which is downloadable from Apple iTunes or Google Play on mobile phones and other electronic devices. The Zap App allows customers to create a digital wallet in which the New Zealand dollar value of Zap is stored for its customers to use to purchase goods or services from Participating Retailers.

### Details of Arrangement

2. Capitalised terms in this Ruling have the same meaning as in the Terms and Conditions of Zap and the Zap Participating Retailer Agreement (discussed in [7]).

#### Parties to the Arrangement

3. The Arrangement involves:
   - the Applicant: ZNZL, being the owner of the ZNZL gift card and loyalty scheme and the Issuer of Zap;
   - Issuing Agents: Red Rat Clothing Limited (RRCL) and other retailers that ZNZL appoints to issue Zap;
   - Holders: people who hold Zap through the Zap App and are entitled to receive goods or services when they redeem Zap;
   - Participating Retailers: the stores in which Holders may redeem the Zap for goods or services; and
   - Customers: people who purchase Zap and who may not be the same people as the Holders if they allow another person to use or take possession of the Zap.
4. ZNZL is a New Zealand resident company, and all Participating Retailers are resident in New Zealand.
5. ZNZL, Issuing Agents and all Participating Retailers are "registered persons" (as defined in s 2(1)).

6. Zap Terms and Conditions state that only an Approved Holder can acquire, hold or use Zap. An Approved Holder must be an individual legally residing in New Zealand and over the age of 10 years.

## Terms and conditions documented

7. The terms and conditions of the ZNZL digital gift card and loyalty scheme are set out in two documents (which are not materially different to the updated documents as at 5 October 2020 provided to Inland Revenue on 29 January 2021:
   - Terms and Conditions of Zap;
   - Zap Participating Retailer Agreement.
8. ZNZL has entered into a Zap Participating Retailer Agreement with RRCL. RRCL is the Original Participating Retailer.
9. Participating Retailers are those that agree to accept Zap from Holders in exchange for goods and services. Participating Retailers accede to the Participating Retailer Agreement by executing and delivering an Accession Agreement in the form of Schedule 1 in the Zap Participating Retailer Agreement.
10. Each Participating Retailer undertakes to each other Party to accept Zap for redemption against goods or services with effect from the Effective Date on the terms of the Participating Retailer Agreement and the Zap Terms and Conditions. Zap Terms and Conditions are defined as the terms and conditions relating to Zap accessible on the Zap website **https://zap.me**.
11. Clause 3.1 of the Zap Participating Retailer Agreement provides for the appointment of Participating Retailers as Issuing Agents by the Issuer. Clause 3.2 states that the Issuing Agent issues Zap to customers as agent for the Issuer, and not in its own capacity.
12. Clause 2.7 of the Zap Participating Retailer Agreement states:

    > The Issuer and each Participating Retailer agree that each Zap operates as a digital gift voucher for the purposes of the GST Act. In particular, the Issuer and each Participating Retailer agree that section 5(11G) of the GST Act applies and the time of supply is on redemption of Zap for goods or services provided by the Participating Retailer to the customer. The Issuer does not redeem Zap for goods or services.

## Zap gift cards

13. Zap are prepaid, digital gift cards that are issued by ZNZL or Issuing Agents on behalf of ZNZL.
14. Zap are underpinned by blockchain technology to ensure the gift cards cannot be spent twice. According to the applicant, this creates a more secure form of gift card, as the blockchain technology prevents the forgery and fraud that can occur with traditional forms of gift cards.
15. Zap operates through the Zap App that is downloadable from Apple iTunes and Google Play.
16. The Zap App allows customers to create a digital wallet, in which the New Zealand dollar value of Zap is stored for use by its customers to purchase goods or services from Participating Retailers.

## Purchase of gift cards

17. A customer can purchase Zap from RRCL as Issuing Agent. Purchases can also be made online or through the Zap App.
18. A customer purchases Zap using New Zealand dollars. One "Zap" is the equivalent of one New Zealand dollar. In addition, RRCL offers eligible customers a revolving consumer credit facility called EZPay to assist them to finance their purchases. RRCL allows approved EZPay customers to exchange some or all of their undrawn EZPay credit for Zap. Once payment is received or customer credit is approved, RRCL transfers the Zap into the customer's digital wallet that they have downloaded onto their phone or other electronic device.
19. The amount of Zap a customer can load onto their digital wallet is unlimited.

## Holders own the gift card

20. A Holder's Zap is held in their digital wallet. The Holder is deemed to be the rightful legal owner of the Zap for all purposes.

## Redeeming Zap

21. Holders can use Zap to purchase goods and services from Participating Retailers. Holders redeem Zap by using a QR code or through a Participating Retailer's point-of-sale system.

### Right to assign

22. Holders and Participating Retailers can gift, sell, assign or transfer their Zap to any Approved Holder.
23. Holders can gift or sell peer to peer just as any card or paper-based gift card can be. By operating through the Zap App, these transactions are more secure and more traceable.

### No right to redeem for cash

24. A Holder cannot redeem their Zap for cash from ZNZL, a Participating Retailer or any other person.
25. If a Holder's Zap is lost, stolen or not exchanged for goods and services, Zap cannot be refunded or replaced, and the Holder cannot receive any equivalent value denominated in New Zealand dollars or other currency.

### Expiry

26. Each Participating Retailer has the right to set an expiry date, at its discretion, after which it is no longer required to accept Zap gift cards in exchange for goods and services. The Participating Retailer must notify ZNZL in writing of the expiry date at least 48 hours prior to it taking effect. The expiry date will be published on the Zap App.

### Loyalty

27. When a customer purchases goods or services using Zap, Participating Retailers may choose to offer the customer bonus Zap which the retailer has purchased from ZNZL. Bonus Zap the customer receives are available for the customer to use on a later transaction and may lapse if not used within a short timeframe. Bonus Zap may be redeemed with that Participating Retailer, or another Participating Retailer that accepts Zap. This is to encourage loyalty to Zap Participating Retailers.

### Reconciliation process

28. In accordance with the monthly reconciliation process, the Issuing Agent must remit funds held as Issuing Agent to the Issuer, and Participating Retailers may exchange Zap received from customers as consideration for goods and services for New Zealand dollars. Where an Issuing Agent is also a Participating Retailer, the amounts may be offset. Bonus Zap purchased may also be netted off. The Issuer remits the dollar value of the Zap less the Exchange Fee to Participating Retailers. The Participating Retailer is not charged any fees from the Effective Date until the date falling six months after the Effective Date (the Grace Period).

## How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

(a) Under s 5(11E) and s (11EA), no supply occurs in respect of any Zap:
   (i) issued by ZNZL to a Holder;
   (ii) issued by any Issuing Agent to a Holder;
   (iii) issued by ZNZL to a Participating Retailer; or
   (iv) supplied by a Participating Retailer to a Holder under the loyalty scheme (that is, bonus Zap).

(b) Section 5(11F) does not apply to the supply of goods and services, when Zap are redeemed for goods or services.

(c) Under s 5(11G), any goods and services Participating Retailers supply to Holders on redemption of Zap are treated as a supply of goods and services for GST purposes. Accordingly, Participating Retailers are required to charge Holders GST and account for GST output tax when Holders acquire goods and services by redeeming their Zap.

## The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 6 August 2020 and ending on 31 March 2023.

This Ruling is signed by me on the 8th day of April 2021.

**Howard Davis**
Group Leader – Tax Counsel Office

# QUESTION 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 21/04: When an employer is party to an employee share scheme, when does an employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arise?

### Question

When an employer is party to an employee share scheme (ESS), when does an employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arise?

### Answer

When an employer is party to an ESS, the employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) will arise when the related "employee amount" from the formula in s DV 27(7) is recognised for the ESS employee.

The "employee amount" is the amount for the ESS employee calculated on the share scheme taxing date in accordance with the formula in s CE 2(1). Where the amount calculated is:

- negative, the ESS employee has a deduction **on the share scheme taxing date** (subject to any applicable general limitations, other than the employment limitation);
- positive and the employer has an employee benefit reporting obligation in respect of the ESS employee, then the ESS employee derives the amount **on the ESS deferral date**; and
- positive and the employer does not have an employee benefit reporting obligation in respect of the ESS employee, then the ESS employee derives the amount **on the share scheme taxing date**.

This QWBA does not consider arrangements that may be subject to the application of ss BG 1 (Tax Avoidance) or GB 49B (Employee Share Schemes).

### Key provisions

Income Tax Act 2007 – ss CE 2 and DV 27

### Key terms

**Employee benefit reporting obligation** means the requirement to provide employment income information under s RD 22(3) of the Income Tax Act 2007 and ss 23E to 23H of the Tax Administration Act 1994, as modified by s 23K of the Tax Administration Act 1994, in relation to a benefit received under an ESS.

**Employee share scheme** (ESS) has the meaning given in s CE 7. Broadly, an ESS (subject to specified exceptions) is an arrangement with a purpose or effect of issuing or transferring shares in a company to a person (an ESS employee) who will be, is, or has been an employee (or shareholder employee) of that company or of another company in the same group, if that arrangement is connected to the person's employment or service. It also includes the provision of shares to an associate of the ESS employee, if the arrangement is connected with the ESS employee's employment or service.

**ESS deferral date** means the 20th day after the share scheme taxing date for the benefit.

**Share scheme taxing date** has the meaning given in s CE 7B. Broadly, this date is the earlier of the following dates (subject to specified exclusions):

- The first date when the shares are held by or for the benefit of an ESS employee (or associate) and, after which, under the provisions of the ESS, there is:
  - no material risk that beneficial ownership may change or that a right or requirement in relation to the transfer or cancellation of the shares may operate;
  - no benefit accruing to the ESS employee (or associate) in relation to a fall in value of the shares; and
  - no material risk that there will be a change in the terms of the shares affecting the value of the shares.
- The date when the shares or related rights of an ESS employee (or associate) are cancelled or are transferred to a person who is not associated with an ESS employee.

## Explanation

1. A new regime for the taxation of employee share schemes (ESSs) came into force on 29 September 2018 (enacted by the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018).
2. The objective of the new regime is to ensure neutral tax treatment of ESS benefits as compared with other forms of employee remuneration. That is, to the extent possible, the tax position of both the employer and the employee should be the same whether remuneration for labour is paid in cash or shares.

### Employee amounts – s CE 2

3. Section CE 1(1)(d) provides that a benefit received under an employee share scheme in connection with a person's employment or service is income of the person.
4. Section CE 2(1) provides that an ESS employee receives a benefit for the purposes of s CE 1(1)(d) equal to the positive amount calculated on the share scheme taxing date using the following formula:

   share value – consideration paid + consideration received – previous income.
5. The terms used in the formula are defined in s CE 2(2). Broadly, the terms have the following meanings:
   - **Share value** is the market value of the shares or related rights owned by an ESS employee or associate on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights.
   - **Consideration paid** is the amount of consideration paid or payable by an ESS employee or associate in relation to the transfer of the shares or related rights under the ESS.
   - **Consideration received** is the amount of consideration paid or payable to an ESS employee or associate in relation to a transfer or cancellation of the shares or related rights under the ESS.
   - **Previous income** is the total amount of income under s CE 1(1)(d) that the ESS employee has in relation to the shares or related rights before 29 September 2018.
6. While the formula in s CE 2(1) is calculated on the share scheme taxing date, s CE 2(7) to (9) provides that if the employer has an employee benefit reporting obligation in respect of the benefit (a positive amount calculated using the formula), then the ESS employee is treated as deriving employment income in relation to the benefit on the ESS deferral date (20 days later).
7. If the formula in s CE 2(1) results in a negative amount (for example, because the share value on the share scheme taxing date is less than the consideration paid in relation to the transfer), ss CE 2(3) and DV 27(4) provide that it is a deduction for the ESS employee. Section DV 27(4) supplements the general permission and overrides the employment limitation (see s DV 27(10)). The ESS deferral date under s CE 2(7) to (9) applies only to benefits (positive amounts calculated using the formula in s CE 2(1)); that is, not negative amounts.

### Employer amounts – s DV 27

8. Subject to the general permission (s DA 1) and general limitations (s DA 2), a deduction is available to employers for ESS benefits that matches the income to employees in timing and quantity, as explained in [9] to [21].
9. Where an employer is party to an ESS and is the employing or contracting company for an ESS employee, s DV 27(6) effectively provides that the employer has an amount of expenditure or loss equal to the positive amount calculated in accordance with the formula in s DV 27(7):

   employee amount – previous deductions.
10. The terms used in the formula are defined in s DV 27(8). Broadly, the terms have the following meanings:
    - **Employee amount** is the amount for the ESS employee calculated under the formula in s CE 2(1). This could be a positive or negative amount.
    - **Previous deduction**s is the total amount of deductions that have been allowed to the employer or an associate for expenditure or loss incurred in relation to the employee amount before 29 September 2018.
11. If the result of the formula in s DV 27(7) is a negative amount then, instead of expenditure or loss under s DV 27(6), the amount is income of the employer under ss DV 27(9) and CV 20.
12. The employer's expenditure or loss under s DV 27(6) is generated by the formula in s DV 27(7). Section DV 27(2) denies a deduction for most other expenditure or loss on an ESS – for example, payments to an ESS trust or reimbursements paid to a parent for issuing shares.

## Timing

13. The uncertainty addressed in this QWBA arises because timing under s DV 27 for the expenditure or loss under s DV 27(6) or the income under s DV 27(9) arising for the employer is unclear. Ordinary principles for when expenditure is incurred or income is derived cannot be applied given the nature of the expenditure or loss arising under s DV 27(6). The expenditure or loss does not relate to any actual cost, outlay or receipt, but is created by the formula in s DV 27(7). The obligations under the ESS may not even be obligations of the employer – for example, it may be a parent company required to issue shares or make payment to the employee under the ESS. If some form of actual cost or outlay is incurred by the employer, s DV 27(2) generally denies a deduction for most of those costs or outlays.
14. The main feature of the formula in s DV 27(7) is the "employee amount" that is calculated for the ESS employee on the share scheme taxing date under s CE 2(1).
15. As set out in [5] to [7], the recognition of the "employee amount" by the ESS employee is deferred by 20 days (to the ESS deferral date) under s CE 2(7) to (9) where the employer has an employee benefit reporting obligation in respect of the benefit (being a positive amount calculated under s CE 2(1)). In such a case, the benefit is treated as paid on the ESS deferral date under s RD 6(3)(a) of the Income Tax Act 2007 and s 23K(1) of the Tax Administration Act 1994.
16. An employer will usually have an employee benefit reporting obligation for a benefit under s RD 22. An exception is where the ESS employee is a former employee for whom the employer has not chosen under s RD 7B to withhold an amount of tax.
17. The above circumstances lead to uncertainty as to whether the employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arises on the share scheme taxing date or the ESS deferral date.
18. Purpose and context are relevant for determining the meaning of a provision (in light of s 5 of the Interpretation Act 1999, *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36 at [22] to [24] and *CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175 at [444]). In light of the purpose and context of the new ESS regime and s D 27, the Commissioner considers that the employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) resulting from the application of the formula in s DV 27(7) arises at the same time the related "employee amount" calculated under s CE 2(1) and used in s DV 27(7) is recognised.
19. This is because the purpose and context of the new ESS regime demonstrate that the share benefit is to be taxed in the same way as an equivalent cash payment followed by an acquisition of shares in the issuing company. This is shown in ss CE 2 and DV 27 for income and deductions arising under an ESS, and in s CD 43(6E) to (6K) for the related adjustments to the calculation of the employer's available subscribed capital. These provisions apply as follows:
    - The ESS employee is treated as receiving the share benefit when they have done everything they need to earn the shares and hold them in the same way as any other shareholder. This occurs through the calculation of the benefit being performed on the share scheme taxing date: ss CE 2(1) and CE 7B.
    - The employer is treated as incurring an equivalent cost at the same time as the employee recognises the income. The deduction to employers is to match the income to employees in timing and quantity. This occurs through the calculation of the deduction being linked to the "employee amount" under s DV 27(6) to (8).
    - The employer (in the usual case) has an uplift in its available subscribe capital under s CD 43(6E) to (6K) at the same time.
20. The recognition of the benefit by the ESS employee is deferred by 20 days (to the ESS deferral date) under s CE 2(7) to (9) when an employer has employee benefit reporting obligations. This period is to allow employers time to compile and report the relevant information. Where that deferral applies, the recognition of the amount calculated for the employer under s DV 27(7) must also be deferred in that manner. While the benefit can be calculated as at the share scheme taxing date, the employer has not "incurred" anything in respect of the amount calculated under s DV 27(7) at that time. The employer does not have any obligations existing for the expenditure or loss under s DV 27(6) prior to s DV 27 creating it.

## Examples

21. The following examples are of a general nature and assume the general permission (s DA 1) is met and the general limitations (s DA 2) to deductibility do not apply.

**Example 1 – Simple option: market value increasing**

On 1 April 2020, A Co issues an option to its employee to subscribe for 10,000 shares in A Co for an exercise price of $1 (being the market value of a share in A Co on 1 April 2020). The option may be exercised only after 31 March 2023, provided the employee has been in continuous employment with A Co for the three-year period from when the option was issued. The employee exercises their option on 15 July 2023 and is issued shares on the same day.

The share scheme taxing date is when the option is exercised and shares are issued to the employee on 15 July 2023. The market value of the shares on 15 July 2023 is $15,000. The exercise price paid by the employee for the shares is $10,000.

The employee's benefit of $5,000 is calculated in accordance with s CE 2(1) on 15 July 2023.

If the employer has employee benefit reporting obligations for the benefit, the employee is treated as deriving employment income of $5,000 under ss CE 1(1)(d) and CE 2 on the ESS deferral date of 4 August 2023. The related employer expenditure or loss under s DV 27(6) also arises on 4 August 2023.

If the employer does not have employee benefit reporting obligations for the benefit (for example, because, after having been in continuous employment with A Co for three years, the employee leaves employment before exercising the option and A Co has not elected to withhold an amount of tax), s CE 2(7) to (9) and the ESS deferral date do not apply, and the employee is treated as deriving employment income of $5,000 under ss CE 1(1)(d) and CE 2 on the share scheme taxing date of 15 July 2023. The related employer expenditure or loss under s DV 27(6) also arises on 15 July 2023.

**Example 2 – Simple option: market value decreasing**

This example uses the same facts as in example 1, except the market value of the shares on 15 July 2023, the share scheme taxing date, is $9,500. The exercise price paid by the employee for the shares is still $10,000.

The employee's deduction of $500 is calculated and arises on the share scheme taxing date of 15 July 2023 in accordance with ss CE 2 and DV 27(4).

The related employer income of $500 under ss DV 27(9) and CV 20 also arises on 15 July 2023.

## References

### Legislative references

**Income Tax Act 2007**

Sections BG 1, CD 43(6E) to (6K), CE 1(1)(d), CE 2, CE 7, CE 7B, CV 20, DA 1, DA 2, DV 27, RD 6(3)(a), RD 7B, RD 22

**Tax Administration Act 1994**

Sections 23E to 23H, as modified by s 23K

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

**Interpretation Act 1999**

Section 5

### Case references

*Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36

*CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175

# INTERPRETATION STATEMENT

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

## IS 21/03: GST – Registration of non-residents under section 54B

### Introduction

1. Section 54B has been described as an "enhanced" registration system for non-residents. It allows non-resident businesses to recover GST input tax on goods and services acquired in New Zealand for the purpose of making supplies outside New Zealand. GST operates on what is known as the "destination principle" where goods and services are taxed in the country in which those services are consumed by end-users. GST should not generally be an economic burden on businesses that form part of a supply chain.
2. In 2011, a government discussion document about GST on cross-border supplies between businesses,[1] recognised that the existing legislation worked well for domestic supplies between GST-registered persons, and where goods and services were exported and zero-rated, but that it did not work as effectively for non-resident businesses receiving services in New Zealand. This was because, although non-resident businesses were able to register for GST under s 51, their ability to claim input tax credits for GST incurred was limited. This limitation was because the legislation allows a deduction for input tax for goods or services to the extent that those goods or services are used for or available for use in making taxable supplies. Taxable supplies are supplies made in New Zealand. Therefore, non-resident businesses that made no supplies in New Zealand or that predominantly made supplies outside New Zealand were unable to get a full deduction for the GST that they had incurred in New Zealand. This resulted in such businesses bearing the New Zealand GST as an economic cost despite the services being acquired for making supplies to final consumers outside New Zealand.
3. Since s 54B was introduced in 2013, there have been several remedial amendments to it and related provisions. In addition, legislation was introduced affecting non-resident suppliers of cross-border remote services and low value goods imported into New Zealand. This means more non-residents are treated as making supplies in New Zealand and have an obligation to register under the standard registration provisions. Commentators say that eligibility for registration under s 54B has not always been well understood.
4. The requirements for a person to be eligible to register under s 54B are cumulative. This statement steps though each requirement and provides examples as to how it applies.



[1] *GST: Business-to-Business Neutrality across Borders* (government discussion document, Policy Advice Division, August 2011).

## Registration of non-residents – s 54B

5. The requirements for registration of certain non-resident suppliers are set out in s 54B(1):

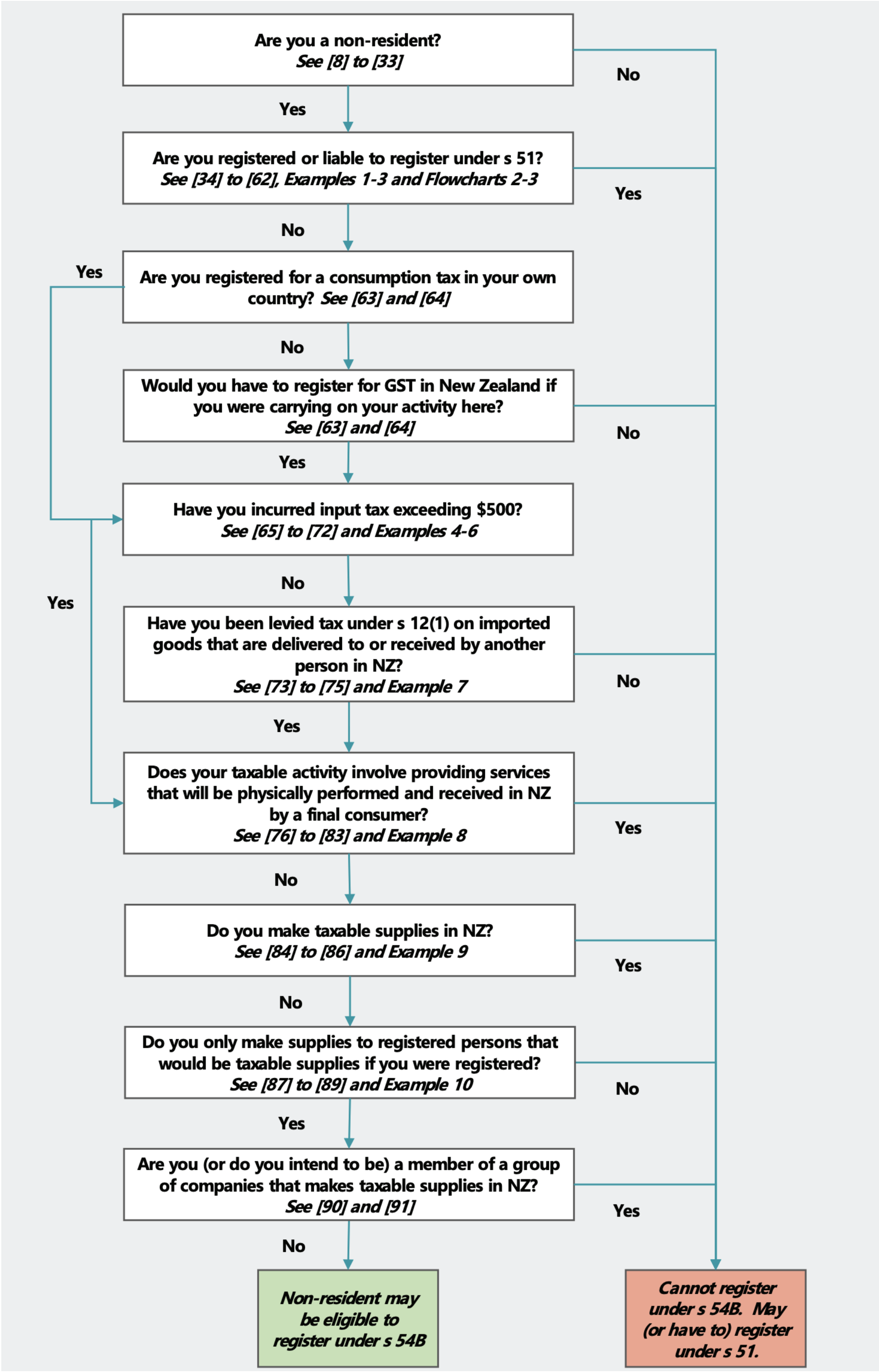
> **54B Requirements for registration for certain non-resident suppliers**
>
> *Requirements for registration*
>
> (1) Despite section 51(3), the Commissioner may register a person who is a non-resident and has not become liable to be registered under section 51(1) if the Commissioner is satisfied that the person meets the following requirements:
>
> (a) the person—
>
> (i) is registered for a consumption tax in the country or territory in which they are resident; or
>
> (ii) if the country or territory in which the person is resident does not have a consumption tax, or has a consumption tax that does not apply to the person's activities, is carrying on a taxable activity, and has a level of taxable activity in a country or territory that would render them liable to be registered under section 51(1) if they were carrying out the taxable activity in New Zealand; and
>
> (b) for the first taxable period after the date of registration in New Zealand, the amount of the person's input tax is likely to be more than $500 or the person is likely to be liable for tax levied under section 12(1) in relation to the importation of goods that are received by another person or that the person delivers to another person; and
>
> (c) the person's taxable activity does not involve a performance of services in relation to which it is reasonably foreseeable that the performance of the services will be received in New Zealand by a person other than in the course of making taxable or exempt supplies; and
>
> (d) the person is not making, or intending to make,—
>
> (i) a taxable supply in New Zealand; or
>
> (ii) a supply in New Zealand that would be a taxable supply if the person were registered under section 51, to a person in New Zealand who is not a registered person; and
>
> (e) the person is not, and does not intend to become, a member of a group of companies that makes taxable supplies in New Zealand.

6. The seven requirements for registration of certain non-resident suppliers are that:

- the person must be a non-resident for GST purposes (discussed from [8]);
- the person is not liable to be registered under s 51 (discussed from [34]);
- the person is registered for a consumption tax in the country or territory in which they are resident or the level of their taxable activity would require them to register in New Zealand if they were carrying on that activity in New Zealand (discussed from [63]);
- the amount of the person's input tax exceeds $500 or the person is likely to be liable for tax levied under s 12(1) in relation to imported goods received by another person or that are to be delivered to another person (discussed from [65]);
- the person's taxable activity does not involve the performance of services where those services will be received by an end-user in New Zealand (discussed from [76]); and
- the person is not making or intending to make taxable supplies in New Zealand (discussed from [84]); or the person is not making supplies to an unregistered person that would be taxable supplies if the supplier was registered (discussed from [87]), and
- the person is not a member, or intending to become a member, of a group of companies that makes supplies in New Zealand (discussed from [90]).

7. These seven requirements are summarised in *Flowchart 1 - Overview of registration requirements of s 54B* with reference to the relevant discussion and examples. As the third, fourth and sixth requirements contain alternative requirements this translates to nine questions that may be required to be satisfied to meet registration under s 54B.

**Flowchart 1 - Overview of registration requirements of s 54B**



## First requirement – person must be "non-resident"

8. The first requirement for registration of certain non-resident suppliers is that the person must be non-resident. Most people are familiar with the income tax test for residency and know whether they are non-resident for income tax purposes. However, the GST definition of resident is wider, so some non-residents may be treated as a resident for GST purposes and may be unaware of the difference in the two definitions.

9. The law relating to determining whether a person is non-resident for GST purposes is set out in "IS 18/07: Goods and services tax – zero-rating of services related to land", *Tax Information Bulletin* Vol 31, No 1 (February 2019): 17. The Commissioner's view on when a person is resident for GST purposes is consolidated in "GST – Definition of a resident" (exposure draft PUB00390, Inland Revenue, May 2021). The following analysis reproduces parts of and is consistent with that analysis.

10. A non-resident is defined in s 2 to mean a person "to the extent that the person is not resident in New Zealand". The definition of "resident" in s 2 modifies the income tax definition of resident by providing for three exceptions in paras (a) to (c). Paragraphs (b) and (c) relate to unincorporated bodies and the effect of the day count tests in the income tax residency tests.

11. The exception in para (a) deems a person to be resident **to the extent** that the person carries on their taxable or other activity in New Zealand **from a fixed or permanent place** in New Zealand that is **related to** that activity. Non-residents may have a presence or connection to a place in New Zealand related to their taxable or other activities and may be unsure whether that is sufficient to for them to be treated as resident for GST purposes.

12. Therefore, the key considerations are what is meant by:
    - a "taxable activity or other activity";
    - a "fixed or permanent place";
    - "relating to that activity or other activity"; and
    - "to the extent that", and whether it means a person can be both resident and non-resident for GST purposes.

### Taxable activity or other activity

#### Taxable activity

13. For the purposes of the resident definition, it is the taxable activity that needs to "relate to" the fixed or permanent place. The term "taxable activity" is also relevant to the second and third requirements for registration under s 54B set out in [6].

14. A broad definition for this term is given in s 6(1)(a) with certain activities being specifically excluded in s 6(3). The key requirements of a taxable activity are:
    - there must be an activity;
    - that is carried on continuously or regularly by a person; and
    - that involves the making of taxable supplies.

15. Notably, however, s 6(3) excludes certain activities from being taxable activities. Examples of excluded activities are:
    - the making of exempt supplies (such as the supply of financial services and the supply of accommodation in a dwelling); and
    - private recreational pursuits or hobbies.

16. Determining whether a taxable activity is being carried on is always a question of fact. It involves examining all the circumstances of the particular case. The concept of a taxable activity is not considered further in this statement as it is covered in other publications, see "IS 20/04: Goods and services tax – GST treatment of short-stay accommodation", *Tax Information Bulletin* Vol 32, No 6 (July 2020): 69.

### Other activity

17. Paragraph (a) in the definition of "resident" also includes "other" activities in its scope. The terms "activity" and "other activity" are not defined in the Act.

18. The word "activity" has a broad meaning. It may refer to "a course of conduct or series of acts which a person has chosen to undertake or become engaged in": *Newman v CIR* (1994) 16 NZTC 11,229 (HC). Similarly, the Court of Appeal in *CIR v Bayly* (1998) 18 NZTC 14,073 said, at 14,078:

    > In its standard dictionary usage, "activity" is "the state of being active; the exertion of energy, action" (Oxford English Dictionary). In the context of ss 6 and 8 [of the Goods and Services Tax Act 1985] it points to the combination of tasks undertaken, or course of conduct pursued by the registered person and whether or not it amounted to a business, trade or profession in the ordinary sense.

19. Both *Newman* and *Bayly* discuss the meaning of an "activity" in their discussion of a "taxable activity". The Commissioner's view is that "activity" in "other activity" bears the same meaning.

20. The reference to "other activities" expands the range of activities so that not only "taxable activities" can result in residency under the Act.

21. However, the Commissioner's view is that "other activity" is not limited to activities that involve the making of exempt supplies. The word "other" implies that Parliament intended a wide variety of activities to be covered by para (a).

## Fixed or permanent place

22. For para (a) to apply, a person must also have a "fixed or permanent place" in New Zealand relating to the taxable activity. The term "fixed and permanent place" is not defined in the Act.

23. In the context of para (a), it is the place that must be "fixed" or "permanent". The word "place" indicates a physical location or a link to a particular geographical point.

24. The ordinary meanings of the words "fixed" and "permanent" indicate that the physical location must be lasting and unchanging and not temporary. An element of permanence is necessary, so a transient connection to a place will not meet the test. However, ownership of the physical location is not necessary. Having a fixed or permanent place merely requires the person to have that place permanently at their disposal or be able to use that place on a permanent basis.

25. The Commissioner notes that a similar concept of "fixed establishment" is used in the Income Tax Act 2007, and the phrase "permanent establishment" is used in New Zealand's double tax treaties. Case law discusses the meanings of these phrases, and the concepts likely overlap with the concept of a "fixed or permanent place".

26. However, the Commissioner's view is that the "fixed establishment" and "permanent establishment" concepts are not equivalent to "fixed or permanent place" under the Goods and Services Tax Act. The ordinary meaning of the word "establishment" is arguably a stronger term than "place", so "place" may be wider in its scope. Also, tax treaties often define a "permanent establishment" to include or exclude specific types of establishments. In contrast, the definition in the Goods and Services Tax Act is general in its terms.

### "Relating" to that taxable activity or other activity

27. Paragraph (a) also requires the person to have a fixed or permanent place "relating" to the taxable activity or other activity.

28. The ordinary meaning of "relating" is a connection between things: *Concise Oxford English Dictionary* (12th ed, Oxford University Press, Oxford, 2011). This suggests a degree of connection is required between the fixed or permanent place and the relevant activity.

29. The context of the provision does not appear to require a departure from the ordinary meaning of "relating to". The provision is part of the definition of "resident" in the Act, which affects both the imposition of GST on supplies under s 8 and whether supplies can be zero-rated under the zero-rating provisions. In general, these provisions are intended to give effect to the destination principle, under which supplies of goods and services are taxed in the jurisdiction where the goods and services are consumed. Requiring a connection between a person's activity in New Zealand and a fixed or permanent place in New Zealand before the person is considered resident for GST purposes (and subject to GST at the standard rate) appears to be consistent with that purpose.

### "To the extent that"

30. For GST purposes, a person is deemed to be resident in New Zealand "to the extent that" the person carries on, in New Zealand any taxable activity or any other activity while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity.
31. Similarly, the definition of "non-resident" in s 2 states that non-resident "means a person **to the extent that** the person is not resident in New Zealand" [emphasis added].
32. The use of the phrase "to the extent that" implies that a single legal person can, for the purposes of the Act, be both resident and non-resident.
33. Further discussion on when a person is resident for GST purposes (including examples) can be found in "GST – Definition of a resident" (exposure draft PUB00390, Inland Revenue, May 2021).

## Second requirement – person is not liable to be registered under s 51

34. The second requirement for registration of certain non-resident suppliers is whether the person has become liable to be registered under s 51(1) for GST purposes. The opening words to s 54B(1) are:

> Despite section 51(3), the Commissioner may register a person who is a non-resident **and has not become liable to be registered under section 51(1)** if the Commissioner is satisfied that the person meets the following requirements: [Emphasis added]

35. Registration under s 54B is not available for non-residents who are liable to be registered under s 51. Special rules apply to a non-resident who is carrying on a taxable activity in branches or divisions. This is discussed at [62].
36. Key considerations as to whether a non-resident is liable to register under s 51 are the value of the supplies made and where the supplies are treated as being made. Where supplies are treated as being made depends on the type of supply and who is being supplied. The place of supply rules are covered in greater detail in [40] to [57] and Flowchart 2 and Flowchart 3.
37. Recent legislative changes have made certain non-resident suppliers liable to be registered under s 51 for goods and services supplied to New Zealand residents. This is because certain supplies are treated as being made in New Zealand:
    - Suppliers of "low-value imported goods" that are treated as supplied in New Zealand may be liable to be registered. These changes relate to "distantly taxable goods" that a non-resident supplies to a person who resides in New Zealand. For further information, see "Taxation (Annual Rates for 2019-2020, GST Offshore Supplier Registration, and Remedial Matters) Act, 2019", *Tax Information Bulletin*, Vol 31, No 8 (September 2019): 2.
    - Secondly, suppliers of cross-border "remote services" (such as e-books, music and video streaming, online games and other software services) may be liable to be registered. These services do not necessarily have a connection either to a place of supply or to the recipient of the supply. For further information, see "Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016", *Tax Information Bulletin* Vol 28, No 6 (July 2016): 12.
    - However, if the non-resident supplier only makes these supplies to registered persons for use in their taxable activity, the supplies will be treated as supplied outside New Zealand. In that case, the non-resident supplier would not be liable to register under s 51 and the non-resident may be able to register under s 54B.
    - Where a person is not liable to be registered under s 51 they may be able to register voluntarily under s 51(3), see [60] to [61].

### General registration provision – s 51

38. A person becomes liable to be registered where that person carries on a taxable activity and, in the course of carrying on all taxable activities, makes supplies in New Zealand where the total annual value of those supplies exceeds $60,000: s 51(1). Section 51(1) states:

> **51 Persons making supplies in course of taxable activity to be registered**
>
> (1) Subject to this Act, every person who, on or after 1 October 1986, carries on any taxable activity and is not registered, becomes liable to be registered—
>
> (a) at the end of any month where the total value of supplies made in New Zealand in that month and the 11 months immediately preceding that month in the course of carrying on all taxable activities has exceeded $60,000 (or such larger amount as the Governor-General may, from time to time, by Order in Council declare):
>
> provided that a person does not become liable to be registered by virtue of this paragraph where the Commissioner is satisfied that the value of those supplies in the period of 12 months beginning on the day after the last day of the period referred to in the said paragraph will not exceed that amount:

(b) at the commencement of any month where there are reasonable grounds for believing that the total value of the supplies to be made in New Zealand in that month and the 11 months immediately following that month will exceed the amount specified in paragraph (a):

provided that any such person shall not become liable where the Commissioner is satisfied that that value will exceed that amount in that period solely as a consequence of—

(c) any ending of, including a premature ending of, or any substantial and permanent reduction in the size or scale of, any taxable activity carried on by that person; or

(d) the replacement of any plant or other capital asset used in any taxable activity carried on by that person; or

(e) the supply, to persons who are non-residents but are physically present in New Zealand, of telecommunications services that are treated as being supplied in New Zealand under sections 8(6) and 8A.

## Taxable activity

39. The first requirement of s 51(1) is that the person is carrying on a taxable activity. This was discussed from [13] to [16] regarding whether a person is a non-resident.

## Place of supply

40. To be liable to register under s 51(1), the person must be making supplies "in New Zealand" in the course or furtherance of a taxable activity. To determine the place of supply for goods, follow Flowchart 2 (after [53]) and for services, follow Flowchart 3 (after [60]).

41. Section 8(2) provides a general rule for where supplies are made. Under the general rule, supplies made by a New Zealand resident are deemed to be supplied in New Zealand and supplies by a non-resident are deemed to be supplied outside New Zealand. Section 8(2) states:

> **8 Imposition of goods and services tax on supply**
>
> …
>
> (2) For the purposes of this Act, goods and services shall be deemed to be supplied in New Zealand if the supplier is resident in New Zealand, and shall be deemed to be supplied outside New Zealand if the supplier is a non-resident.

42. The general rule is displaced by s 8(3) for certain supplies by non-residents:

> (3) Despite subsection (2), goods and services are treated as being supplied in New Zealand if the supplier is a non-resident and—
>
> (a) the goods are in New Zealand at the time of the supply and are not distantly taxable goods to which paragraph (ab) applies; or
>
> (ab) the goods are distantly taxable goods to which subsection (4E) does not apply; or
>
> (b) the services are physically performed in New Zealand by a person who is in New Zealand at the time the services are performed; or
>
> (c) the services are remote services supplied to a person resident in New Zealand, other than services that are physically performed in New Zealand by a person who is in New Zealand at the time the services are performed.

43. The four circumstances in which the goods or services are treated as supplied in New Zealand are when the:

- goods are in New Zealand at the time of supply (s 8(3)(a));
- goods are "distantly taxable goods", unless the supply is to a registered person for the purposes of carrying on that person's taxable activity (s 8(3)(ab));
- services are physically performed in New Zealand by a person in New Zealand at the time the services are performed (s 8(3)(b)); and
- services are "remote services" supplied to a person resident in New Zealand (other than services physically performed in New Zealand) (s 8(3)(c)).

44. To understand these rules, it is helpful to consider:

- where the goods are at the time of supply; or
- where the services are performed; and
- whether the recipient of the supply is receiving the goods or services for the purpose of carrying on their taxable activity.

## Goods in New Zealand at time of supply

45. Where goods are in New Zealand at the time of supply they are treated as supplied in New Zealand, even though they are supplied by a non-resident or the contract is made outside New Zealand. However, this rule can be overridden if the recipient is a registered person who is acquiring the goods for the purposes of that person's taxable activity. This is provided for in s 8(4), which treats the supply as being made outside New Zealand unless the supplier and recipient agree to treat the supply as made in New Zealand:

> (4) Despite subsection (3), if a supplier who is a non-resident supplies goods and services, to which subsection (3)(a) or (b) would apply but for this subsection, to a registered person for the purposes of carrying on the registered person's taxable activity, the goods and services are treated as being supplied outside New Zealand unless the supplier and the recipient of the supply agree that this subsection will not apply to the supply.

46. *Example 1: Supply in New Zealand* demonstrates that a non-resident may not be able to register under s 54B, and may in fact be required to register under s 51, where they are making supplies of goods that are in New Zealand at the time of supply.

**Example 1: Supply in New Zealand**

Non-resident company Merino has an agreement to supply merino cot blankets to another non-resident company Natural Baby Supplies, who is not registered for GST in New Zealand.

Merino arranges to have the cot blankets made in New Zealand by High Country Wool Co. Natural Baby Supplies intends to supply these to a retailer in New Zealand (NZ Wool Babies). Under the agreement between Merino and Natural Baby Supplies, the blankets will be delivered to NZ Wool Babies store.

Although the supply by Merino to Natural Baby Supplies is made between two non-resident companies, the goods are in New Zealand at the time of supply. This means that Merino could be liable to register under s 51, if the annual value of the supplies exceeds $60,000, or if less than $60,000 it could voluntarily register.

Merino could not register under s 54B to claim back GST charged to it by (High Country Wool) because it is making supplies in New Zealand to an unregistered person.

## Services performed in New Zealand

47. If the services a non-resident supplies are performed in New Zealand, they will be treated as supplied in New Zealand by s 8(3)(b). However, provided the recipient is a registered person who is acquiring the services for the purposes of their taxable activity, the services will be treated as supplied outside New Zealand under s 8(4). Again, **unless** the supplier and recipient agree that s 8(4) does not apply and have the services treated as supplied in New Zealand.

48. The reason for allowing supplies of goods or services to a registered person (for the purposes of their taxable activity) to be treated as supplied outside New Zealand is because the transaction is GST neutral – the non-resident supplier would charge GST output tax and the resident recipient would deduct the GST as input tax, if the goods or services were acquired for the purposes of making taxable supplies.

49. Some non-residents wanting to register under s 54B are not aware that they will be treated as making supplies in New Zealand. This can arise where a subcontractor performs the services in New Zealand. Understanding the contractual arrangements entered into and identifying exactly what is being supplied, who is making the supply and who is receiving the supply is required to determine where a supply is treated as being made.

50. The following examples consider whether services are performed in New Zealand and are therefore treated as supplied in New Zealand. In *Example 2: Services performed by a sub-contractor*, the non-resident is treated as making supplies in New Zealand, as the services are performed in New Zealand by a subcontractor. In *Example 3: Professional services advice to a non-resident*, the non-resident is not treated as making supplies in New Zealand because the services performed in New Zealand are a separate supply to the services provided by the non-resident.

**Example 2: Services performed by a sub-contractor**

A non-resident electrical contractor (Sparky Inc) has an agreement with a non-resident retail clothing company to fit out all its retail outlets. A new retail outlet is to be opened in New Zealand. Sparky arranges for the New Zealand fit out to be carried out by a New Zealand firm, Zappadee Ltd. The contract with Zappadee Limited is for goods and services amounting to $65,000. Because the services are performed in New Zealand, Zappadee Ltd charges Sparky GST at the standard rate. Sparky wants to know if it can register under s 54B to claim back the GST charged.

Sparky cannot register under s 54B because Sparky is providing services to the non-resident clothing retailer which are performed in New Zealand through Zappadee Ltd and received in New Zealand. As the value of the supplies exceeds $60,000 Sparky is liable to register under s 51.

**Example 3: Professional services advice to a non-resident**

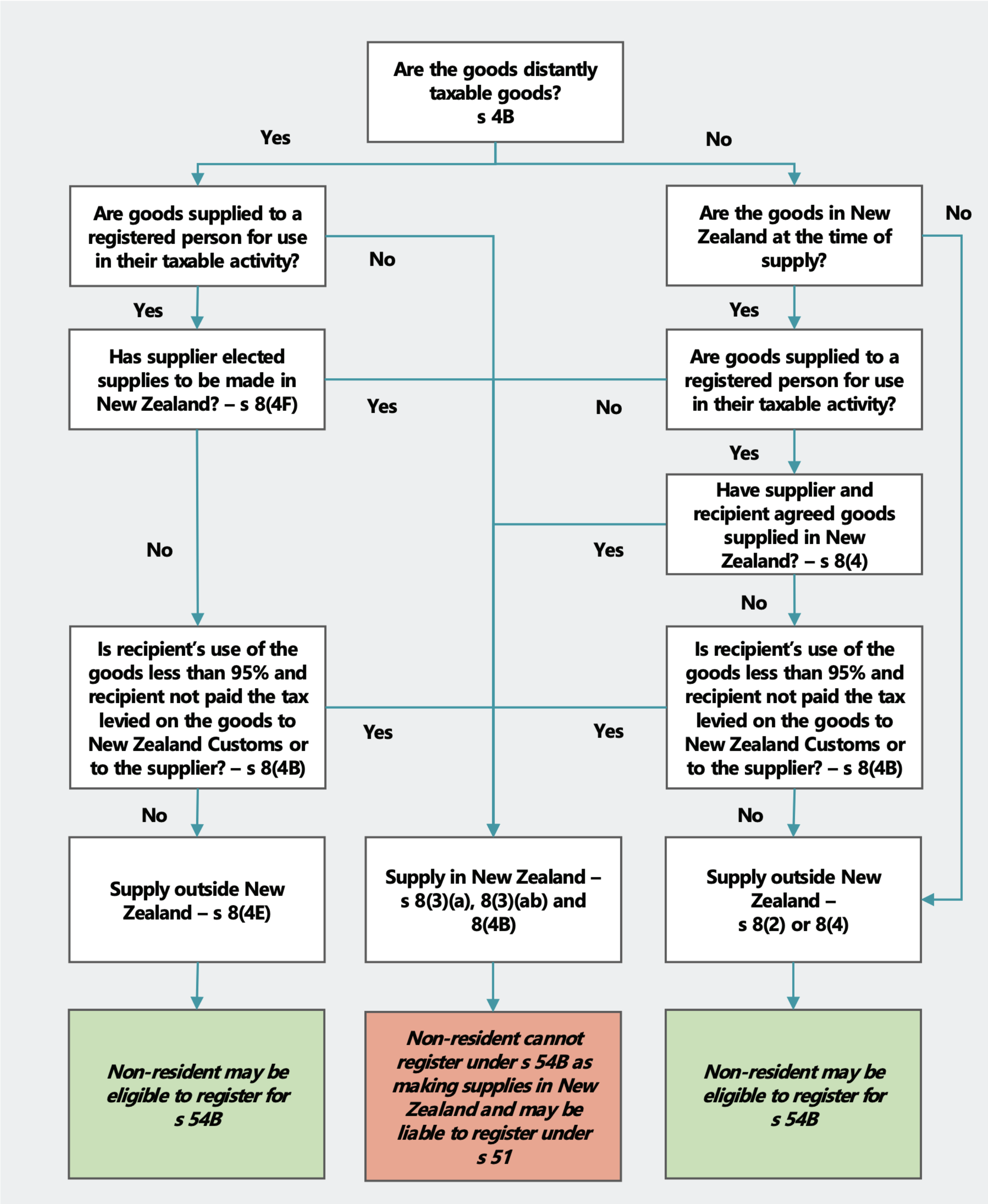
A professional services firm in Hong Kong is asked to provide advice to a non-resident group of companies looking to make a global acquisition. The firm is asked to provide a report on the merits of the global transaction. The Hong Kong firm seeks advice from a New Zealand professional services firm in relation to a property situated in New Zealand. The New Zealand firm carries out due diligence in relation to the land and, as requested, prepares transfer documents to a nominee company to enable the land to be transferred if the transaction proceeds. Because the transfer documents would result in a change to the land the law firm has charged GST at the standard rate. This is a very minor component of a large-scale transaction.

In this case the supply by the Hong Kong firm of its global impact assessment on a multinational contract is a separate supply to its client. The services performed in New Zealand are a separate supply to the Hong Kong firm. The Hong Kong professional services firm could register under s 54B.

## "Distantly taxable goods" or low value imported goods

51. "Distantly taxable goods", defined in s 4B, are often referred to as "low value imported goods". These are generally defined as goods that:
    - individually have a value of NZ$1,000 or less;
    - are outside New Zealand at the time of supply;
    - are supplied by a non-resident; and
    - are delivered to New Zealand.
52. These distantly taxable goods are treated as supplied in New Zealand, unless the goods are supplied to a registered person for the purposes of carrying on the registered person's taxable activity: s 8(4E). This is consistent with the principle that GST should not be a cost to businesses in the supply chain and should be borne by the final consumer. However, the non-resident supplier can choose that s 8(4E) not apply, which means the goods would be treated as supplied in New Zealand. The circumstances when they may make this choice are set out in s 8(4F). This choice requires:
    - value of the supply to be no more than $1,000; and
    - non-resident supplier to reasonably expect that more than 50% of the value of supplies made to persons in New Zealand in the following 12 months will be made to non-registered persons.
53. Therefore, where a non-resident supplier of distantly taxable goods supplies goods that exceed the annual threshold of $60,000, that person is liable to register under s 51. Such non-resident suppliers will not be eligible to register under s 54B.
54. *Flowchart 2: Non-resident GST registration under s 54B – Place of supply – goods* illustrates how to determine the place of supply for goods supplied by a non-resident.

**Flowchart 2: Non-resident GST registration under s 54B – Place of supply – goods**




## "Remote services" – not connected to a location

55. A "remote service" is defined as a service where, at the time of the performance of the service, no necessary connection exists between the recipient's physical location and the place of physical performance. These services include the supply of e-books, software, and digital services.

56. A non-resident supplier of remote services to a New Zealand resident will also be treated as making supplies in New Zealand under s 8(3)(c), so potentially liable to register under s 51. However, if the supply of remote services is to a registered person for the purposes of that registered person's taxable activity, the supply is treated as made outside New Zealand. The supplier may choose to treat the supply as made in New Zealand (s 8(4D)) and register under s 51. If the non-resident supplier does so, the supply is zero-rated under s 11A(1)(x), and the person may be able to claim back the amount of GST incurred in making the supplies in New Zealand. Section 11A(1)(x) states:

**11A Zero-rating of services**

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

…

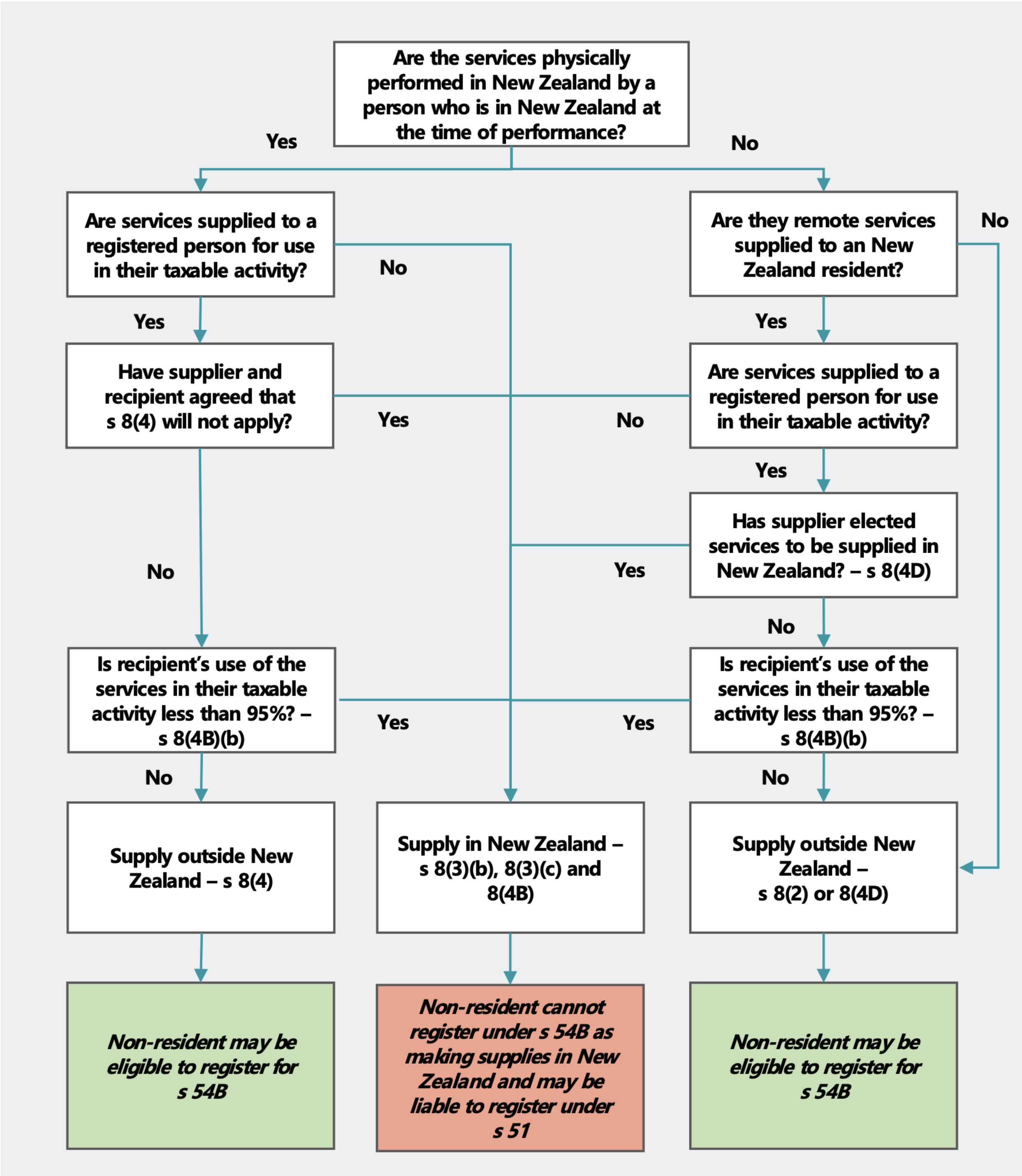
(x) the services are remote services to which section 8(3)(c) applies that are provided to a registered person and the supplier has chosen under section 8(4D) to treat the supply as made in New Zealand.

57. Several rules determine when supplies are received in New Zealand and when non-resident suppliers are required to register under s 51. For more information, see "Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016", *Tax Information Bulletin* Vol 28 No 6 (July 2016): 12.

58. If a person is liable to be registered under s 51, they cannot register under s 54B.

59. *Flowchart 3: Non-resident GST registration under s 54B – Place of supply – services* illustrates how to determine the place of supply of services supplied by a non-resident.

**Flowchart 3: Non-resident GST registration under s 54B – Place of supply – services**



### Voluntary registration

60. A person who is not liable to register under s 51(1) but who carries on a taxable activity may register voluntarily under s 51(3). For example, a non-resident making supplies in New Zealand, where the value of the supplies is below the threshold to require registration, could voluntarily register. This would enable the non-resident to claim GST input tax on goods and services used to make those supplies in New Zealand. However, they could not claim any GST input tax on goods and services used to make supplies overseas.

61. However, for a non-resident who is not making supplies in New Zealand (and this includes a non-resident who only supplies registered persons in New Zealand), then, unless they are registered under s 54B, they are not entitled to recover input tax incurred in New Zealand. The reason for this is that, for a person registered under s 51, input tax deductions are available only to the extent to which the goods and services are used for or are available for use in making taxable supplies in New Zealand.

### Branches or divisions

62. A non-resident person, who has a branch or division making supplies in New Zealand, may register that branch or division under s 51. For the purposes of s 54B, the branch or division is treated as a separate person (s 54B(5)). This means that the non-resident may still apply to be registered under s 54B provided they meet the requirements of s 54B(1).

## Third requirement – person is registered for a consumption tax – s 54B(1)(a)

63. The third requirement for registration of certain non-resident suppliers under s 54B is that the non-resident must be registered for a consumption tax in their home country or be carrying on a taxable activity and making a sufficient level of supplies that would render them liable to be registered under the New Zealand Act. Section 54B(1)(a) provides:

> (i) the person—is registered for a consumption tax in the country or territory in which they are resident; or
>
> (ii) if the country or territory in which the person is resident does not have a consumption tax, or has a consumption tax that does not apply to the person's activities, is carrying on a taxable activity, and has a level of taxable activity in a country or territory that would render them liable to be registered under section 51(1) if they were carrying out the taxable activity in New Zealand;

64. The requirement in s 54B(1)(a) is to ensure the non-resident is a genuine business with a level of activity equivalent to the level at which a New Zealand business would be required to be registered for GST.

## Fourth requirement – input tax exceeds $500 or tax levied under s 12(1) – s 54B(1)(b)

65. The fourth requirement for registration of certain non-resident suppliers under s 54B is that, for the first taxable period after the date of registration in New Zealand:
    - the amount of the person's input tax is likely to be more than $500; or
    - the person is likely to be liable for tax levied under s 12(1) in relation to the importation of goods that are received by another person or that the person delivers to another person.

66. While the provision seems straightforward, some non-residents seeking registration under s 54B have not been able to meet this requirement because they have not been the recipient of the supply or treated as the person who has paid the GST. Section 54B(1)(b) states:

> (b) for the first taxable period after the date of registration in New Zealand, the amount of the person's input tax is likely to be more than $500 or the person is likely to be liable for tax levied under section 12(1) in relation to the importation of goods that are received by another person or that the person delivers to another person;

67. To meet the first part of the requirement in s 54B(1)(b), the non-resident must have incurred "input tax".

### Input tax

68. "Input tax" is defined in s 3A:

> **3A Input tax defined**
>
> (1) **Input tax**, in relation to a registered person, means –
>
> (a) tax charged under section 8(1) on a supply of goods or services acquired by the person:
>
> (b) tax levied under s 12(1) on goods entered for home consumption under the Customs and Excise Act 2018 by the person:
>
> (c) an amount determined under subsection (3) after applying subsection (2).

69. For a person to have "input tax", the supply of goods or services must be "acquired" by the person.

70. For GST purposes, the focus is on the contractual arrangement between the supplier and the recipient of the supply (*Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA)).

71. In determining whether the non-resident has the required level of input tax for s 54B(1)(b), it is necessary to look at the contractual arrangements entered into to determine who has incurred the input tax. In *Example 4: Business incurs expenditure on staff training* and *Example 5: Business incurs expenditure on management conference*, the contractual recipient of the supply is the non-resident company.

**Example 4: Business incurs expenditure on staff training**

Watchtower Limited sends three trainee air traffic controllers to train on simulators in New Zealand. Watchtower doesn't operate in New Zealand. It pays the trainees' course fees and accommodation and incurs GST. Watchtower also reimburses the trainees for incidentals such as meals and local travel costs. At the end of the training the trainees leave New Zealand. Provided the amount of input tax exceeds $500 and Watchtower meets all the other requirements of s 54B, it could register and claim back the input tax paid on its New Zealand business expenses.

**Example 5: Business incurs expenditure on management conference**

PRW is a US company that doesn't trade in New Zealand. PRW organises a conference in New Zealand for its management team. PRW makes all the bookings and pays all New Zealand costs associated with the conference (for example, venue hire, accommodation and meals) and incurs the GST.

Provided the amount of input tax exceeds $500 and PRW meets all the other requirements of s 54B, it can claim the GST paid on its New Zealand business expenses.

72. The non-resident companies incurred input tax on the supplies they received in New Zealand. The non-resident companies are placed in the same position as a New Zealand GST-registered business that would be able to claim input tax deductions on the services it acquired for the purpose of making taxable supplies[2]. However, sometimes the correct contractual position is that the non-resident company seeking to register has not incurred any input tax as shown in *Example 6: Contractual recipient of the supply*.

**Example 6: Contractual recipient of the supply**

A non-resident company (Chefco) is registered for consumption tax in its home territory as a supplier of chef training services. It enters into an arrangement with a New Zealand cooking school, Gourmet Chefs Ltd, for it to provide an introductory 6-week training course on basic chef skills. Once the students have the basic skills, Chefco can then refer the best students through to more advanced training in the home territory.

Under the arrangement, Chefco refers prospective students to enrol with Gourmet. Gourmet will provide a certificate of achievement to those who successfully meet the requirements. Gourmet agrees to send the invoices directly to Chefco so that the course will be pre-paid before the students arrive.

Chefco wants to know if it can register under s 54B to claim back the GST incurred on the invoices from Gourmet.

Chefco has not incurred the GST as the contract for supply is a supply of training services provided by Gourmet to the students. As Chefco has not incurred the GST it cannot meet the requirements of s 54B(1)(b).

## Tax levied under s 12(1)

73. The alternative requirement for s 54B(1)(b) is that the person has had tax levied under s 12(1) on imported goods that were received by or delivered to another person in New Zealand. There is no threshold requirement for the amount of tax levied under s 12(1). The reason for this alternative requirement is that under s 20(3LC), in situations where the imported goods are received by or delivered to another person in New Zealand, the recipient of the goods is treated as having paid the tax levied. Without this alternative requirement, a non-resident importer of goods would not have **incurred** the input tax to meet the $500 threshold.

[2] See: Chapter 6 – *GST policy issues*, (Officials' issues paper, Policy and Strategy, Inland Revenue, February 2020) on the potential zero-rating of conference fees and training fees charged to non-resident businesses.

74. Section 20(3LC) was introduced so non-residents could not recover GST input tax on high value goods imported by the non-resident that they then delivered to a New Zealand customer. Section 20(3LC) does not apply if the non-resident importer is the receiver of the goods and is not delivering them to another person in New Zealand. This is provided for in s 20(3LB). To establish that s 20(3LC) did not apply the non-resident importer would need to demonstrate that the imported goods were not intended to be delivered to another person.

75. In *Example 7: Allowing non-resident goods importers to register*, a non-resident company is placed in the same position as a New Zealand GST-registered business that can claim back the GST incurred on the goods and services acquired for the purposes of making taxable supplies.

**Example 7: Allowing non-resident goods importers to register**

**Allowing non-resident goods importers to register**

Prestige Classics is a non-resident company that sells a luxury motor vehicle to a motor vehicle dealership, Swanky Motors, in New Zealand. The contract is entered into in Australia and a deposit is paid at that time. The payment of the deposit triggers the time of supply. At the time of supply the vehicle is outside New Zealand. As the vehicle is outside New Zealand at the time of supply, the place of supply is outside New Zealand. A term of the contract is that Prestige will import the vehicle and personally deliver it to Swanky Motors (by one of Prestige's employees). Prestige incurs expenses in New Zealand relating to its employee's accommodation and incidental costs in the course of delivering the vehicle to Swanky Motors. The GST amount incurred in relation to the employee's expenses is $275.00. Prestige wants to recover the GST on these costs.

Prestige arranges to import the vehicle and is levied tax on the import under s 12(1). Although Prestige has not incurred input tax exceeding $500, it has been **levied tax under s 12(1)** on the import of the vehicle and is therefore able to meet the requirement of s 54B(1)(b).

Provided Prestige meets all the other requirements of s 54B, it could register under s 54B to claim back the GST costs for the expenditure incurred by its employee while delivering the vehicle. It cannot claim the tax levied on the vehicle as this is treated as paid by Swanky Motors under s 20(3LC).

**Note:**

If Prestige registers under s 54B, Swanky Motors may be able to claim an input tax deduction under ss 20(3) and 20(3LC) if:

- It is a registered person acquiring the vehicle for the purposes of its taxable activity, and
- It has appropriate supporting documents, such as Prestige's GST registration number and evidence of the tax levied under s 12(1) on the import of the vehicle.

## Fifth requirement – performance of services received in New Zealand – s 54B(1)(c)

76. The fifth requirement for registration of certain non-resident suppliers focuses on where the services are performed and whether they are received by someone in New Zealand as a final consumer. A person cannot register under s 54B if the **non-resident's taxable activity** involves a performance of services that are likely to be received in New Zealand by a person who is not a registered person or is a registered person but is not receiving the services in the course of making taxable or exempt supplies: s 54B(1)(c).

77. Section 54B(1)(c) provides:

> (c) the person's taxable activity does not involve a performance of services in relation to which it is reasonably foreseeable that the performance of the services will be received in New Zealand by a person other than in the course of making taxable or exempt supplies; and …

78. Under s 54B(1)(c), there are three main considerations:

- Does the non-resident's taxable activity involve providing services?
- Is it reasonably foreseeable that the services will be received in New Zealand?
- Is the recipient receiving the services "other than in the course of making taxable supplies"?

79. Section 54B(1)(c) applies to non-residents whose taxable activities involve providing services where it is reasonably foreseeable that those services will be performed in New Zealand.

80. The second and third considerations are sometimes misunderstood. The second consideration focuses on where the services are received, which is not the same as where the supply is deemed to be made for GST purposes. Once again, the focus needs to be on the nature of the contract entered into to determine who is supplying what to whom.

81. The third consideration looks at the recipient of the services and whether they are receiving the services as an end consumer. An end-consumer receives services "other than in the course of making taxable supplies" if:

- the recipient is not GST registered, or
- the recipient is a registered person but the services are not for the purposes of making taxable supplies, and are acquired for other purposes such as for private consumption.

82. If the services are received by a New Zealand–registered person for the purposes of making taxable supplies, then this will not prevent registration of the non-resident under s 54B.

83. *Example 8: Supply of services performed and received in New Zealand* builds on *Example 6: Contractual recipient of the supply* and illustrates how s 54B(1)(c) can prevent registration under s 54B even when the non-resident company incurs the GST input tax.

**Example 8: Supply of services performed and received in New Zealand**

Following the completion of the first introductory basic skills course (Example 6), non-resident company Chefco and New Zealand registered business Gourmet Chefs Ltd decide to vary their agreement. Chefco decides that it would like to incorporate the basic skills training as a component of its three-level Chef Training programme leading to a Diploma in Culinary Arts. Gourmet will be a contracted provider of services supplied to Chefco. Chefco outsources other components of its training and has similar arrangements with several other cooking schools and restaurants in its home territory.

The foreign students will be enrolled with Chefco who will award the achievement certificates if the training is completed successfully. Gourmet agrees to hold places for the students, and invoices Chefco in advance of each course. The fee includes GST, as the services will be performed in New Zealand. Chefco wants to know if it can register under s 54B to claim back the GST incurred on the invoice from Gourmet.

Chefco's taxable activity is providing and arranging chef training for individuals, like the students sent to New Zealand. However, Chefco's taxable activity involves the performance of services where it is foreseeable that the services will be received in New Zealand by the students. Part of the service provided by Chefco to the students is to provide the training at Gourmet, a service that is performed and received in New Zealand. The students will not be receiving the services for the purposes of making taxable supplies.

Therefore, Chefco cannot register under s 54B because s 54B(1)(c) is not met.

## Sixth requirement – not making taxable supplies in New Zealand – s 54B(1)(d)

84. Under the sixth requirement for registration of certain non-resident suppliers, the non-resident seeking registration under s 54B must not be making taxable supplies in New Zealand or supplies that would be taxable if the non-resident were a registered person. Section 54B(1)(d) states:

> (d) the person is not making, or intending to make, —
>
> (i) a taxable supply in New Zealand; or
>
> (ii) a supply in New Zealand that would be a taxable supply if the person were registered under section 51, to a person in New Zealand who is not a registered person; and …

85. Section 54B(1)(d)(i) applies to prevent registration under s 54B where the person is making or intending to make taxable supplies in New Zealand. This will include persons who are treated as making such supplies in New Zealand under s 8(3) but will allow a person to register under s 54B if the only supplies they make are to registered persons. This is because these supplies are treated as made outside New Zealand under s 8(4), unless the supplier and recipient agree to treat them as supplied in New Zealand. If there is an agreement to treat the supplies as made in New Zealand, the non-resident may register under s 51.

86. The policy reason for not requiring the non-resident to register under s 51 and return GST output tax on business-to-business supplies is that the GST collected would be offset by input tax deductions claimed by the GST-registered recipients of the supplies (as explained in *Example 9: Non-resident supplies remote services to New Zealand GST-registered business*).

**Example 9: Non-resident supplies remote services to New Zealand GST-registered business**

Accounts4U Ltd is a non-resident company that produces accounting software packages for small businesses. It supplies a small number of New Zealand GST-registered businesses but does not make supplies to any unregistered customers in New Zealand.

Accounts4U wants to send two of its staff to demonstrate a new enhancement to the software package to its customers in New Zealand. The marketing and demonstration will take place on the clients' premises over the course of a week. The staff will incur accommodation, food and transport costs in New Zealand which will be inclusive of GST.

Accounts4U wants to register under s 54B to claim back the GST incurred on the employees' expenses.

As Accounts4U is a non-resident company, under the general place of supply rules (s 8(2)), supplies by the non-resident are treated as being made outside New Zealand. The supply of software products is the supply of remote services, which under s 8(3)(c) can be treated as made in New Zealand. However, because the supplies by Accounts4U are made to GST-registered customers, the supplies are treated as supplied outside New Zealand under s 8(4D), unless Accounts4U chooses otherwise.

Therefore, Accounts 4U is not prevented from registering under s 54B by s 54B(1)(d)(i).

## Supply that would be a taxable supply if it were to an unregistered person

87. Section 54B(1)(d)(ii) focuses on the nature of the supply and the GST status of the recipient. For this provision to apply and prevent the non-resident from registering under s 54B:
   - the supply must be of goods or services that "would be" a taxable supply if the person were registered; and
   - the recipient must be an unregistered person.
88. As with s 54B(1)(d)(i), a business-to-business supply by a non-resident is treated as a supply outside New Zealand, but a supply to an unregistered person is treated as a supply in New Zealand, so may be a taxable supply.
89. Section 54B(1)(d)(ii) applies to prevent a non-resident from registering under s 54B where the supplies are to an unregistered person, even where the level of supplies to an unregistered person does not meet the threshold for registration in New Zealand. The only way for the non-resident to register and claim any GST input tax it incurs is to voluntarily register, which would make it liable to account for GST on supplies made in New Zealand. *Example 10: Non-resident company intending to make taxable supplies in New Zealand* demonstrates the application of s 54B(1)(d)(ii). It is drawn from Example 1 in "Taxation (Annual Rates for 2016–17, Closely held Companies, and Remedial Matters) Act 2017", *Tax Information Bulletin* Vol 29, No 5 (June 2017): 89 at 91.

**Example 10: Non-resident company intending to make taxable supplies in New Zealand**

Video Game Startup Co is a small non-resident video game production company that is developing its first video game. While the worldwide sales of the game for the first year of its release are expected to be in excess of $60,000, and Video Game Startup already has a few New Zealand-based customers, Video Game Startup does not expect that sales of the game to New Zealand-resident private consumers will be above the $60,000 GST registration threshold for at least the next two years. Therefore, even though the company is supplying a remote service to New Zealand consumers, it does not have a liability to register for GST in New Zealand under the remote services rules.

Therefore, if Video Game Startup does not register for GST (or does not become liable to register for GST under s 51(1)), the remote services rules will not apply to impose GST on its supplies to New Zealand consumers. In other words, as a non-registered person, Video Game Startup does not make taxable supplies because its supplies are not charged with GST under s 8.

Video Game Startup intends to send two of the animators it employs, Shane and Matt, to an animation conference in Auckland. The conference price includes GST at 15%.

Video Game Startup wishes to claim back the GST it incurs on the conference fees for Shane and Matt. However, Video Game Startup is not eligible to register under s 54B because of the exclusion in s 54B(1)(d)(ii): Video Game Startup makes supplies of remote services to New Zealand consumers that, if Video Game Startup were a GST-registered person, would be charged with GST.

## Seventh requirement – not a member of a group of companies that makes supplies in New Zealand

90. The final requirement is s 54B(1)(e). The non-resident cannot be a member of a group of companies that makes supplies in New Zealand or intend to become a member of such a group. Cross-border grouping is permitted for GST, but a group with resident and non-resident members must register under s 51. Section 54B(1)(e) states:

> (e) the person is not, and does not intend to become, a member of a group of companies that makes taxable supplies in New Zealand.

91. If a non-resident registered under s 54B becomes part of a group of companies that makes taxable supplies, then the person is treated as being registered under s 51 from that date: s 54B(2).

## Administrative issues

92. This section discusses six administrative issues in relation to registration:
    - the application for registration (from [93]);
    - returns and taxable periods (from [94]);
    - accounting basis (from [97]);
    - claiming input tax deductions (from [99]);
    - refunds and timing (from [104]);
    - cancellation of registration (from [106]); and
    - supplies on cessation (from [110]).

### Application for registration

93. A non-resident who applies to be registered under s 54B must complete an IR 564. The IR 564 outlines the information required to be provided with the application to ensure that the requirements for registration are met. From a practical perspective, applications for registration may be forwarded after the period for which the non-resident wishes to register, together with appropriate documentation to support the requirements.

### Returns and taxable periods

94. A non-resident who applies to be registered under s 54B can request the frequency of return filing to be a one-month, two-month or six-month period. A three-month period is not available for non-residents registering under s 54B.

95. A three-month taxable period is available for registered persons whose only supplies are of distantly taxable goods or remote services that are treated as supplied in New Zealand under s 8(3)(c): s 15(6). This period is not available to a person registered under s 54B, since that person cannot be making taxable supplies in New Zealand.

96. Where the person registered under s 54B has a branch or division registered in New Zealand under s 51 there is no requirement for the person, the branch or divisions to have consistent taxable periods. This is provided for in s 54B(6).

> (6) In relation to the registration of the person, section 56(6) does not apply to require the person and the branch or division to have, between themselves, consistent practices for taxable periods and accounting bases.

### Accounting basis

97. A person registered under s 54B must use the payments basis of accounting for GST. This means the person can claim an input tax deduction only once payment for the supply has been made. This requirement is provided for in s 19(1B):

> (1B) Despite subsection (1), if the Commissioner registers a non-resident person under section 54B, the person must account for tax payable on a payments basis for the purpose of section 20.

98. As already noted at [96] in relation to taxable periods, this accounting basis may differ from the accounting basis used by a separately registered branch or division of the person.

### Claiming input tax deductions

99. For non-residents registered under s 54B, a full input tax deduction may not be available. This is because an apportionment may be required under s 20(3L). Section 20(3L) provides that the person may deduct input tax **to the extent to which** the goods or services are used for or available for use in making taxable supplies "treating all the supplies made by the person as if they were made and received in New Zealand".

100. This means that if all the supplies made by the non-resident would be taxable supplies in New Zealand, the full input tax deduction may be available. However, the input deduction may be adjusted if the person is also making what would be "exempt supplies" if made in New Zealand. The non-resident would be entitled to claim back GST based on the proportion of taxable supplies to total supplies. This means the non-resident is treated the same as a New Zealand resident who similarly makes both taxable and exempt supplies.

101. *Example 11: No apportionment required* and *Example 12: How apportionment applies to a non-resident – financial services*, demonstrate how apportionment will apply to a non-resident. *Example 12* was used in *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill: Commentary on the Bill* (Policy Advice Division of Inland Revenue, September 2012.

**Example 11: No apportionment required**

Redstock Wines is a winery operating in South Australia. It supplies local wholesalers and exports the balance of its wine stock to a leading supermarket in the United Kingdom. It sends some winemakers to New Zealand to train viticulture students under a contract with a University and incurs GST on the winemakers' travel and accommodation costs.

If Redstock Wines were a New Zealand–resident company, its supplies would all be taxable. The expenditure is incurred as part of carrying on its taxable activity of winemaking and supplying wine for sale. As a result, Redstock Wines is entitled to claim all the GST incurred as a deduction. Assuming Redstock Wines makes no taxable supplies in New Zealand, the GST incurred will be available as a refund.

102. A question arises as to whether a non-resident providing financial services can apply s 20F in determining the percentage of GST input tax they can claim. The very nature of the s 54B registration is that it applies to persons who are not making supplies in New Zealand or are making supplies to registered persons in New Zealand which are able to be treated as made outside New Zealand. However, for the purposes of the election under s 20F, and s 11A(1)(q) and (r), the supplies need to be made to New Zealand registered recipients. This means that non-resident financial services providers cannot use s 20F to determine the level of input tax claimable.

**Example 12: How apportionment applies to a non-resident – financial services**

Bank Co is a financial services and insurance provider that is registered for GST in Australia and looking to expand into New Zealand. It registers for GST in New Zealand and incurs GST on professional services fees it receives from a New Zealand provider. Bank Co's Australian business comprises 50% household mortgages, 25% life insurance and 25% health and contents insurance.

Both the mortgage provider and life insurance components of Bank Co's business would be exempt if they were made and received in New Zealand because they are financial services. Therefore, Bank Co can claim 25% of the GST incurred as a deduction in its New Zealand return.

103. In *Example 12*, if Bank Co registered under s 54B and subsequently started making supplies in New Zealand then, under ss 54B(2) and 51B(1)(d), it would be treated as being registered under the general registration provision of s 51. Sections 54B(2) and 51B(1)(d) state:

> **54B Requirements for registration for certain non-resident suppliers**
>
> …
>
> (2) If a non-resident person who is registered under this section starts making taxable supplies, or becomes a member of a group of companies that is making taxable supplies, they are treated as registered on the date specified by the Commissioner under subsection (1), and not being registered under this section from the date on which they start making taxable supplies or the date on which they join the group, as applicable.
>
> …
>
> **51B Persons treated as registered**
>
> (1) For the purposes of Parts 3 and 6, and of Part 9 of the Tax Administration Act 1994, the following are treated as registered persons making supplies in the course or furtherance of a taxable activity:
>
> …
>
> (d) a non-resident person referred to in section 54B(2).
>
> …

## Refunds and timing

104. For non-residents registered under s 54B, the Commissioner has 90 working days from the day after the return is filed, to either make the refund or notify the registered person of any further information required or of any investigation into the claim: s 46(1B).

105. The period of 90 days is intentionally longer that the standard period for a registered person to give the Commissioner enough time to make appropriate enquiries before releasing the refunds.

## Cancellation of registration

106. If the person is not carrying on a taxable activity anywhere in the world, the Commissioner can cancel the person's registration: s 52(5). Cancellation takes effect from the last day of the taxable period in which the Commissioner makes that decision or another date if the Commissioner determines it appropriate.

107. For non-residents registered under s 54B, the Commissioner also has the power to cancel the registration, if the person:

- no longer meets the requirements of s 54B(1)(a); or
- has either not filed a return or filed a late return for three consecutive periods.

108. Section 54C provides:

> **54C Cancellation of registration of certain non-residents**
>
> (1) Section 52 applies to the cancellation of registration of a non-resident person registered under section 54B as modified by this section.
>
> (2) The Commissioner may, in addition to the powers provided under section 52(5) and (5A), cancel the person's registration if—
>
> (a) the Commissioner is satisfied that the person no longer meets the requirements of section 54B(1)(a):
>
> (b) for 3 consecutive taxable periods, the person has either not filed a return or has filed a late return.

109. The power of cancellation given in s 54C(2) is described in "Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013", *Tax Information Bulletin* Vol 25, No 9 (October 2013): 33 as being for two reasons:

- Cancellation for failure to comply with s 54B(1)(a) is to ensure only genuine businesses are eligible to register. This provision means that if a non-resident's overseas registration lapses or the value of their supplies drops below the $60,000 threshold, the Commissioner can de-register them.
- Cancellation for non-filing or consistent late-filing is a measure to encourage compliance. Where a non-resident's involvement with New Zealand is limited or non-existent for periods, the filing of nil returns demonstrates an intention to maintain registration.

## Supplies on cessation

110. When the registration of a person ceases, s 5(3) deems a supply to be made of any goods and services forming part of the taxable activity. This means the person needs to account for GST output tax on their business assets. The supply is deemed to be made in the course of that activity and to be made immediately before the person ceases to be registered. However, s 5(3B) was inserted to ensure that on cessation of registration of a non-resident, two adjustments are made. The first is to limit the deemed supply of goods to only goods present in New Zealand at the time the person ceases to be registered. Secondly, an adjustment must be made for services that would be performed in New Zealand.

111. Section 5(3B)(c) and (d) states:

> **5 Meaning of term supply**
>
> …
>
> (3B) For the purposes of this Act, when a person who is a non-resident ceases to be a registered person,—
>
> …
>
> (c) any goods that are part of the assets of the taxable activity carried on by the person that are present in New Zealand at the time the person ceases to be registered are treated as supplied by the person in the course of the taxable activity at a time immediately before the person ceases to be registered:
>
> (d) any services that would be performed in New Zealand as part of the taxable activity carried on by the person at the time the person ceases to be registered are treated as performed by the person in the course of the taxable activity at a time immediately before the person ceases to be registered.

## Examples

112. The following additional examples show how s 54B applies to more detailed scenarios.

**Example 13: Satisfying all s 54B requirements**

Kingland is a manufacturing company in a manufacturing group in the United Kingdom. It is registered for VAT in the UK. Kingland has a contract to supply machines to Wallaby Co in Australia. The machines require an additional electronic component for them to meet Australian standards. Kingland decides to send the machines to New Zealand and have a New Zealand Company, Black Engineering, make the necessary adjustments. This involves fitting a component, adjusting, testing and certifying each of the machines. The engines are shipped to the NZ warehouse owned by Black Engineering.

Once the work has been completed the machines are exported to Australia. None of the machines are supplied to customers in New Zealand.

Black Engineering charges GST on the goods and services provided, as the goods (the components) and the services (the fitting, testing and certifying) are in New Zealand at the time of supply.

As this is a significant contract incurring more than $500 GST, Kingland wants to know if it can register under s 54B to claim back the GST charged on supplies it receives in New Zealand.

Each of the s 54B requirements needs to be considered to determine whether Kingland can register on this basis:

- *Non-resident:* Kingland is a non-resident for income tax purposes. The warehouse in New Zealand is the premises of Black Engineering and is not a fixed or permanent place of Kingland. It is not a place available to Kingland and will not make Kingland a resident for GST purposes.
- *Not liable to register under s 51(1):* As Kingland is a non-resident, under s 8(2) the supplies it makes are treated as made outside New Zealand. It is not making any supplies in New Zealand and therefore does not have a liability to register under s 51(1).
- *Registered for a consumption tax (s 54B(1)(a)):* Kingland is registered for VAT in the UK so satisfies s 54B(1)(a).
- *Input tax of $500 or tax levied under s 12(1) - (s 54B(1)(b)):* Kingland is the recipient of goods and services in New Zealand and incurs input tax exceeding $500 so satisfies s 54B(1)(b).
- *Non-resident's taxable activity involves a performance of services received by someone other than for making taxable supplies - (s 54B(1)(c)):* Kingland's taxable activity involves the manufacture and supply of engines. It has customers in the UK, Europe, Canada and Australia. Its customers are manufacturers who incorporate the engines into their products. No person receives the performance of services in New Zealand as a result of Kingland's taxable activity. Therefore, Kingland is not precluded from registering under s 54B(1)(c).
- *Not making, or intending to make a supply in NZ, that would be taxable if the person was registered under s 51(1)- (s 54B(1)(d)):* Kingland does not make supplies in New Zealand, nor does it intend to. Therefore, Kingland is not precluded from registering under s 54B(1)(d).
- *Not part of a group of companies, making taxable supplies in New Zealand, or intending to become part of a group making taxable supplies – (s 54B(1)(e)):* While Kingland is part of a group in the UK, no member of the group makes taxable supplies in New Zealand.

Therefore, Kingland can register for GST under s 54B and claim back the GST charged by Black Engineering.

**Example 14: Effect of supplying into New Zealand**

Kingland is approached by a New Zealand company TuiCo, who is registered for GST. TuiCo wants to trial using one of the engines in their small boutique manufacturing business. The value of the supply is $45,000. Kingland wants to know whether supplying an engine to TuiCo will affect its GST registration under s 54B.

As noted above, one of the key requirements is that Kingland is not liable to register under s 51. Kingland could become liable to register under s 51 if it makes supplies in New Zealand and is required to register.

- The supply by Kingland to TuiCo is below the threshold for being liable to register under s 51. This means that Kingland is not liable to register under s 51.
- Provided Kingland remains a non-resident for GST purposes (and does not have a fixed or permanent place) it will be treated as making supplies outside NZ (s 8(2)). However, because the engines are being improved and certified by Black Engineering, the goods (being the engine) are in NZ at the time of supply so are treated as supplied in NZ by s 8(3)(a). But, because the supply to TuiCo is to a registered person, under s 8(4), the supply can be treated as supplied outside New Zealand.

Therefore, the supply is not a "taxable supply in New Zealand" and Kingland would not be prevented from registering under s 54B(1)(d)(i). It would also not be prevented from registering by s 54B(1)(d)(ii) because the supply is to a person for making taxable supplies. Therefore, even if TuiCo orders a second engine, Kingland can remain registered under s 54B and does not have to revert to registering under s 51.

## References

### Case references


*CIR v Bayly* (1998) 18 NZTC 14,073 (CA)

*Newman v CIR* (1994) 16 NZTC 11,229 (HC)

*Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA)


### Legislative references


Goods and Services Tax Act 1985 – ss 2 ("non-resident", "resident"), 3A ("input tax"), 4B, 5(3) and (3B), 6(1) and (3), 8, 11A(1)(x), 12(1), 15(6), 19(1B), 20(3L), (3LC) and (3LB), 46(1B), 51, 51B, 52(5), 54B, 54C

Income Tax Act 2007, s YD 2


### Other references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*GST: Business-to-business neutrality across border* (government discussion document, Policy Advice Division, August 2011). **taxpolicy.ird.govt.nz/sites/default/files/2011-dd-gst-businesstobusiness.pdf**

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"GST: The definition of resident", *Tax Information Bulletin* Vol 5, No 12 (May 1994): 4. **www.taxtechnical.ird.govt.nz/tib/volume-05---1993-1994/tib-vol5-no12**

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"IS 20/04: Goods and services tax – GST treatment of short-stay accommodation", *Tax Information Bulletin*, Vol 32, No 6, (July 2020): 69. **www.taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no6**

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"Taxation (Annual Rates for 2016–17, Closely held Companies, and Remedial Matters) Act 2017", *Tax Information Bulletin* Vol 29, No 5 (June 2017): 89. **www.taxtechnical.ird.govt.nz/tib/volume-29---2017/download-tib-vol29-no5**

"Taxation (Annual Rates for 2019-2020, GST Offshore Supplier Registration, and Remedial Matters) Act, 2019", *Tax Information Bulletin* Vol 31, No 8 (September 2019): 2. **www.taxtechnical.ird.govt.nz/tib/volume-31---2019/download-tib-vol31-no8**

"Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013", *Tax Information Bulletin* Vol 25, No 9 (October 2013): 33. **www.taxtechnical.ird.govt.nz/tib/volume-25---2013/tib-vol25-no9**

*Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill: Commentary on the Bill* (Policy Advice Division of Inland Revenue, September 2012). **taxpolicy.ird.govt.nz/sites/default/files/2012-commentary-lvaerm.pdf**

"Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016", *Tax Information Bulletin* Vol 28, No 6 (July 2016): 12. **www.taxtechnical.ird.govt.nz/tib/volume-28---2016/tib-vol28-no6**

# OPERATIONAL STATEMENT

Operational statements set out the Commissioner of Inland Revenue's view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.



## OS 21/01: Income tax treatment of accommodation provided to employees

### Background

Some employers provide accommodation for their employees. They may provide the accommodation directly or fund the cost of it - by paying the cost on behalf of the employee, by reimbursing the employee for the cost incurred, or by paying the employee an accommodation allowance.

Generally, where an employer incurs expenditure that gives rise to a private or domestic benefit to an employee in connection with their employment that expenditure is taxable to the employee. The provision of accommodation or the funding of the cost of accommodation is an example of this kind of expenditure.

The general rule where an employer provides accommodation (whether directly or by funding it) is that the employer must withhold and pay the resulting PAYE on the value of what the employee receives.

Despite this general rule, in specific circumstances accommodation related to an employee's role is exempt from tax.

This Statement deals with the tax treatment of:

- the provision of accommodation by the employer or the payment of an accommodation allowance to the employee;
- reimbursement by the employer of accommodation expenditure incurred by an employee (also known as expenditure on account).

The purpose of this Statement is to clarify when these circumstances apply and to assist in determining the amount of tax payable.

The Statement is divided into two parts: Part 1 covers when employer-provided accommodation will be taxable, and Part 2 covers how to calculate the resulting tax liability. Examples are provided throughout the statement to illustrate the outcome in different scenarios.

Employers often provide not only accommodation but also travel for their employees. These employers may find it useful to refer to the Commissioner's position on employer provided travel: *Operational Statement OS 19/05: Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax* (Inland Revenue, 2019).

### Summary of approach

1. In determining whether accommodation provided to an employee is taxable the following should be considered:

   Does what is being provided to the employee fall within the definition of "accommodation" in the Act?
2. Some types of accommodation are specifically excluded from the definition such as a room, berth or other lodging provided on a mobile workplace such as a ship, a truck or an oil rig or accommodation provided in a remote location outside New Zealand. If the accommodation is excluded, then it is not taxable. (See the discussion from [7] to [12])

   The second question is: Even if the accommodation is not excluded, do any of the exemptions apply?
3. Even if what is provided is within the statutory definition of "accommodation", it may still be exempt from tax if it falls into one of the expressly provided for exemption categories:
   - out-of-town secondments and projects;[1]
   - ongoing multiple workplaces;[2]
   - meetings, conferences and training courses.[3]

See the discussion in [13] to [47].

[1] Section CW 16B.

[2] Section CW 16F.

[3] Section CW 16D.

4. Once it has been established that the accommodation provided is taxable, the value of the accommodation provided needs to be determined. Generally, the value of the accommodation is based on the market value of what is supplied, but specific rules may vary this. This is addressed in more detail from [48] onward.

## Application of this statement

5. This statement clarifies the Commissioner's existing position on the tax treatment of employer provided accommodation to an employee.

## Definitions

6. In this Statement:
   - **Employer** includes a person, who, in connection with the employment or service of an employee of the employer:
     - provides accommodation for the employee; or
     - pays an amount for the employee's accommodation.
   - **Employer-provided accommodation** means:
     - accommodation an employer organises and pays for;
     - accommodation an employee organises but the employer pays for;
     - accommodation an employer reimburses an employee for; or
     - an allowance paid to an employee by their employer to cover the cost of accommodation.
   - **Home** means a dwelling the employee uses as their residence.
   - **Hometown** means the city or town where the employee's home is located.
   - **Workplace** means a particular place or base:
     - at which an employee performs their employment duties; or
     - from which an employee's duties are allocated.

     This means that a workplace is not confined to premises of the employer but can also be any place from which the employee performs employment duties, which could be a client's premises.
   - A **distant workplace** is a workplace that is not within reasonable daily travelling distance of the employee's home.

## Part 1: Is taxable accommodation provided to the employee?

### Is what is supplied to the employee "accommodation" under the Act?

7. Accommodation is defined in section CE 1(2) as including "board or lodging, and the use of a house or living premises (or part thereof), whether permanent or temporary".
8. Ordinarily, "board or lodging" refers to the provision of the employee's meals and somewhere to sleep.
9. What is considered accommodation under the Act is, therefore, quite broad, so all manner of living arrangements can fall within the definition. As discussed above accommodation includes both accommodation directly provided by the employer, paid for by the employer, or paid for by the employee (which is then reimbursed by the employer).

**Example 1**

Barbara, Karen and Vanessa all live and work in Wellington and are employees of an apartment developer. Their employer has just completed an apartment building. Three apartments in the building are still vacant. As a bonus to the employees for their good work, the employer offers each of them the right to live in their own apartment rent-free for 12 months.

Barbara moves into an apartment and lives there for 12 months.

Karen already has an apartment of her own. She asks if, instead of moving into one of the apartments, she could have money instead - to the value of the new apartment's weekly rental. Her employer agrees and pays her that amount per week as an accommodation allowance.

By the time Vanessa decides whether she will take up the offer, all the remaining apartments have already sold. Vanessa decides to rent an apartment from one of the new purchasers, and her employer agrees to pay the rent to that owner on Vanessa's behalf.

Each employee in this example has received accommodation from their employer for the purposes of the Act. The accommodation will be taxable to each employee to the value of the accommodation received.

10. As accommodation provided to employees is taxable income to them, their employer is typically obliged to withhold the tax payable on their behalf (like a salary and wage payment). Inland Revenue is aware that some employers choose to "gross up" these payments to the employee – in essence paying for the tax arising from the accommodation on the employee's behalf instead of deducting the tax from the employee's wages.

11. Some types of accommodation are explicitly excluded from the broad definition, and as a result are not subject to tax. These types of accommodation are:

- a berth, room or other lodging provided on a mobile workplace such as a ship, truck or oil rig;[4]
- a station in Antarctica;[5]
- a room or lodging provided for shift workers such as fire-fighters, ambulance staff and caregivers when they are periodically required to sleep at their workplace and the accommodation is provided only for the duration of the performance of the duties;[6]
- accommodation provided at remote locations outside New Zealand where an employee is expected to "fly in and fly out" such as mines in Australia;[7] and
- temporary accommodation provided to manage outbreak or spread of COVID-19.[8]

12. Flowchart 1 assists in determining whether the employer has provided accommodation that is excluded:

[4] Section CE 1(2)(b)(i).

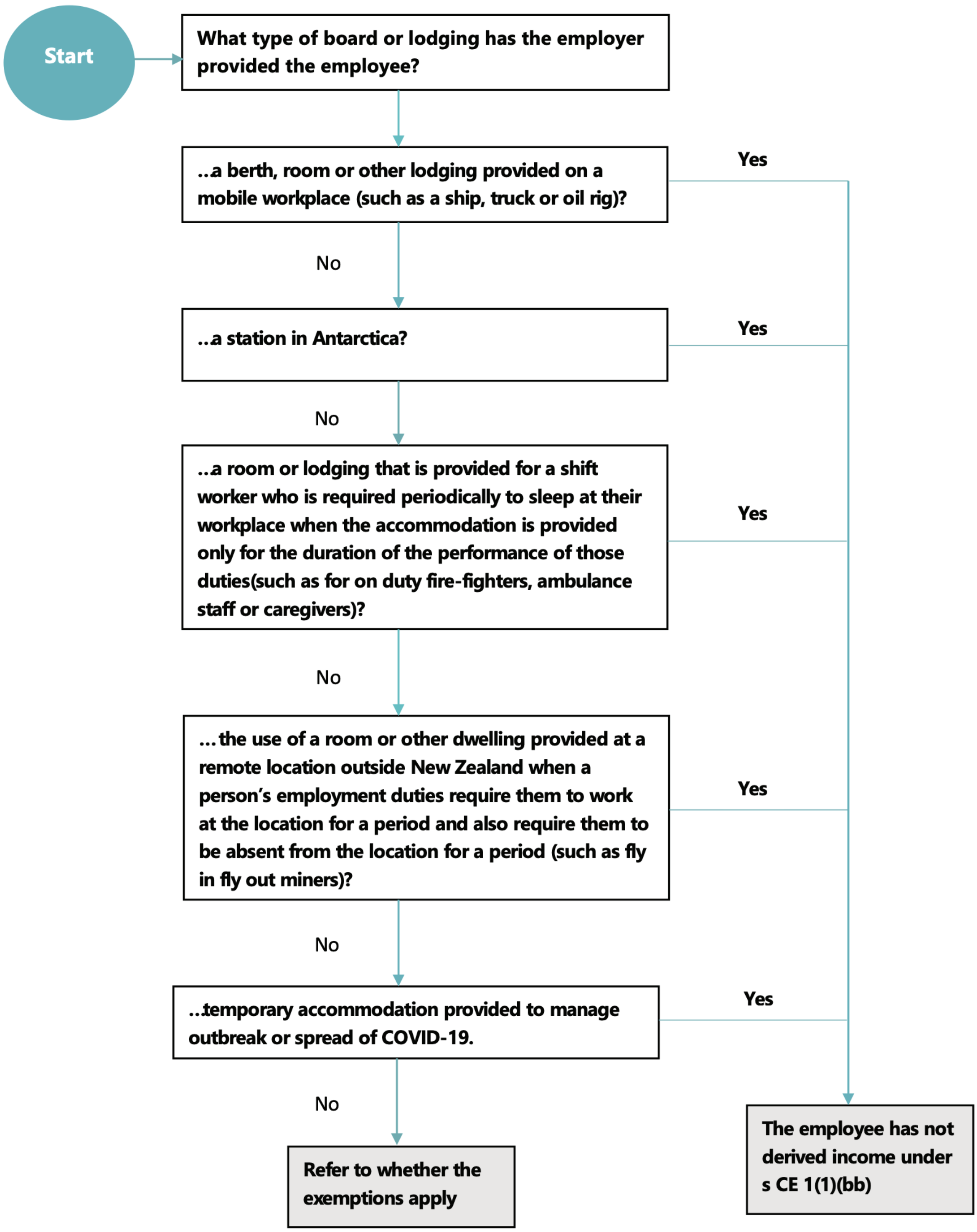
[5] Section CE 1(2)(b)(iii).

[6] Section CE 1(2)(b)(iii).

[7] Section CE 1(2)(b)(iv).

[8] Section CE 1(4) and the Income Tax (Employment Income—Meaning of Accommodation) Regulations 2021.

**Flowchart 1: Determining whether the employer has provided accommodation that is excluded**




## Even if what is provided is accommodation, do any of the exemptions apply?

13. Certain types of employer-provided accommodation, which are included in the definition of "accommodation", may still be exempt from tax. These exemptions fall into three broad categories:

- out-of-town secondments and projects (discussed from [15]);[9]
- ongoing multiple workplaces (discussed from [39]);[10]
- conferences and overnight stays (discussed from [43]).[11]

[9] Section CW 16B.
[10] Section CW 16F.
[11] Section CW 16D.

14. It is important to note that none of these exemptions will apply if employer-provided- accommodation is provided under an explicit salary trade-off arrangement (that is, if the employee opts to receive a lower salary than what they are otherwise entitled to in exchange for accommodation provided by the employer).[12] Accommodation provided under such an arrangement will be taxable income to the employee.

## Employee accommodation – out-of-town secondments and projects (section CW 16B)

15. When an employee needs to work at a new work location that is not within reasonable daily travelling distance of their residence, employer-provided accommodation will be exempt from tax if:
    - there is a reasonable expectation that the employee's secondment to that work location will be for a period of two years or less, in which case the payment will be exempt for up to two years (discussed from [19]); or
    - the employee's move is to work on a project of limited duration the principal purpose of which is the creation, enhancement or demolition of a capital asset and the employee's involvement in that project is expected to be for three years or less; in which case, the payment will be exempt for up to three years (discussed from [22]); or
    - the move is to work on Canterbury earthquake recovery projects; however, due to the passage of time since the Canterbury 2011 earthquake, this exception is now of limited application.

### Definitions – residence and reasonable daily travelling distance

16. For any of the exemptions to apply, the employee must travel from their residence to a workplace and the workplace must be outside the reasonable daily travelling distance.

17. "Residence" is not defined in the Act, but the Commissioner considers that "residence" refers to the employee's home immediately before the change in location and the distance test is assessed with reference to that residence and the travelling distance between that residence and the work location.

18. The Commissioner's position on what she considers to be "reasonable daily travelling distance" was published in "Guidance on a 'reasonable daily travelling distance'", *Tax Information Bulletin* Vol 21, No 9 (December 2009): 6. This guidance is also applicable to the accommodation exemptions.

### Reasonable expectation that the secondment will be for two years or less

19. Where a reasonable expectation exists that the employee's secondment to a workplace that is not within a reasonable daily travelling distance will be for a period of two years or less, the accommodation will generally be exempt from tax for the length of the secondment. This is illustrated in Example 2 below.

20. Reasonable expectation is considered at the time the secondment is entered into - how long each party expected the secondment to last when it started. Things that may be taken into account in terms of forming that expectation include the employee's terms of employment or whether the expectation is captured in a written employment agreement or in some other way (for example, by way of communication between the parties). This is illustrated in Example 2.

21. The expectation could also be captured in other documents such as board minutes, planning documents, and correspondence with the third party for whom the employer is carrying out the project.

**Example 2**

Tahi lives in Auckland and is seconded to a job in Wellington for 12 months. Tahi's employer agrees to meet her costs of living in Wellington. There is no formal secondment agreement between the parties, but correspondence and other documentation clearly demonstrate how long the parties expect the secondment to be.

As the secondment is for two years or less (in this case, 12 months) any employer-provided accommodation at the distant location is not taxable.

**Example 3**

Liam lives and works in Auckland. He is an accountant who has worked for his employer for 10 years. The employer sends Liam to New Plymouth for three months to audit a large client. Liam pays for his stay in a hotel in New Plymouth, and his employer fully reimburses him for this cost.

As Liam's employer expects him to work in New Plymouth for a period two years or less, the payment that Liam receives as reimbursement for his accommodation costs in New Plymouth is not taxable.

[12] Section CW 16B(2).

### Accommodation linked to long-term projects of limited duration

22. When an employee is required to work at a distant workplace in relation to a long-term project of limited duration, employer-provided accommodation can be exempt where a reasonable expectation exists that the employee will be working at a distant workplace on that project for a period of three years or less.

23. This period takes into account certain business practices, particularly in the construction industry. For example, employees might be housed at or near a construction site, might share accommodation, or might be employed on a "fly in, fly out" basis, so would not be relocating. Employees may be recruited from overseas with no intention that they ever relocate permanently to New Zealand.

24. Projects covered by this exemption are not limited to the construction industry, but may involve, for example, upgrades of existing infrastructure or information technology development and implementation.

25. The three-year period is the time the employee is involved in the project, not the length of the project itself (which may be longer). The reasonable expectation needs to exist when the employee commences work on the project.

26. The project must satisfy the following requirements:
    - The project's main aim must be the creation of a capital asset, whether a new asset, a replacement of an existing asset, an upgrade, or refurbishment;
    - The employee must be engaged exclusively on project work (bar incidental activities); and
    - The project must involve work for a client that is not associated with the employer (the associated party rules in sections YB 1 to YB 16 apply).

**Example 4**

Helio is seconded by his employer to oversee project management on the initial stages of a dam construction project carried out by a client in a remote area of the North Island. Because of the scale of the project, the number of workers and the remoteness of the location, Helio's employer sets up an accommodation facility to house its employees working on the project, including Helio. The entire project is expected to take around seven years to complete, however Helio is only involved in the preliminary work. Both Helio and his employer expect Helio to work on the project for the first two and a half years.

Helio is working on a project involving the construction of a capital asset. Both he and his employer expect him to be working at the distant work location for three years or less. Therefore, the value of the accommodation provided to Helio is exempt.

### Exemption for out-of-town secondments and long-term projects can cease to apply if circumstances change

27. Even if the employer-provided accommodation meets the requirements to be considered exempt, the accommodation can cease to be exempt if circumstances change. The accommodation will cease to be exempt if:
    - the employer pays part of or all the costs associated with buying the employee a house in or near the new work location;
    - the employee's involvement in the secondment or project comes to an end; or
    - the expectation that the employee will only be at the new location for a maximum of two years or three years (whichever applies) changes so that the employee is reasonably expected that they will be at the distant workplace for longer.

28. From the point in time that the circumstances change as outlined above, any employer-provided accommodation will be taxable, but accommodation provided before that time will remain exempt. This is illustrated in Example 5:

**Example 5**

Fatima works for an employer in Auckland. Her employer sends her to work in Hamilton for an expected 18-month period. After four months, Fatima decides she wants to relocate permanently to Hamilton. Her employer agrees to make the job in Hamilton permanent and to pay Fatima an accommodation allowance for the first six months after her arrival in Hamilton.

For the first four months, the employer reasonably expected that Fatima would not be working in Hamilton for more than two years. Therefore, the payments to cover Fatima's accommodation for those first four months are exempt under the two-year rule. But now that Fatima is expected to be working in Hamilton for more than two years, any payments to cover her accommodation after the initial four months are taxable.

### Expected period initially exceeds the time limit but subsequently reduces

29. If a secondment is initially expected to exceed the relevant two or three-year period, it will be subject to tax.
30. However, if this expectation changes and the total period will be less than the relevant time limit (two or three years as relevant), the employer-provided accommodation becomes exempt from the date the expectation changes. The employer-provided accommodation up to the date the expectation changes remains taxable – there is no retrospective exemption following the change in expectation. This is illustrated in Example 6.

> **Example 6**
>
> Raj lives in Napier. His employer sends him to Tauranga to set up and manage a new office. The initial expectation is that Raj will be in Tauranga for four years. Raj's employer provides him with accommodation in Tauranga. As the secondment is expected to be more than two years the accommodation will be taxable.
>
> One year into the secondment, Raj's employer decides Raj only needs to stay in Tauranga for another six months as the company has found someone based locally to run the office on a permanent basis. As the expectation of the total secondment duration is now less than two years (18 months), the final six months of the accommodation provided to Raj are exempt from tax. The accommodation provided for the first 12 months, before the change in expectation, remains taxable.

### New employees and out-of-town secondments and long-term projects

31. The exemptions described above for employer-provided accommodation generally apply in relation to existing employees. However, they can apply to new employees in specific instances.
32. New employees only qualify for the two-year exemption for secondments when:
    - the employee is newly recruited to work at a particular work location but is then temporarily sent to work at another work location (for example, an individual is recruited to work in Auckland but before starting in Auckland is sent to work in Dunedin for a month before returning to Auckland); or
    - an employee working for one employer is seconded to work for another employer on a temporary basis, with the expectation that the employee will return to work for the original employer (for example, an individual working for an Australian accountancy firm is sent to work for an affiliated New Zealand firm in Auckland for 18 months).
33. New employees qualify for the three-year exemption for work on a project of limited duration subject to the same conditions as existing employees.

### Exceptional circumstances – extended exemption period

34. In exceptional circumstances, employer-provided accommodation can continue to be treated as exempt even though the employee continues to work at the distant workplace for longer than the two or three-year period in the exemption.
35. "Exceptional circumstances" are confined to those that are outside the control of the employer and employee, such as a natural disaster or medical emergency, with the result that the employee must stay at the work location. The employer-provided accommodation can continue to be treated as exempt for as long as the exceptional circumstance means the employee is unable to leave the work location.

### Restarting the time period

36. For the purpose of determining whether a time limit for the exemption for secondments or projects applies, a break in a period of continuous work at a distant workplace may result in a restart of the time period. However, the break will be ignored if a reason that is more than incidental for the cessation of the employment or service at that location is to allow a further period of exemption.[13]

### Relationship with the relocation payments rule

37. If an employee is not eligible for the above out-of-town secondments and projects exemption, they may still qualify for the accommodation exemption for up to three months after their arrival, under section CW 17B (tax-exempt relocation payments).
38. For a list of relocation expenses that are eligible under section CW 17B, see *Determination Det 09/04 – Eligible relocation expenses* (Inland Revenue, 2009). Relocation expenses include such things as the cost of removal and transport of household effects.

[13] Section CW16C(6).

## Employer-provided accommodation – ongoing multiple workplaces

### Multiple workplace exemption

39. An employee may be required to work at more than one workplace on an ongoing basis. When this occurs, employer-provided accommodation that they receive in relation to working at a distant workplace (one outside a reasonable daily travelling distance) is exempt from tax, without an upper time limit.[14] This is illustrated in Example 7.

40. The multiple workplace rule can also apply when an employee is sent on a short-term business trip to another location. This is illustrated in Example 8.

41. In these circumstances, the employee will continue to have ongoing duties at their usual place of work while they are working at the distant work location during the business trip.

**Example 7**

Lucia manages two offices, one in Christchurch and one in Dunedin. She works in Christchurch two days a week and in Dunedin for three days a week. Her home is in Dunedin.

Lucia has more than one ongoing work location. When she works in Christchurch, she is beyond reasonable daily travelling distance from her home in Dunedin. An accommodation payment to cover her hotel costs when staying in Christchurch is exempt under the multiple workplace rule. Therefore, the Christchurch accommodation is not taxable.

**Example 8**

Carmen is chief executive of a large group of companies based in Auckland. The group has offices in several cities across New Zealand. Each month Carmen visits one of these offices as part of her management duties. Typically, these visits last up to a week, and Carmen's employer arranges and pays for her accommodation at a nearby hotel.

When Carmen is visiting the offices away from Auckland, she has more than one ongoing workplace for the duration of her visit. Therefore, the cost of her accommodation while working at those offices is exempt under the multiple workplace rule.

### Multiple workplace exemption does not apply to a home office

42. The multiple workplace exemption does not apply when the employee has two workplaces and one of those workplaces is a home office.[15] Any accommodation provided to such an employee by their employer is taxable.

## Employee-provided accommodation – meetings, conferences and training courses

43. When an employee needs to attend a work-related meeting, conference or training course that requires at least an overnight stay, any employer-provided accommodation is exempt from tax without an upper time limit.[16]

44. While the need for accommodation would usually arise because the work-related meeting, conference or training course is beyond reasonable daily travelling distance from the employee's home, this need not be the case. Some courses may be held locally but may require employees to stay overnight for reasons such as networking and team building.

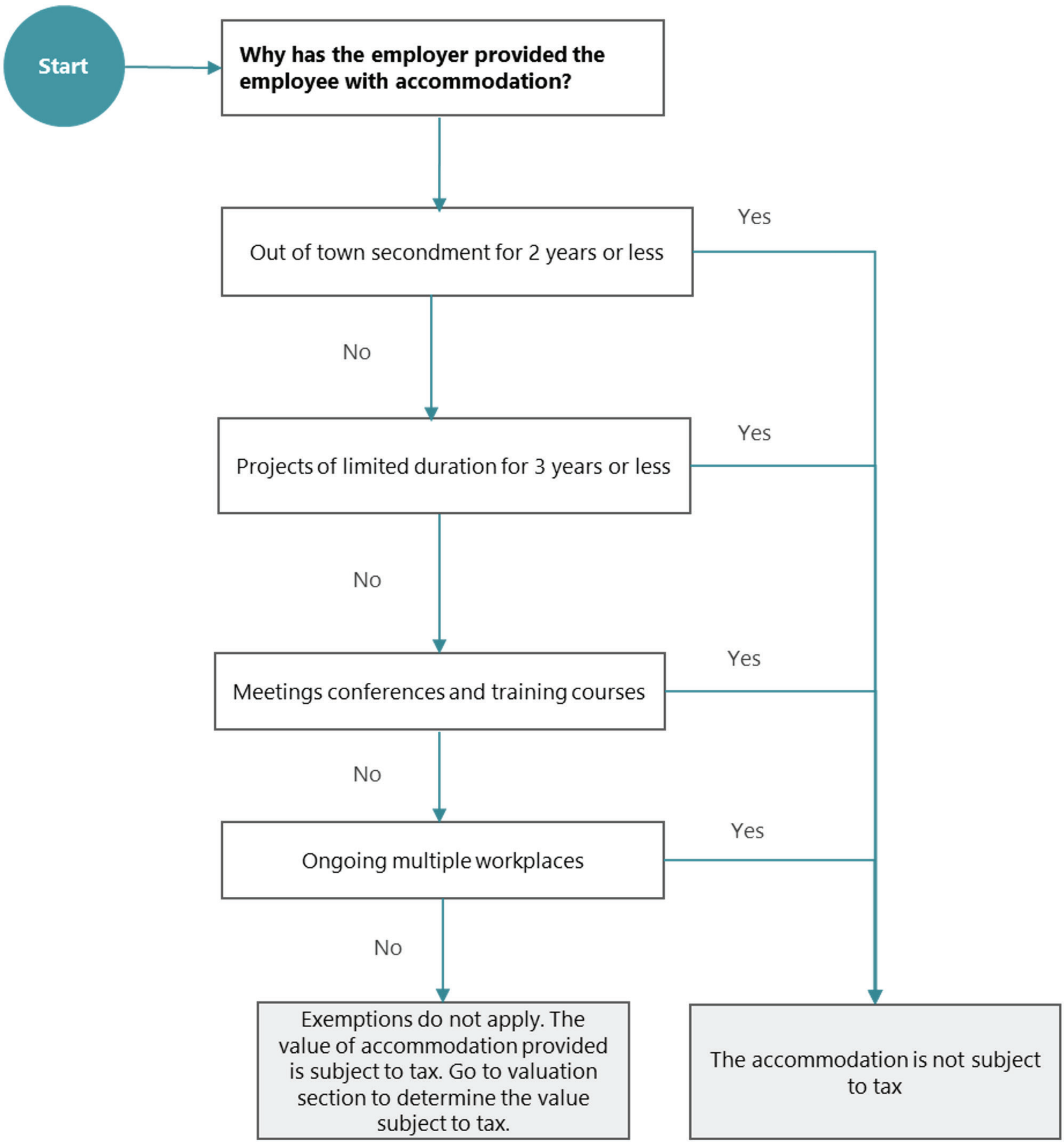
45. This exemption covers both local and distant accommodation situations. The definition of "period of continuous work" includes a period that the employee is required to stay in a location that is not distant from the employee's regular workplace.[17]

46. If a stopover is required in travelling to or from the location, accommodation at that stopover is also exempt.

47. Flowchart 2 summarises the above and assists in determining whether accommodation is exempt:

[14] See section CW 16F.
[15] Section CW 16F.
[16] Section CW 16D.
[17] Section CW 16D(4).

**Flowchart 2: Determining whether the accommodation is exempt**




## Part 2: What is the value of the accommodation subject to tax?

48. If accommodation is taxable, the next step is to determine the value (often referred to as the taxable value).

### What are the general valuation rules?

#### Value where the employer physically provides employee accommodation

49. Where an employer physically provides employee accommodation the value of that accommodation is the market rental value.

50. The Commissioner broadly considers that market rental value refers to the amount that would be arrived at by two non-associated parties, on an arm's length basis, for the rental of the accommodation.

51. For guidance on estimating the likely market rental value of employer-provided accommodation, see *Commissioner's Statement CS 16/02: Determining "market rental value" of employer-provided accommodation* (Inland Revenue, 2016), and with reference to employees of boarding schools: *Commissioner's Statement CS 18/01: Determining "market rental value" of employer-provided accommodation - Boarding Schools* (Inland Revenue, 2018).

### Value for accommodation allowance or payment of accommodation expenditure

52. Where an accommodation allowance or accommodation expenditure is paid by the employer (whether directly or by reimbursement to the employee), the market value is the amount paid. This amount may be varied by the adjustments discussed from [54].

53. Some providers of accommodation services (such as hotels, managed apartments, and short stay accommodation providers) offer accommodation to their clients in addition to other services that do not fall within the definition of accommodation under the Income Tax Act 2007. These additional services may include, for example, wireless internet access. The cost of these additional services are sometimes, but not always, itemised separately from the accommodation provided when the recipient is billed. Where the cost of these additional services are not separated out from the cost of the accommodation provided by the service provider, the Commissioner takes a pragmatic approach and would treat the benefit received from these additional services as part of the accommodation received.[18]

## Adjustments to the taxable amount

54. Once the market value has been determined, several factors may result in adjustments being made before the taxable amount is determined:
    - Rent paid by the employee: If an employee pays rent on the accommodation provided, the amount of rent paid should be subtracted from the market value to determine the taxable value. (See [55].)
    - Business or work use: Where a portion of the premises is used for work by the employee (for the employer that provides the accommodation), a pro-rated adjustment may be made to reflect that. The taxable value will be the portion of the premises used by the employee for accommodation only. (See from [56].)
    - Shared accommodation: An adjustment is allowed when two or more employees share accommodation. (See from [58].)
    - Overseas accommodation: The taxable value of employer-funded accommodation provided to employees as part of an overseas posting is capped at the average or median rental value for accommodation in the vicinity where the employee would have lived if in New Zealand.[19] This cap, which is of significance to employees who remain tax resident in New Zealand, recognises that the market rental value of accommodation in overseas locations can be disproportionately high compared with the value of accommodation that an employee might occupy if working in New Zealand (see from [60]).
    - Ministers of religion: A specific valuation rule applies to accommodation supplied by religious bodies to their ministers (see from [67]).[20]

### Rent paid by the employee

55. The taxable value should be reduced by the amount of any rent that the employee pays for that accommodation. This is illustrated in Example 9.

**Example 9**

As part of Michael's salary package, his employer agrees to pay his accommodation costs in Auckland up to a value of $500 per week. Michael finds an apartment that he likes, but the weekly rent is $700 per week. His employer agrees to pay the rent to that value, on the basis that Michael pays the $200 difference to his employer.

The taxable value of the accommodation that Michael receives in this example is $500 per week, as the $200 per week rent that he pays to his employer is deducted from the taxable value of the accommodation received.

[18] For clarity – where the costs of non-accommodation services are itemised separately from the cost of accommodation provided, the tax treatment of the non-accommodation services must be considered on their own facts.

[19] Section CE 1C.

[20] Section CE 1E. Section CE 1D also provides rules for calculating the market value of accommodation where accommodation is physically provided by the New Zealand Defence Force, but this will not be covered in any detail in this Statement.

### Work use of accommodation

56. If part of the accommodation provided is used for work purposes, the taxable value is accordingly reduced on a pro-rata basis. To qualify, a clearly identifiable part of the accommodation needs to be used "wholly or mainly" for work purposes related to the employee's employment (with the employer providing the accommodation). That portion of the premises does not need to be used solely for work purposes to meet the "wholly or mainly" test, but it must at least be used predominantly for work purposes and its primary purpose must be work related.
57. The deduction is determined by apportioning between the business and private use of the accommodation. This is illustrated in Example 10. Any non-work-related use will be ignored, if it is temporary, sporadic or otherwise minor (such as using an office for checking personal emails or a family member occasionally using it for personal projects).

**Example 10**

Miha works as a dental assistant. Her employer provides her with accommodation that has a market rental of $500 a week. Miha has set up one bedroom in the property as a workspace to make dental impressions. It is usually used as a workspace, but it also has a sofa bed. On occasion, when Miha has house guests, the sofa bed is used as a bed for the guest to sleep.

The use of the space as an occasional sleeping area for guests is ignored as it is temporary and sporadic – it is wholly or mainly used as a workspace. As the workspace is one-tenth of the total floor area of the accommodation, $50 is deducted from the rent paid, with the result that the taxable value is $450 per week.

### Shared accommodation – apportionment of taxable value

58. Generally, when two or more employees share accommodation provided by their employer, the taxable amount is still the market rental value - the issue is only one of apportionment between the employees.
59. The amount may be apportioned equally between the employees or, if the employer and employees agree, apportioned between the employees on a different basis (for example, based on bedroom size). This is illustrated in Example 11.

**Example 11**

George and Tana work for a start-up in Wellington. Their employer rents a $400 per week two-bedroom property for them to live in.

Tana manages to pick his bedroom first and chooses the bigger of the two rooms.

The market rental value of the property is $400 per week. As Tana has a bigger room than George, they agree with their employer that the value of the accommodation will be split on a 60:40 basis – the taxable value of the accommodation received by Tana will therefore be $240 per week, and by George will be $160 per week.

### Accommodation provided to employees working overseas – exception to the general rules

60. An exception to the general valuation rules is for accommodation provided to employees working overseas. This exception allows the use of a New Zealand–equivalent-based value for the market value rather than the market value of the actual overseas accommodation provided.[21]
61. In establishing the value of an equivalent New Zealand property, it is necessary to consider where the employee would likely be working for the employer at the overseas location, the equivalent accommodation the person would likely occupy if living in New Zealand, and the average or median market rental values at or near that equivalent work area.
62. What is received overseas is only relevant if the rental value of the overseas accommodation is less than the average or median market rent of the equivalent New Zealand accommodation. In those circumstances, the value used for tax purposes is the rental value of the overseas accommodation. This is illustrated in Example 12.

[21] The New Zealand equivalent value can also be used for determining the taxable value of an allowance or amount paid for or towards the provision of the accommodation.

**Example 12**

Zoe is seconded by her employer to work at its site in Brussels for three years and is provided with a flat for the duration of her secondment. The rent the employer pays is equivalent to $50,000 a year. Zoe would work in central Wellington if working in New Zealand and would be likely to be living in a two-bedroom apartment with her partner in central Wellington where an average annual rental value would be $24,000.

The market value of the accommodation Zoe receives is therefore the cost of the accommodation that she would have had in Wellington, not the value of the equivalent accommodation in Brussels. As a result she is taxed on an accommodation value of $24,000 per year.

63. In establishing the comparable New Zealand property, a relevant factor is the number of family members in the employee's household in the overseas location, their ages (adults and children) and their living requirements.

64. For example, if an employee has a household of four but goes on secondment overseas while their family remains behind, their New Zealand equivalent accommodation will be determined based on what accommodation they would be likely to occupy as a person living alone. Equally, if their spouse joined them but not their children, the equivalent accommodation would be the accommodation that they would be likely to occupy as a couple rather than as a family of four. This is illustrated in Example 13.

**Example 13**

Jo is seconded by her employer to Jakarta for three years and is provided with an apartment in central Jakarta for the duration of her secondment. The rent her employer pays is equivalent to $25,000 a year. Jo would normally work in central Wellington if working in New Zealand and live in a five-bedroom house in Tawa with her adult children.

Jo's children are settled at university and value their independence, so as a family they decide that Jo will go to Jakarta by herself, while her adult children will remain behind and maintain the house in Tawa.

Therefore, Jo only needs a small apartment in Jakarta as she will be the only occupant. As a result, the market value of the accommodation Jo receives is the equivalent of a small apartment close to central Wellington.

The cost of the equivalent apartment in Wellington would cost $35,000 a year. As this value is more than the value of the accommodation she is receiving in Jakarta, the taxable amount is the value of the Jakarta accommodation – $25,000 per year.

65. If the employee's role in New Zealand can be performed in more than one location in New Zealand, an average of the multiple locations can be used to determine the New Zealand equivalent accommodation. If the employee's role in New Zealand can be performed anywhere in New Zealand, a New Zealand wide valuation can be used. Either the average or the median market rental value for the whole of New Zealand can be used. This is illustrated in Example 14.

**Example 14**

Anahera works as a software developer for a company based in Auckland and Wellington. Four months ago, her employer agreed for her to move from Wellington to Katikati to trial working remotely. Following a successful trial, her employer agrees that Anahera's position can be performed from anywhere in New Zealand.

Anahera then secures a two-year secondment to work for the company's new office in Reykjavik, Iceland. Due to differences in time zones, this work requires her to be permanently based in Reykjavik.

As part of her secondment, Anahera receives accommodation for her and her two children, who will join her in Reykjavik, to the value of $50,000 per year.

To calculate the New Zealand equivalent, the average cost of accommodation in New Zealand as a whole is used, because Anahera's role in New Zealand can be performed anywhere in New Zealand. This would be approximately $26,000 per year for Anahera and her two children. This is less than the amount she receives from her employer for accommodation in Reykjavik. As a result, the amount that the equivalent accommodation would cost her in New Zealand ($26,000 per year) is the taxable value of the accommodation.

66. There are a range of sources available to help determine average or median market rental values. For example, the Tenancy Services website, which provides market rental statistics: **www.tenancy.govt.nz/rent-bond-and-bills/**

### Accommodation provided by religious bodies to ministers of religion

67. The value of accommodation supplied to ministers of religion is determined under section CE 1E.[22] A long-standing administrative practice had previously capped the value of church-supplied accommodation at 10% of a minister's stipend. This practice was incorporated into the legislation with effect from 1 April 2015.

68. A "minister of religion" is defined in the Act as a person:

- who is ordained, commissioned, appointed, or otherwise holds an office or position, regardless of their title or designation, as a minister of a religious denomination or community that meets the charitable purpose of the advancement of religion;
- whose duties are related mainly to the practice, study, teaching, or advancement of religious beliefs; and
- whose accommodation is used as an integral part of performing their duties.

69. The requirement that a minister's church-provided accommodation is used as an integral part of performing the minister's duties will be met as long as there is an expectation underlying a minister's pastoral duties that some church members might visit their home, irrespective of whether any visits happen in practice. Therefore, ministers do not need to record whether visits happen to satisfy this requirement.

70. The amount of income arising to a minister from accommodation provided to them is calculated using the following formula:[23]

 remuneration × (1 – adjustment) + excess rental

 Where:

 **remuneration** is 10% of the remuneration that the minister receives from the religious society or organisation for the income year for the performance of their duties as a minister

 **adjustment** is the value of the accommodation that is apportioned to work-related use, expressed as a decimal fraction of the total value of the accommodation. To be eligible for apportionment, the minister needs to use the relevant part of the accommodation wholly or mainly for work purposes. For example, if the minister uses 10% of the accommodation wholly or mainly for work purposes, the value of the adjustment would be (1 - 0.1) = 0.9. If more than one minister of religion lives in the accommodation, the adjustment is apportioned equally between them

 **excess rental** is the difference between the received accommodation's market rental value and the market rental value of accommodation that is reasonably commensurate with the duties of the person as a minister and for the location in which they perform their duties. The amount of excess rental cannot be less than zero for the purpose of the calculation.

This is illustrated in Example 15.

71. However, no adjustment is allowed simply because ministers of religion share accommodation. The value of the employer-provided accommodation is calculated with reference to the employee (or employees) who receives the accommodation as part of their work.

72. If the accommodation is provided for only part of the year, the calculations of the value are with reference to that part of the year.

**Example 15**

Anareia is an ordained parish priest for the Anglican Church. She serves her parish in the East Cape region. Along with of her stipend of $60,000 per year, the church provides her with accommodation in a three-bedroom house in Ruatoria.

Anareia uses one large bedroom as an office to meet with visiting parishioners. The value of the room (based on floor area) is about 15 percent of the total value of the property.

The value of the accommodation provided to Anareia is $16,000 per year. This is commensurate with her duties as minister and for the location where she is based. As a result, the "excess rental" for the purposes of calculating the value of the accommodation received is nil.

The value of her accommodation received is therefore:

$6,000 (being 10% of her annual stipend) × (1 – 0.15) + 0 = **$5,100**.

[22] This specific valuation rule only applies to accommodation physically provided by the church. In all cases (for example, an accommodation allowances or reimbursement) the general valuation rules apply.

[23] Section CE 1E(2).

73. This exemption does not apply to an accommodation allowance or reimbursement received by a minister of religion. The ordinary rules for calculating the value of an accommodation allowance or reimbursement apply.
74. It is important to note that the definition of "minister of religion" specifically excludes a member of a religious society or order referred to in section CW 25. Section CW 25 provides for an exemption for board and lodging provided to members of religious societies and orders whose sole occupation is service in a society or order and who are not paid for their service. This exclusion does not apply to a minister of religion who receives a stipend (and is therefore paid) for their service.

**Tony Munt**
National Advisor, Technical Standards

Date of issue: 10 June 2021

## 2021 CPI adjustment to Operational Statement OS 19/03: *Square metre rate for the dual use of premises*

In accordance with Section DB 18AA of the Income Tax Act 2007, the Commissioner advises that the square metre rate for the 2021 income year (1 April 2020 to 31 March 2021) is set at $44.75. The amount reflects the June 2019 Household Economic Survey utility costs information sourced from Statistics New Zealand and the annual movement of the Consumers Price Index for the twelve months to March 2020 and 2021, which showed an increase of 2.5% and 1.5% respectively.

Operational Statement *OS 19/03: Square metre rate for the dual use of premises* provides further information on the use of the square metre rate.

## Kilometre rates for the business use of vehicles for the 2021 income year

The table of rates for the 2020/2021 income year for motor vehicle expenditure claims.

In accordance with s DE 12(4) the Commissioner is required to set and publish kilometre rates. These rates can be used to calculate expenditure claims for the business use of a motor vehicle. They may also be used by employers as a reasonable estimate for reimbursement of expenditure incurred by employees for the use of a private motor vehicle for business purposes. More information is available on the Inland Revenue website www.ird.govt.nz/ (search keywords "claiming vehicle expenses").

The rates set out below apply for the 2020/2021 income year for business motor vehicle expenditure claims. The tier one rates reflect a decrease in overall vehicle costs largely due to lower fuel costs in response to reduced global demand (Covid-19 pandemic) and reduced interest and maintenance costs.

The table of rates for the 2021 income year:

The Tier Two rate is for running costs only. Use the Tier Two rate for the business portion of any travel over 14,000 kms in a year.

| Vehicle type | Tier One rate | Tier Two rate |
|---|---|---|
| Petrol or diesel | 79 cents | 27 cents |
| Petrol hybrid | 79 cents | 16 cents |
| Electric | 79 cents | 9 cents |

Operational Statements *OS 19/04A: Commissioner's statement on using a kilometre rate for business running of a motor vehicle - deductions* and *OS 19/04B: Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle* provide further information on the use of the kilometre rates.

# LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

## National Average Market Values of Specified Livestock Determination 2021

### Note to this determination

This note does not form part of the national average market values of specified livestock determination 2021 (the determination) but is produced to aid Inland Revenue staff, taxpayers and their agents in their understanding of how the values contained in this determination are arrived at and how they should be used.

Section EC 15 of the Income Tax Act 2007 (the Act) requires the Commissioner of Inland Revenue (the Commissioner) to make a determination declaring the national average market values (NAMV) for an income year for each class of specified livestock set out in Schedule 17 of the Act. The determination is published in May each year.

These NAMVs are used by taxpayers that are in the business of livestock farming to value their livestock on hand, where the taxpayer has elected to use the herd scheme to value livestock in the income year.

As the name of this determination suggests, NAMVs provide the national average market value for the specified livestock classes. As such they may not always reflect the market value of the livestock of a particular taxpayer, or even of a particular region. This being so, the values are not intended to be used for any other purpose than that for which they are produced; valuing livestock of taxpayers who have elected to value their livestock under the herd scheme in the income year for which the determination relates.

To ascertain the market value of the various classes of livestock the Commissioner contracts with experienced livestock valuers situated throughout the country[1]. Each valuer is asked to provide the market value of the various specified livestock classes located in a specified region. There is generally more than one valuer contracted for each region. The market valuations required are for "good quality on-farm animals (capital stock)" as at 30 April.

From these values the CIR then calculates the national average market value for each livestock class. In the case of sheep, beef, dairy cattle and deer (red, wapiti and elk) classes a weighted average is used (based on total livestock numbers for a type of livestock in that region compared to the national herd numbers for that type of livestock[2]). Because of their comparatively low numbers, a straight average is used for the remaining livestock types (except "other deer"). The value of "other deer" is taken as the mid-point of the trophy and meat markets.

[1] Thirty-eight valuations were obtained for the 2021 determination.

[2] Numbers are based on data collated by Statistics New Zealand.

## National Average Market Values of Specified Livestock Determination 2021

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2021".

This determination is made in terms of section EC 15 of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2020-2021 income year.

For the purposes of section EC 15 of the Income Tax Act 2007 the national average market values of specified livestock, for the 2020-2021 income year, are as set out in the following table.

**NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK**

| Type of livestock | Class of livestock | Average Market Value per Head $ |
|---|---|---|
| **Sheep** | | |
| | Ewe hoggets | 123.00 |
| | Ram and wether hoggets | 119.00 |
| | Two-tooth ewes | 191.00 |
| | Mixed-age ewes (rising three-year and four-year old ewes) | 174.00 |
| | Rising five-year and older ewes | 153.00 |
| | Mixed-age wethers | 129.00 |
| | Breeding rams | 323.00 |
| **Beef Cattle** | ***Beef breeds and beef crosses:*** | |
| | Rising one-year heifers | 563.00 |
| | Rising two-year heifers | 911.00 |
| | Mixed-age cows | 1138.00 |
| | Rising one-year steers and bulls | 716.00 |
| | Rising two-year steers and bulls | 1088.00 |
| | Rising three-year and older steers and bulls | 1391.00 |
| | Breeding bulls | 2894.00 |
| **Dairy Cattle** | ***Friesian and related breeds, Jersey and other dairy breeds:*** | |
| | Rising one-year heifers | 707.00 |
| | Rising two-year heifers | 1291.00 |
| | Mixed-age cows | 1528.00 |
| | Rising one-year steers and bulls | 413.00 |
| | Rising two-year steers and bulls | 762.00 |
| | Rising three-year and older steers and bulls | 1077.00 |
| | Breeding bulls | 1592.00 |
| **Deer** | ***Red deer, wapiti, elk, and related crossbreeds:*** | |
| | Rising one-year hinds | 174.00 |
| | Rising two-year hinds | 327.00 |
| | Mixed-age hinds | 349.00 |
| | Rising one-year stags | 212.00 |
| | Rising two-year and older stags (non-breeding) | 420.00 |
| | Breeding stags | 1873.00 |

| Type of livestock | Class of livestock | Average Market Value per Head $ |
|---|---|---|
| **Deer (continued)** | ***Other breeds:*** | |
| | Rising one-year hinds | 91.00 |
| | Rising two-year hinds | 159.00 |
| | Mixed-age hinds | 196.00 |
| | Rising one-year stags | 110.00 |
| | Rising two-year and older stags (non-breeding) | 202.00 |
| | Breeding stags | 416.00 |
| **Goats** | ***Angora and angora crosses (mohair producing):*** | |
| | Rising one-year does | 95.00 |
| | Mixed-age does | 116.00 |
| | Rising one-year bucks (non-breeding)/wethers | 61.00 |
| | Bucks (non-breeding)/wethers over one year | 72.00 |
| | Breeding bucks | 435.00 |
| | ***Other fibre and meat producing goats (Cashmere or Cashgora producing):*** | |
| | Rising one-year does | 71.00 |
| | Mixed-age does | 97.00 |
| | Rising one-year bucks (non-breeding)/wethers | 59.00 |
| | Bucks (non-breeding)/wethers over one year | 69.00 |
| | Breeding bucks | 383.00 |
| | ***Milking (dairy) goats:*** | |
| | Rising one-year does | 295.00 |
| | Does over one year | 403.00 |
| | Breeding bucks | 597.00 |
| | Other dairy goats (culls) | 86.00 |
| **Pigs** | | |
| | Breeding sows less than one year of age | 256.00 |
| | Breeding sows over one year | 337.00 |
| | Breeding boars | 390.00 |
| | Weaners less than 10 weeks of age (excluding sucklings) | 95.00 |
| | Growing pigs 10 to 17 weeks of age (porkers and baconers) | 152.00 |
| | Growing pigs over 17 weeks of age (baconers) | 215.00 |

This determination was signed by me on the 26th day of May 2021.

**Rob Falk**
National Advisor
Technical Standards, Legal Services
Inland Revenue

## References

### Legislative References

*Income Tax Act 2007: s EC 15*

# FDR 2021/02

## A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (The Colchester Global Bond Enhanced Currency Fund NZD Hedged Accumulation Class – Z Shares)

Any investment by a New Zealand resident investor in the NZD Hedged Accumulation Class Z-Shares of the Colchester Global Bond Enhanced Currency Fund is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest.

### Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist - Network, under section 7 of the Tax Administration Act 1994.

### Discussion (which does not form part of the determination)

Investments in the NZD Hedged Accumulation Class - Z-Shares ("NZD Hedged Z-Share Class") of the Colchester Global Bond Enhanced Currency Fund ("the Fund"), an Irish Managed Investment Scheme, are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors. The Fund is structured as a multi-class Managed Investment Scheme.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the Fund each year.

The Fund invests in a portfolio of global fixed interest securities and other financial arrangements. The Fund has on issue a number of share classes that provide holders of that class of shares with an interest in the pool of investments held by the Fund. The NZD Hedged Z-Share Class of the Fund is a share class denominated in New Zealand dollars .

Foreign currency hedging arrangements are in place within the NZD Hedged Z-Share Class of the Fund which effectively provide investors in this class with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

Section EX 46(10)(c) of the Income Tax Act 2007 does not apply to prevent the use of the fair dividend rate ("FDR") method but would apply if the NZD Hedged Z-Share Class of the Fund was the only class of shares on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in the NZD Hedged Z-Share Class of the Fund, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

### Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
   - Is an Irish Managed Investment Scheme;
   - Is known at the date of this determination as the Colchester Global Bond Enhanced Currency Fund; and
   - Is operated with separate classes of shares.
2. The attributing interest consists of the New Zealand dollar denominated class of shares issued in the Colchester Global Bond Enhanced Currency Fund NZD Hedged Accumulation Class – Z Shares, a class of shares that provides exposure solely to the Colchester Global Bond Enhanced Currency Fund that predominantly (i.e. 80% or more by value at a time in the income year) holds financial arrangements such as international fixed interest securities; and
3. The investment assets attributable to the New Zealand dollar denominated class of shares are subject to currency hedging arrangements undertaken by the non- resident for the purpose of eliminating exchange rate risk for New Zealand investors on a highly effective basis.

## Interpretation

In this determination unless the context otherwise requires:

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007; and

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007.

## Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

## Application Date

This determination applies for the 2022 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this 12th day of May 2021

**Greg Adamson**
Technical Specialist - Network

# REGULAR CONTRIBUTORS TO THE TIB

**Tax Counsel Office**

The Tax Counsel Office (TCO) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The TCO also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

**Legal Services**

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

**Technical Standards**

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

**Policy and Regulatory Stewardship**

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

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