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TAX INFORMATION Bulletin

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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 **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 **ird.govt.nz/subscription-service/subscription-form** to receive regular email updates when we publish new draft items for comment.

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
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New legislation

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QB 23/06: GST – goods purchased on deferred payment terms 291

This question we've been asked explains when a person registered for GST on a payments basis can claim an input tax deduction for goods purchased on deferred payment terms.

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 2022—23, Platform Economy, And Remedial Matters) Act 2023

Overview

The Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Act 2023 was introduced on 8 September 2022. It received its first reading on 22 September 2022, its second reading on 8 March 2023 and its third reading on 28 March 2023. The new Act received Royal assent on 31 March 2023.

It amends the:

- Income Tax Act 2007
- Goods and Services Tax Act 1985
- Tax Administration Act 1994
- Taxation (Annual Rates for 2021—22, GST, and Remedial Matters) Act 2022
- Income Tax Act 2004
- Companies Act 1993
- Insolvency Act 2006, and
- Residential Tenancies Act 1986.

The new legislation:

- Implements an information reporting and exchange framework developed by the Organisation for Economic Co-operation and Development on digital platforms
- Introduces rules to collect GST on accommodation and transportation services provided through electronic marketplaces
- Clarifies the GST treatment of charges, including fees and levies, payable under New Zealand Acts and regulations
- Reforms the GST apportionment and adjustment rules for assets used for both business and private purposes or in making exempt supplies
- Removes uncertainty created by recent changes to Australia's application of its corporate tax residence rules by ensuring affected New Zealand companies have uninterrupted access to New Zealand's loss grouping, consolidation and imputation credit regimes
- Resolve integrity issues with the application of the domestic dividend exemption and corporate migration rules to dual resident companies
- Exempts public transport, bicycles, electric bicycles, scooters, electric scooters, and certain vehicle share services for these modes of transport, from fringe benefit tax
- Exempts "build-to-rent" developments from the interest limitation rules for residential property in perpetuity, for as long as they meet the requisite asset class definition
- Grant overseas donee status to nine New Zealand charities with overseas charitable purposes
- Provide targeted relief in response to the recent North Island floods, and
- Make other minor technical and remedial changes to tax legislation.

Annual rates for 2022-23

Annual setting of income tax rates

Section BB 1 and Schedule 1 of the Income Tax Act 2007

Section 3 of the Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Act 2023 sets the annual income tax rates that apply for the 2022–23 tax year at the rates specified in Schedule 1 of the Income Tax Act 2007.

Background

Section BB 1 of the Income Tax Act 2007 requires that income tax rates be set by an annual taxing Act.

Key features

The annual income tax rates for the 2022–23 tax year are set at the rates specified in schedule 1 of the Income Tax Act 2007. These rates are the same as those that applied for the 2021–22 tax year.

Effective date

The amendment is effective for the 2022–23 tax year.

Platform economy

Information reporting

Sections 3, 22, 89C(lbab), 91AABB, 94D, 142J, 142K, 143(2E), 185E, 185S, 185T and 226F of the Tax Administration Act 1994

The amendments give legislative effect in New Zealand to an information reporting and exchange framework developed by the Organisation for Economic Co-operation and Development (OECD).

The reporting rules require platform operators to provide tax authorities with information about sellers and the income they earn from certain activities on digital platforms. This information will then be exchanged between tax authorities which have implemented the rules.

Under the rules, platform operators based in New Zealand are required to provide Inland Revenue with information about consideration sellers receive from the following activities provided through digital platforms:

- the rental of immovable property (including commercial, short-stay, and visitor accommodation), and
- personal services (including any time-based or task-based work, such as ride-sharing, food and beverage delivery, and graphic and web design services).

The rules also include requirements for platform operators to report on consideration earned by sellers from the sale of goods and vehicle rentals. However, the requirement for platform operators to report on information about the sale of goods and vehicle rental is not in force and platform operators will only be required to report on this information if these rules are implemented in New Zealand.

The material in this *Tax Information Bulletin* item explains New Zealand's implementation of the model reporting rules for digital platforms. It does not provide comprehensive analysis of the rules themselves. The rules themselves, including associated commentary and guidance, are available on the OECD's website. Further information on where this material can be accessed is included at the end of this item.

Background

Inland Revenue receives information about income earned by taxpayers from a range of sources. For employees, Inland Revenue receives income information from employers on a regular basis. For those with investment income, Inland Revenue receives information from companies, banks, and other investment vehicles on a regular basis. Inland Revenue relies on this information to administer the tax system. This information is used to make sure that taxpayers are paying the right amount of tax and are receiving correct entitlements under social policy schemes.

Taxpayers that provide their skills, assets, and labour through digital platforms will have corresponding tax obligations, such as being required to declare their income and expenses from these activities, pay tax on any profits they make, and potentially being required to register for GST.

Despite digital platforms having become an increasingly popular means of conducting businesses or supplementing income, Inland Revenue did not receive information about income taxpayers earnt from their activities on such platforms prior to the enactment of this legislation, unless specific requests were made. By design, digital platforms hold a significant amount of information about taxpayers (such as the amount of consideration received for activities provided through the platforms) that can assist Inland Revenue and other tax authorities to ensure taxpayers are complying with their tax obligations.

The OECD developed the *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy* in response to calls for a global reporting framework that would enable tax authorities to have improved visibility over income taxpayers earned from their activities carried out through digital platforms. In addition to improving tax authorities' access to information, the rules are intended to reduce compliance costs for platform operators that could otherwise face reporting obligations in multiple jurisdictions with different reporting rules.

Similar reporting rules have been in place for digital platform operators in the European Union. These took effect at the beginning of 2023. The OECD's rules are similar in their operation and scope to the EU rules. This should enable information-sharing between tax authorities based in the EU and other OECD members that have implemented the rules.

Information reported to Inland Revenue under these rules will be exchanged with foreign tax authorities under the *Multilateral Convention for Mutual Administrative Assistance in Tax Matters* on a similar basis to information reported to Inland Revenue under the Common Reporting Standard. The information sharing is pursuant to a multilateral competent authority agreement—the *Multilateral Competent Authority Agreement on Automatic Exchange of Information on Income Derived through Digital Platforms*—that New Zealand's competent authority signed in November 2022.

All legislative references in this article are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

Key features

The key features of the amendments include:

- Incorporating model reporting rules for digital platforms developed by the Organisation for Economic Co-operation and Development (OECD) into the TAA. These rules are defined as the "model reporting standard for digital platforms".
- Providing the option to implement the OECD "extended model reporting standard for digital platforms" by Order in Council in New Zealand at a later date, but by no later than 1 April 2026.
- Changes to the TAA necessary to support the interpretation and implementation of the model reporting standards in New Zealand.
- Requiring Reporting Platform Operators and Sellers to comply with the requirements set out in the reporting standards, including due diligence procedures, reporting, and record keeping.
- New civil penalties that could apply if Reporting Platform Operators and Sellers do not comply with their obligations under the reporting standards.
- A regulation-making power that enables the Governor-General to make Orders in Council that block the effect of future changes to the model reporting standards if necessary.

Effective date

The amendments take effect on 1 January 2024 and would be effective for the 2024 and later calendar years. On this timeframe:

- New Zealand-based Reporting Platform Operators would be required to collect information on Sellers that receive Consideration from activities on their platforms from 1 January 2024.
- These Reporting Platform Operators would need to report this information to Inland Revenue in early 2025, and Inland Revenue could exchange information with other tax authorities in early 2025.

Detailed analysis

Key terms

"**Reporting Standards**" refers to the OECD publications the *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy* (July 2020) and Part II of the *Model Reporting Rules for Digital Platforms: International Exchange Framework and Optional Module for Sale of Goods* (June 2021), as applicable.

The following terms are defined in the applicable reporting standard. These definitions are accurate at the time of publication.

A "**Platform**" means any software, including a website or a part thereof and applications, including mobile applications, accessible by users and allowing Sellers to be connected to other users for the provision of Relevant Services, directly or indirectly, to such users. The operations of the Platform may also include the collection and payment of Consideration in respect of Relevant Services. The term Platform does not include software exclusively allowing the:

a) processing of payments in relation to Relevant Services

b) listing or advertising of Relevant Services, or

c) redirecting or transferring of users to a Platform without any further intervention in the provision of Relevant Services.

A "**Platform Operator**" is an Entity that contracts with Sellers to make available all or part of a Platform to such Sellers.

A "**Reporting Platform Operator**" is any Platform Operator that is resident for tax purposes in New Zealand or, where a Platform Operator does not have a residence for tax purposes, either:

a) is incorporated under the laws of New Zealand, or

b) has its place of management (including effective management) in New Zealand.

A "**Seller**" is a Platform user that is registered at any moment during the Reportable Period on the Platform for the provision of Relevant Services. (Note: The Reporting Standards also include definitions of "Active Seller" and "Excluded Seller" which are relevant for the purposes of due diligence procedures and determining which Sellers are reportable. These rules are set out in the Reporting Standards.)

"**Consideration**" is compensation in any form that is paid or credited to a Seller in connection with Relevant Services, the amount of which is known or reasonably knowable by the Platform Operator.

A "**Relevant Service**" is:

a) the rental of immovable property, or

b) a Personal Service for Consideration.

Overview

In summary, the new rules will affect:

- Sellers on digital platforms that receive Consideration from Relevant Activities, and
- operators of digital platforms that connect buyers with Sellers of Relevant Activities.

Relevant Activities include the rental of immoveable property (such as visitor and short-stay accommodation) and personal services (such as ride-sharing). These activities were identified by the OECD as the most significant in the gig and sharing economy currently.

Under the Reporting Standards, Sellers on digital platforms must provide additional information to Platform Operators. This information includes their tax file number, country of tax residence, and other identifying information. New Zealand-based Platform Operators are then required to report information to Inland Revenue about the income earned by Sellers on their Platform. To the extent this information relates to New Zealand tax residents, Inland Revenue will use this information for tax administration purposes, such as checking that income had been included in Sellers' income tax returns. Where information relates to non-resident Sellers, Inland Revenue will share this information with those non-resident Sellers' tax authorities who could also use it for tax administration purposes.

Example 1: Basic operation of the Reporting Standards in New Zealand

Graeme (a New Zealand tax resident) and Lottie (a non-resident for tax purposes) operate through a New Zealand-based digital platform.

Under the amendments, the operator of the digital platform must collect identifying information from Graeme and Lottie and provide this, as well as details of the Consideration they receive from Relevant Activities, to Inland Revenue.

Inland Revenue can:

- use information it receives from the Platform Operator about Graeme for tax administration purposes (such as checking that Graeme has included income from his sales on the digital platform in his income tax return), and
- share information it receives from the Platform Operator about Lottie with the tax authority in the jurisdiction in which Lottie is a tax resident. Lottie's tax authority could also use this information for tax administration purposes.

Reporting Platform Operators are required to conduct due diligence procedures for Sellers on their Platform, collect and collate information about the Seller and the Consideration received from Relevant Activities, and report this to Inland Revenue.

This information must be reported for each calendar year by 7 February following the end of the calendar year.

Penalties may apply in circumstances where Reporting Platform Operators and Sellers do not comply with their obligations under the Reporting Standards.

Implementation of the Reporting Standards in New Zealand

Consistent with the approach for other international information-sharing agreements, the TAA refers to the OECD documents and incorporates them into New Zealand law by reference instead of full transposition.

Part 11B of the TAA contains provisions related to international information sharing agreements. New provisions have been inserted into Part 11B to refer to the model reporting standards for digital platforms. In particular, section 185E(5) provides that sections 185S and 185T impose requirements on a person relating to the reporting of information as required by the model reporting standard for digital platforms and, subject to implementation, the extended model reporting standard for digital platforms.

Broadly, these new sections apply to operators of New Zealand-based digital platforms and Sellers on those Platforms. They require operators and Sellers to comply with all requirements as set out in the Reporting Standards.

New section 185E(5) refers to two new Reporting Standards. These are:

- the model reporting standard for digital platforms, and
- the extended model reporting standard for digital platforms.

These Reporting Standards are defined in section 3.

New defined terms have been inserted into section 3. These terms are:

- the "model reporting standard for digital platforms"
- the "extended model reporting standard for digital platforms", and
- "reporting platform operator".

Sections 185S(4)(a) and 185T(4) provide that terms used in Part 11B have the same meaning as set out in the applicable Reporting Standard.

Model reporting standard for digital platforms

The definition of the "model reporting standard for digital platforms" refers to the OECD publication, the *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy.* This standard was developed by the OECD and G20 and it was agreed by the Council for the OECD. This was published in July 2020.

This standard contains the rules that require Reporting Platform Operators to provide information about tax resident and non-resident Sellers who provide the rental of immoveable property and Personal Services.

Extended model reporting standard for digital platforms

This definition encompasses both the "model reporting standard for digital platforms" as described above, and an additional standard, the *Model Reporting Rules for Digital Platforms: International Exchange Framework and Optional Module for Sale of Goods.* This was published by the OECD in June 2021. The definition only refers to Part II of the publication as Part I is the draft text for the international exchange agreement.

This extended standard imposes reporting obligations for Reporting Platform Operators that facilitate the sale of goods and vehicle rentals.

The OECD produced this to match reporting rules designed by the European Commission that apply to members of the European Union from 2023 (known as "DAC7").[1] Members of the European Union can share information with jurisdictions outside of the European Union to the extent that the receiving jurisdiction has rules of equivalence with the European Union.

The extended model reporting standard for digital platforms has not been implemented in New Zealand. The Minister of Revenue could recommend an Order in Council be made to implement these requirements in New Zealand, but this must be made before 1 April 2026. If not made by then, and the extended model reporting standard for digital platforms is to apply in New Zealand, Parliament would need to pass legislation providing for the implementation of the standard.

Inland Revenue does not expect it would use information about the sale of goods and vehicle rental for tax compliance purposes at this time. When the Bill was introduced, it was understood that New Zealand must implement this standard to

1 Council Directive (EU) 2021/514 (DAC7) introduces an obligation on platform operators to provide information on income derived by sellers through the platform and allows tax authorities of EU Member States to collect and automatically exchange such information.

receive information from foreign tax authorities. It became evident this was not a requirement and Inland Revenue could receive information from foreign tax authorities about the rental of immovable property and personal services from foreign tax authorities without implementing the extended model reporting standard for digital platforms.

The extended model reporting standard for digital platforms may be implemented in New Zealand if the benefits become clear in the future. This could be the case if, for example, it became evident that several New Zealand Platform Operators had multiple reporting obligations to foreign tax authorities under foreign rules. It could be easier for New Zealand Platform Operators to report information to one tax authority – Inland Revenue – instead of foreign tax authorities.

Reporting Platform Operator

The definition provides that, for the purposes of these new rules, the term Reporting Platform Operator has the meaning set out in the model reporting standard for digital platforms, or the extended model reporting standard for digital platforms, as applicable.

Broadly, a person is a Reporting Platform Operator if:

- they are a Platform Operator (as defined in the Reporting Standards) and they are a tax resident in New Zealand, or
- if they do not have a residence for tax purposes, they have a place of management (including effective management) in New Zealand or are incorporated in New Zealand.

A person is a "Platform Operator" if they contract with Sellers to make available all or part of a Platform to such Sellers.

The Reporting Standards include special rules that apply in circumstances where there is more than one reporting Platform Operator. These rules prevent the need for multiple Reporting Platform Operators to provide the same information about the same Seller to different tax authorities.

Automatic flow-through of changes made to the model Reporting Standards

A key feature of the new amendments is that any changes made at the OECD level to the model reporting standard for digital platforms will automatically flow-through into New Zealand law unless explicitly blocked by an Order in Council made by the Governor-General made on recommendation of the Minister of Revenue under section 226F (see *Regulations related to the model reporting standards for digital platforms below).*

The same automatic flow-through would also apply to the extended model reporting standard for digital platforms, if implemented in New Zealand.

Implementation and administration of the Reporting Standards

Section 185S contains various provisions that are necessary to support the interpretation, administration, and implementation of the Reporting Standards in New Zealand.

Section 185S(2) and (3) requires Reporting Platform Operators and Sellers to comply with all the requirements of them as set out in the model reporting standard for digital platforms.

Section 185S applies when a person who is resident in New Zealand carries on a business by way of a digital platform through which a Seller of goods or services may operate in New Zealand.

A Platform that has a presence in New Zealand may not necessarily be "carrying on a business by way of a digital platform through which a Seller of goods or services may operate in New Zealand". This may be the case where a New Zealand entity is established to provide supporting functions to a Platform which is based offshore.

Example 2: Application of the Reporting Standards in New Zealand

Rapid Ride is a large ride-sharing digital platform that is headquartered in the EU. Rapid Ride have a New Zealand operation that deals with New Zealand public relations and New Zealand advertising. The New Zealand branch pays licensing fees to the EU-based parent entity.

As the New Zealand branch of Rapid Ride only deals with public relations and advertising, this does not meet the threshold for carrying on a business by way of a digital platform under section 185S(1).

This means that section 185S does not apply to the New Zealand subsidiary of Rapid Ride and they are not required to report in New Zealand. As Rapid Ride is based in Europe, it is anticipated that they will report via the EU and this information will be exchanged in due course with New Zealand to the extent it relates to New Zealand resident underlying Sellers operating through Rapid Ride.

Section 185S(4)(a) imports definitions used in the Reporting Standards into the TAA for Part 11B. Section 185S(4) also further clarifies how certain provisions in the Reporting Standards apply in New Zealand. It specifies that:

- references to a jurisdiction in the Reporting Standards are to be taken as a reference to New Zealand, unless the context requires otherwise (section 185S(4)(b))
- an optional provision in the Reporting Standards that would exclude smaller-scale Platform Operators from the reporting requirements (below EUR 1 million turnover) does not apply in New Zealand (section 185S(4)(c))
- the commencement provision refers to 1 January 2024, being the date that the Reporting Standard will apply from in New Zealand (section 185S(4)(d))
- specific references to financial account identifiers in the Reporting Standard refers to a list maintained by the Commissioner of Inland Revenue (the Commissioner) that outlines receiving jurisdictions using financial account identifier information (section 185S(4)(e))
- an extension to the definition of *Reporting Platform Operator* contained as an optional extension to the reporting rules that would require a Platform that operates in a jurisdiction that has not implemented the rules to report directly to New Zealand does not apply in New Zealand (section 185S(4)(f))
- the due date for Reporting Platform Operators to report information to Inland Revenue is 7 February instead of 31 January (section 185S(4)(g)).

Record-keeping requirements

The TAA includes record-keeping requirements that are set out in section 22. Sections 22(2)(fe) and 22(2)(lf) require Reporting Platform Operators to retain records showing the steps undertaken in the operation of the digital platform and the information relied on for the performance of the due diligence procedures and reporting requirements as set out in the Reporting Standards.

This information must be retained for a period of at least 7 years after the end of the income year to which the information relates.

These records must be kept in New Zealand and in English or te reo Māori unless the Reporting Platform Operator has approval from the Commissioner of Inland Revenue to store the records outside New Zealand or in a language other than English or te reo Māori. Standard Practice Statement SPS 21/02 *Retention of business records in electronic formats, application to store records offshore and keeping records in languages other than English or te reo Māori* contains further information on these rules.

Implementation of the extended model reporting standard for digital platforms by Order in Council

Section 185E(5)(b) sets out that the extended model reporting standard for digital platforms is not in force in New Zealand until it is implemented by an Order in Council.

Section 185T(1) provides that the Governor-General may, on recommendation by the Minister of Revenue, declare a date on which the extended model reporting standard for digital platforms is to be implemented in New Zealand. Section 185T(2) provides that if the extended model reporting standard for digital platforms is implemented in New Zealand, Reporting Platform Operators and Sellers must comply with the requirements set out in this standard.

Until (and unless) the extended model reporting standard for digital platforms is implemented in New Zealand, New Zealand based operators of digital platforms need to consider their reporting obligations to foreign tax authorities. For example, a New Zealand based platform operator that enables European tax residents to sell goods may have to report information to EU tax authorities about EU tax residents. Inland Revenue will not receive and exchange this information unless the extended model reporting standard for digital platforms is implemented.

Section 185T(5) limits the ability for the Governor-General to make an Order in Council implementing the extended model reporting standard for digital platforms in New Zealand. Such an Order must be made by 1 April 2026, being three years after the date on which this provision was enacted, otherwise the extended model reporting standard for digital platforms can only be implemented in the future by primary legislation.

Section 185T(4) provides that section 185S(4), which sets out how definitions used in the Reporting Standards apply for the purposes of Part 11B , equally applies to the extended reporting standard. The effect of this is that defined terms in the extended model reporting standard for digital platforms also apply for the purposes of Part 11B.

Section 185T(4)(b) also empowers the Commissioner of Inland Revenue to make determinations setting the New Zealand dollar equivalent to a monetary threshold in the extended model reporting standard for digital platforms that is expressed in EUR. The threshold applies for the purposes of the "Excluded Seller" definition which is relevant for Reporting Platform Operators that facilitate the sale of goods. The determination would be made under section 91AABB.

Section 91AABB(2) enables the Commissioner to amend the New Zealand dollar equivalent of the EUR threshold if necessary to account for exchange rate fluctuations to ensure its consistency with the extended model reporting standard for digital platforms.

The Commissioner can only make a determination for a year (or years) if the extended model reporting standard for digital platforms has been implemented in New Zealand.

Section 91AABB(5) sets out that a person affected by a determination made under section 91AABB may dispute or challenge the determination in accordance with the processes set out in Parts 4A and 8A.

Section 91AABB(6) requires the Commissioner to publish a notice in a publication chosen by the Commissioner setting out the New Zealand dollar equivalent for these purposes. It is expected this will be Inland Revenue's website.

Due diligence procedures

The Reporting Standards contain due diligence procedures that Reporting Platform Operators must conduct in relation to Sellers that are active on a digital platform for a Reportable Period (a calendar year). This involves collecting identifying information about Sellers, such as their name, date of birth, address, and tax file number (including the jurisdiction that issued the tax file number). Reporting Platform Operators are also required to consider the Seller's tax residence based on address information provided by the Seller. Further information on the due diligence procedures is included in the Reporting Standards themselves.

The Reporting Standards require Reporting Platform Operators to complete the due diligence procedures set out in the standards by 31 December (the end of the reportable period).

Option to report only on New Zealand tax resident Sellers under the model reporting standard for digital platforms

New section 185T(3) provides that Reporting Platform Operators based in New Zealand would be able to choose to apply only the model reporting standard for digital platforms (that covers the rental of immovable property and personal services) and not the extended model reporting standard (that covers the sale of goods and vehicle rentals), provided that the Sellers operating on the digital platform are tax resident in New Zealand and are not tax resident in a country or territory other than New Zealand. The optionality provided by section 185T(3) would only be relevant if the extended model reporting standard was implemented by an Order in Council made under section 185T(1).

Example 3: New Zealand-based digital platform with a New Zealand tax resident Seller receiving Consideration for the sale of goods

Rose is a New Zealand tax resident and provides luxury accommodation in a bach she owns in Waikanae. Rose is not a tax resident in another jurisdiction.

Rose renovates her property and decides to sell second-hand furniture on a New Zealand digital platform, "Kraymond's List", that facilitates the sale of goods.

Under 185T(3) , the operator of "Kraymond's List" could choose:

- to apply the model reporting standard for digital platforms only in respect of Rose — this would mean that it did not need to provide Inland Revenue with any information about Rose; or
- to apply the extended model reporting standard for digital platforms — this would mean it needed to provide information to Inland Revenue about the Consideration Rose received from the sale of the second-hand furniture.

If Rose were a non-resident for tax purposes, the operator would be required to apply the extended model reporting standard and provide Inland Revenue with information about the Consideration Rose received from the sale of goods.

The purpose of this is to recognise that New Zealand has international obligations to collect and share information about non-resident Sellers on New Zealand-based digital platforms with foreign tax authorities. Without collecting and sharing this information, there would be a risk that foreign tax authorities would not share information they hold on New Zealand tax resident Sellers with Inland Revenue. However, as this risk does not arise in relation to collecting and sharing information about New Zealand resident Sellers, providing Reporting Platform Operators based in New Zealand with a choice as to whether they report to Inland Revenue information about New Zealand tax resident Sellers that receive income from the sale of goods or vehicle rentals would allow those operators to reduce their compliance costs.

Form, due date, and use of information under the Reporting Standards

The Act does not prescribe the form and use of information under the Reporting Standards directly. These requirements are contained in the Reporting Standards.

The Reporting Standards require Reporting Platform Operators to provide information to tax authorities in accordance with the OECD Sharing and Gig Economy XML Schema. This ensures that the data tax authorities receive will be in a standardised format that is capable of being exchanged between tax authorities.

The Reporting Standards also require that information be provided by 31 January following the completion of the calendar year (although section 185S(4)(g) changes this to 7 February in New Zealand). This timeframe is necessary to enable jurisdictions to exchange the information with other relevant jurisdictions, thereby ensuring foreign tax authorities have time to use the information in the tax assessment process for Sellers.

Inland Revenue would use the information it receives under the Reporting Standards (and from foreign tax authorities) for tax administration purposes. This would include cross-checking of Sellers' income tax returns against information to ensure that they were declaring income from their activities conducted through digital platforms.

Enforcement and penalties

Jurisdictions that implement the Reporting Standards are required to implement effective enforcement provisions to address any non-compliance by:

- Platform Operators with reporting obligations, and
- Sellers who must provide Platform Operators with information about themselves.

The Act therefore introduces new civil penalties to the TAA that could apply to Platform Operators and Sellers that fail to comply with their obligations under the Reporting Standards. The penalties in the Act are based on penalties introduced to the TAA when the Common Reporting Standard (CRS) (an OECD information exchange relating to financial account information) was implemented in New Zealand.

The definition of "civil penalty" in section 3(1) has been amended to include references to the new penalties for Platform Operators (section 142J) and Sellers (section 142K). This ensures that late payment penalties and use-of-money interest apply when penalties have been assessed if they have not been paid by the due date.

The new civil penalties are discretionary. They must be assessed by the Commissioner before they become payable. Section 94D(1) sets out that the Commissioner may make an assessment for a Reporting Platform Operator of the amount of the penalty that, in the Commissioner's opinion, ought to be imposed. The Commissioner can make an assessment of a penalty under sections 142J and 142K without the need to issue a notice of proposed adjustment (NOPA). This is provided for in section 89C(lbab).

If the Commissioner makes an assessment, the Reporting Platform Operator is liable to pay the penalty assessed. This applies unless the Reporting Platform Operator establishes in proceedings challenging the assessment that the assessment is excessive, or that the Reporting Platform Operator is not chargeable with the penalty.

Under section 142J(6) (for operators) and 142K(3) (for Sellers), if the Commissioner assessed a penalty under either of new section 142J or 142K, the penalty would become payable on the later of:

- 30 days after the date on which the Commissioner makes the assessment for the penalty, and
- the date set out by the Commissioner in the notice of assessment as being the due date for payment of the penalty.

Section 94D(3), penalties would not apply to the extent that a Platform Operator or Seller, as applicable, establishes in proceedings challenging the assessment of the penalty that the penalty is excessive, or that the operator or the Seller is not chargeable with the penalty.

The Commissioner would be required to make an assessment of the penalties before the penalties are payable by the Platform Operator or the Seller. The Commissioner would be able to make an assessment of the penalties without needing to issue a notice of proposed adjustment.

Penalties when Platform Operators fail to comply with their obligations

Section 142J(1) provides that Reporting Platform Operators may be liable for penalties where they have an obligation to comply with the requirements set out in the model reporting standard for digital platforms and/or the extended model reporting standard for digital platforms (as applicable), and they do not meet the requirements for Sellers operating on their Platform. The Commissioner can only assess penalties for Reporting Platform Operators if the non-compliance is serious or unreasonable.

Under section 142J(2) a Reporting Platform Operator will be liable for a penalty of $300 for each occasion that they do not meet the requirements that are set out in the applicable model reporting standard for digital platforms. This is capped at a maximum of $10,000 per "reportable period" (a calendar year) by section 142J(5). Reporting Platform Operators are not liable to pay these penalties if the failure to meet the requirements under the applicable model reporting standard for digital platforms is shown to be due to circumstances outside of their control.

Sections 142J(4) and (5) set out the penalties that may be applied in circumstances where a Reporting Platform Operator does not take reasonable care to meet a requirement and no penalties are imposed under section 142J(2). In these circumstances, the Commissioner can make an assessment of penalties payable on each occasion the Reporting Platform Operator is identified as having failed to take reasonable care to meet a requirement in the applicable Reporting Standards. On the first occasion, the Commissioner can assess a penalty of $20,000. On subsequent occasions, the Commissioner can assess a penalty of $40,000. The maximum amount that can be assessed for a reportable period is $100,000 under section 142J(5).

Example 4: Penalties for Reporting Platform Operators

Inland Revenue anticipates receiving information from a New Zealand based digital platform that enables Sellers to receive Consideration from providing Personal Services through the digital platform. Inland Revenue does not receive this information by 7 February. It writes to the Platform Operator and asks when to expect the information.

The Reporting Platform Operator responds stating they refuse to comply with their obligations under the model reporting standards for digital platforms.

On this occasion, the Commissioner could consider assessing penalties under section 142J. If the Reporting Platform Operator continues to refuse to comply, the Commissioner could consider assessing additional penalties under section 142J, subject to the caps in section 142J(5).

Penalties when Sellers fail to comply with their obligations

A person who is a Seller on a digital platform could be liable for a penalty under new section 142K where they have an obligation to provide information to a Reporting Platform Operator under a reporting standard and they fail to comply with their obligations.

The Commissioner can assess a penalty of $1,000 in circumstances where the Seller:

- provides false or misleading information to the operator about either themselves or another person or entity
- does not provide information to the operator about either themselves or another person or entity within a reasonable time after having received a request for the information, or
- does not provide information that they are required to provide under the applicable reporting standard.

Example 5: Seller fails to provide Platform Operator with required information

Charlie sells goods on a popular digital platform based in New Zealand. He is a non-resident for tax purposes in New Zealand.

As part of Charlie's on-boarding process, the Platform Operator asks Charlie to provide his tax identification number and the country that issued his tax identification number.

Charlie does not provide this information to the Platform Operator because he knows that it would result in information about his sales on the digital platform being shared with his tax authority.

Under the proposed amendments, the Commissioner could assess a penalty of $1,000 that Charlie would be liable to pay under section 142K in these circumstances.

Absolute liability and strict liability offences would not apply

The TAA includes criminal penalties that apply on conviction of absolute liability or strict liability offences. Section 143(2E) ensures that Platform Operators and Sellers cannot be convicted of an absolute liability or strict liability offence if they fail to comply with a requirement under the Reporting Standards.

Regulations related to the model reporting standards for digital platforms

Section 226F contains a regulation-making power that enables the Governor-General to make Orders in Council that provide for the cancellation, reversal, or non-application of changes to the model reporting standards for digital platforms in New Zealand.

In general, changes made to the Reporting Standards by the OECD would take effect in New Zealand without the need for regulation or legislative change to incorporate the effect of the change in New Zealand. This is intended to ensure that New Zealand's rules are the same in their effect as other OECD members that have implemented the same rules.

The purpose of the regulation-making power is to provide a mechanism for blocking changes from having effect in New Zealand that are inappropriate. This could include, for example, changes that are optional and that the Government decides should not have legislative effect.

An Order in Council made under section 226F is not generally able to take effect in a reportable period prior to it coming into force. This means that if an Order in Council was made providing for the non-application of a change to a model reporting standard for digital platforms, that non-application would generally take effect from the following reportable period. However, section 226F(3) enables Orders in Council to be made that take effect from within a reportable period. No Orders made under section 226F could have the effect of requiring a Reporting Platform Operator from applying the effect of the Order retrospectively.

Section 226F(4) also provides that a regulation may provide for the change, extension, limitation, suspension or cancellation of an earlier regulation. Orders in Council made under section 226F are subject to the usual publication requirements for secondary legislation (for example, they would be published on the legislation.govt.nz website).

If an Order in Council is made under section 226F, Inland Revenue would communicate the effect of the changes on its website. Inland Revenue may also communicate the effect of the changes on a targeted basis to Reporting Platform Operators that it is aware of.

Detailed guidance on the model reporting standards for digital platforms

The guidance in this *Tax Information Bulletin item has focused on the specific amendments to New Zealand's tax laws that give effect to, or support implementation of, the OECD model reporting standards for digital platforms in New Zealand.*

Further information, including the relevant OECD publications, FAQs, and interpretative guidance, is available on the OECD's website at **https://www.oecd.org/ctp/exchange-of-tax-information/model-rules-for-reporting-by-platform-operators-with-respect-to-sellers-in-the-sharing-and-gig-economy.htm**

Marketplace rules for listed services

The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 was enacted on 31 March 2023. The amendments give effect to changes that require operators of electronic marketplaces to collect GST on supplies of "listed services" that include:

- ride-sharing and ride-hailing
- delivery services for beverages, food, or both, and
- taxable accommodation

that are performed, provided, or received in New Zealand.

The changes take effect on 1 April 2024 unless otherwise stated.

Inland Revenue is making changes to its systems and processes in time for 1 April 2024 that will support and provide guidance to marketplace operators and those that provide services through electronic marketplaces. This includes changes to the GST registration process for marketplace operators. Information about these changes will be included on Inland Revenue's website closer to 1 April 2024.

The new legislation extends the scope of existing rules that apply to marketplace operators involved in the supply of remote services since October 2016 and low value imported goods (also referred to as "distantly taxable goods") since December 2019.

All legislative references in this section of this *Tax Information Bulletin* are to the Goods and Services Tax Act 1985 (the GST Act) unless otherwise stated.

Key features

Scope of the new rules

From 1 April 2024, the supply of "listed services" made through an electronic marketplace will be subject to GST whether the person providing the services through the electronic marketplace is registered for GST or not. The new rules will require operators of electronic marketplaces to collect and return GST on supplies of listed services that they are treated as making. Marketplace operators will only be required to collect and return GST on supplies of listed services if their total supplies in New Zealand including the listed services exceed, or are expected to exceed, the GST registration threshold of NZ$60,000 in a 12-month period.

The following services, which are further explained later in this report, are included within the scope of "listed services":

- accommodation other than accommodation that would be exempt under the GST Act
- ride-sharing and ride-hailing services
- delivery services for food, beverages, or both

provided that these services are performed, provided, or received in New Zealand.

The new rules apply to marketplace operators regardless of their residence for GST purposes. This means that resident and non-resident marketplace operators need to consider GST registration if they enable the supply of listed services.

Flat-rate credit scheme

A flat-rate credit scheme that requires marketplace operators to pass on a proportion of the GST collected on supplies of listed services to underlying suppliers that are not registered for GST, has been introduced. The flat-rate credit scheme provides a "credit" to underlying suppliers who are not required to be registered for GST because their total supplies are below the GST registration threshold. This is intended to recognise the GST incurred by unregistered underlying suppliers on goods and services used to make supplies of listed services.

Standard GST registration is available for underlying suppliers that do not have to be registered for GST and do not want to apply the flat-rate credit scheme. The flat-rate credit was determined with reference to the average amount of input tax that GST-registered suppliers of listed services recovered. It is not intended to recognise GST on capital assets such as land or vehicles used to make supplies of listed services. This is because a person that supplies listed services, and who is not registered for GST, would not account for output tax on the disposal of such assets.

For underlying suppliers that are registered for GST, they will continue accounting for input tax on their expenses in their own GST returns. They will no longer be responsible for accounting for GST output tax on supplies of listed services as this will be done by marketplace operators unless the underlying supplier has opted out of the marketplace rules.

Opting out of the rules

New provisions enable certain underlying suppliers to opt-out of the marketplace rules. The effect of opting out of the marketplace rules means that underlying suppliers, instead of marketplace operators, would continue being responsible for accounting for GST on supplies of listed services.

Some GST-registered underlying suppliers with larger-scale operations can opt-out of marketplace rules provided they meet certain criteria. Agreement will be required between marketplace operators and underlying suppliers who choose to opt-out of the rules in some circumstances. In other circumstances, underlying suppliers with more significant operations will be able to unilaterally opt-out of the marketplace rules by notifying the marketplace operator. If an underlying supplier opts out of the marketplace rules, they choose to remain responsible for their own GST obligations in respect of supplies they make through electronic marketplaces.

The provisions enabling underlying suppliers to opt-out of the rules came into force on 31 March 2023 to enable these rules to be used ahead of the other rules applying from 1 April 2024.

Consequential amendments

The marketplace rules for listed services are based on existing rules in the GST Act that apply to marketplace operators. These rules have been present in the GST Act since 1 October 2016 when the rules for GST on remote services were introduced. They were expanded on 1 December 2019 with the introduction of GST on distantly taxable goods.

Amendments have been made to the rules for electronic marketplaces, where appropriate, to ensure that those same rules continue to apply to marketplace operators that are treated as suppliers of listed services.

Background

GST is a broad-based consumption tax that applies to the supply of most goods and services made in New Zealand. To ensure GST remains simple, fair, and efficient, a fundamental principle of New Zealand's GST system is that GST should apply to all consumption that occurs in New Zealand.

GST came into force in New Zealand in October 1986 before the introduction of e-commerce and the growth and popularity of the internet. Since then, the scope of GST has been expanded to apply in circumstances not originally envisaged when GST was introduced.

Changes were made in 2016 to ensure that GST applied to cross-border supplies of "remote services". This included remote services that are supplied through electronic marketplaces such as app sales through app stores.

Changes were also made in 2019 to ensure that GST applied to supplies of certain imported goods. These changes included requirements that operators of electronic marketplaces—instead of the seller on the marketplace—would become liable for collecting and returning GST on goods supplied through the marketplace to a consumer providing a delivery address in New Zealand.

These changes were both premised on the principles of maintaining a broad-based GST system, under which GST applied to the broadest possible range of goods and services in New Zealand, and of promoting and protecting the sustainability of the GST base. The application of GST to these cross-border supplies of goods and services also removed distortions that arose when GST was typically being collected by those that provided the same goods and services within New Zealand.

These prior reforms followed consideration and consultation by the Organisation for Economic Co-operation and Development (OECD). In April 2021, the OECD published its report *The Impact of the Growth of the Sharing and Gig Economy on VAT/GST Policy and Administration.* This report outlined a range of options that jurisdictions could implement depending on their overarching policy objectives with its VAT/GST system. One option considered in this report is introducing rules requiring platform operators to collect and return GST on supplies of goods and services they enable sellers to make under a "deemed supplier" or "full liability regime" model. The Government enacted rules broadly aligned with this option as part of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 and following the Government discussion document *The role of digital platforms in the taxation of the gig and sharing economy* which was published in March 2022.

Effective date

The amendments incorporating "listed services" into the GST Act generally take effect on 1 April 2024.

The amendments enabling underlying suppliers to opt-out of the marketplace rules, provided criteria are met, have effect from 31 March 2023, being the date the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 received the Royal assent. This includes the amendments enabling the Commissioner of Inland Revenue (the Commissioner) to issue determinations that set out the criteria a person must meet before they can enter an opt-out agreement with a marketplace operator.

Key terms

There are several terms that have a specific meaning for the purposes of these new rules.

Listed services – This term refers to the services listed in section 8C(2) of the GST Act. The following services are included within the scope of "listed services":

- accommodation other than accommodation that would be GST-exempt
- ride-sharing/ride-hailing services
- delivery services for food, beverages, or both

where these services are performed, provided, or received in New Zealand.

Further information about the scope of "listed services" is included on page 19.

Underlying supplier – This is the person who would be the supplier of taxable accommodation, ride-sharing/ride-hailing, or food or beverage delivery services for GST purposes (and would therefore be responsible for returning GST on the services to Inland Revenue) in the absence of a specific provision of the GST Act deeming another person (such as the operator of an electronic marketplace) to be the supplier of those services. Generally, this refers to an accommodation host, driver, or deliverer who makes the supply of services to the consumer, using an electronic marketplace to find buyers for their services.

Accommodation host or **Host** – This refers to the person who would be the supplier of accommodation services, ignoring the effect of the marketplace rules which treat the operator of the marketplace as the supplier. This will generally be the owner of the land or property that is used to provide accommodation but could also include the person responsible for the operation of a hotel or motel, for example.

Electronic marketplace – The term "electronic marketplace" is defined in section 2(1). It refers to a marketplace that is operated by electronic means through which a person (the underlying supplier) makes a supply of goods, or of remote services by electronic means, or of listed services, through another person (the operator of the marketplace) to a third person (the recipient). It includes a website, internet portal, gateway, store, distribution platform, or other similar marketplace but it does not include a marketplace that solely processes payments.

Marketplace rules – This refers to rules that require operators of electronic marketplaces to account for GST on supplies they are treated as making. These rules apply where an underlying supplier provides listed services through an electronic marketplace to another person (the recipient). Instead of the underlying supplier accounting for GST on the supply of listed services, it is the marketplace operator that accounts for GST on the supply. The supplier, if registered for GST, will be treated as making a zero-rated supply to the marketplace operator and would therefore account for GST on the supply at the rate of 0% (or, in other words, the underlying supplier should include the value of the supply in the "zero-rated sales" box in its GST return).

Flat-rate credit – The term "flat-rate credit" refers to input tax that must be deducted by the operator of an electronic marketplace that is treated as the supplier of listed services where the underlying supplier has not notified the marketplace operator that they are registered for GST. Section 20(3N) sets out the prescribed rate of the flat-rate credit. For a supply of taxable accommodation, ride-sharing/ride-hailing, or delivery services for food and beverages, as at the date of publication, the prescribed rate is 8.5 percent of the value of the supply. The marketplace operator must pass this on to the underlying supplier.

Detailed analysis

Scope of the new rules

(Sections 2 and the definitions of "electronic marketplace", "flat-rate credit", and "listed services", 8(3), 8C, 10(6B), 60C of the GST Act)

The definition of "electronic marketplace" in section 2(1) is amended to reflect the different types of goods and services that can be provided through an electronic marketplace by an underlying supplier.

The definition now sets out that an electronic marketplace is a marketplace operated by electronic means through which another person (an "underlying supplier") may make a supply of certain goods or services through the operator of the marketplace to a recipient of those goods and services. Those goods and services include a supply of remote services, distantly taxable goods, and listed services. The concept of an electronic marketplace remains unchanged, which is essentially an electronic medium that matches buyers and sellers, or allows them to interact, to facilitate the sale and purchase of goods and services. It includes a website, internet portal, gateway, store, distribution platform, or other similar marketplace and excludes a marketplace that solely processes payments.

For these rules to apply, there must be an arrangement that involves an underlying supplier providing services through an electronic marketplace to a recipient. In circumstances where the recipient of the services contracts directly with a person and there is no electronic marketplace involved, the marketplace rules for listed services will not apply. The GST treatment of the supply of these services will depend on whether the supplier of the services is registered for GST.

New defined terms have been inserted for "flat-rate credit" and "listed services". The flat-rate credit refers to the deduction marketplace operators are required to take as input tax, and that must be passed on to underlying suppliers that are not registered for GST in recognition of the GST on goods and services they use to make supplies of listed services.

The definition of "listed services" refers to those services set out in section 8C(2). Listed services are not set out in the Interpretation provision of the GST Act and are instead set out in section 8C.

Section 8C sets out the substantive rules for listed services and signposts to other provisions in the GST Act that are relevant.

The "listed services" are:

- accommodation other than accommodation that would be GST-exempt
- ride-sharing and ride-hailing services, and
- delivery services for food, beverages, or both.

The services set out in section 8C(2) were identified by the OECD as the services creating the most urgent pressures from a GST perspective.

Setting out the listed services in subsection (2) means that additional services could be included as listed services over time. New legislation is required before additional services are included in listed services. There is no regulation-making power for adding to the list.

Section 8C(7) expands the scope of listed services to include services that are closely connected with these services that are advertised, listed, or otherwise made available through an electronic marketplace.

Accommodation other than accommodation that would be GST-exempt

Included in the definition of "listed services" is accommodation other than accommodation that is exempt from GST under section 14(1)(c). Accommodation is generally exempt under section 14(1)(c) if it is accommodation provided in a dwelling that is used by the person as their principal place of residence and for which they have rights of quiet enjoyment.

All other forms of accommodation provided in New Zealand are taxable, usually at 15%. This includes short-term rental and visitor accommodation. However, the GST Act includes special rules for supplies of certain domestic goods and services provided during a stay of more than four weeks in a "commercial dwelling". These rules provide for a special tax rate of 9% on these supplies. Section 10(6B) overrides these special rules for the purposes of accommodation supplied through an electronic marketplace. This is because it would be impractical for marketplace operators to identify whether the listed services would qualify as domestic goods or services supplied during a stay in a commercial dwelling or another type of taxable accommodation. Therefore, all accommodation services provided through an electronic marketplace (other than exempt accommodation) will be subject to GST at the standard rate of 15% where it is provided or received in New Zealand.

NEW LEGISLATION

It will generally be straightforward to determine whether accommodation has been provided or received in New Zealand. This is because underlying suppliers of accommodation in New Zealand will provide the marketplace operator through which accommodation is provided with the address of the property where the accommodation is provided.

A person that owns a property in which taxable accommodation is provided through an electronic marketplace may engage the services of a property manager to manage the property, for example holiday house rentals or apartments with management rights arrangements. In such circumstances the person that is supplying the accommodation through the electronic marketplace is the owner of the property and not the property manager. This means that the owner of the property is the underlying supplier.

In some situations, such as motels, a person (the lessee) may purchase a business lease from the freehold property owner (the lessor) and will run the accommodation business. In this situation, the lessee is supplying the accommodation through an electronic marketplace. It is therefore the lessee who is the underlying supplier, not the lessor.

The disposal of property used to provide accommodation through an electronic marketplace is not a listed service.

Ride-sharing and ride-hailing

The definition of ride-sharing and ride-hailing services is set out in section 8C(8). It sets out that these services are provided through an electronic marketplace that involves the engagement of a personal driver to transport a person to their chosen destination.

Ride-sharing and ride-hailing services therefore would not include services where the travel route is pre-determined by the supplier such as a bus route, a ferry service, cruise, or flight between certain destinations. In these cases, the passenger is not usually able to direct the driver towards a particular place, destination, or route. The passenger will also not usually have control over both the time and the destination.

Many types of transportation services involve the customer purchasing a service directly from a GST-registered supplier of transportation services, such as a bus company or boat charter. In these cases, the services are not provided through an electronic marketplace so the rules for marketplace operators do not apply. This is because the rules for marketplace operators apply only where there is an underlying supplier (of, for example, a listed service), a marketplace operator, and a recipient of the services. In a situation where a person contracts directly with the supplier of the services, there is no marketplace operator involved.

Delivery services for food and/or beverages

The transportation of beverages, food, or both these goods is included as a listed service. This does not include the supply of beverages or food itself. It is only the delivery services that are included in the definition.

The marketplace rules for listed services will not apply in circumstances where a business enters a contract with a person for the delivery of food and/or beverages, and that business engages the services of an independent contractor or an employee to carry out the delivery services. This is because in such circumstances the business is the supplier of the services (and not the independent contractor or the employee). GST will usually already apply to these services because the person providing them will generally be registered for GST.

In contrast, where a person uses an electronic marketplace operated by a third party to enter a contractual relationship with other persons for food and/or beverage delivery services, the marketplace rules for listed services will usually treat the marketplace operator as the supplier of these services for GST purposes. It will therefore be the marketplace operator with the obligation to return GST on the services to Inland Revenue and not the deliverer.

Example 6: Delivery services for food provided but not through an electronic marketplace

Andraya's Eats Ltd carries on a business of delivering restaurant meals to customers via its app. Andraya's Eats Ltd is registered for GST and GST applies to its services.

Andraya's Eats Ltd's business model involves arranging for independent contractors to undertake the delivery of restaurant meals to Andraya's Eats Ltd's customers. There is no contractual relationship between the independent contractors and Andraya's Eats Ltd's customers.

The rules for marketplace operators do not apply because Andraya's Eats Ltd is not an electronic marketplace. This is because the independent contractors that provide delivery services are not providing delivery services under any direct contractual agreement with Andraya's Eats Ltd's customers. The independent contractors are instead providing services to Andraya's Eats Ltd.

Andraya's Eats Ltd should continue to return GST under the standard GST rules.

Closely connected services

Section 8C(7) expands the scope of listed services to include services that are closely connected with a "listed service" referred to in section 8C(2). This means that marketplace operators are required to account for GST on these services if these services are advertised, listed, or otherwise available through the electronic marketplace.

This is intended to include services that are ancillary to the listed service, such as cleaning, where a fee is charged for such services as part of the overall supply of a listed service made through an electronic marketplace.

Example 7: Cleaning services

Jenny seeks accommodation on Waiheke Island for an upcoming holiday. She wants to stay in a holiday home on the beachfront and uses an electronic marketplace that offers accommodation to find a suitable place to stay.

Geoff provides accommodation in his property through the electronic marketplace.

Jenny pays a nightly rate to the electronic marketplace. Jenny is also charged a cleaning fee at the end of her stay. The electronic marketplace collects the cleaning fee as part of the total consideration that it collects from Jenny.

The marketplace operator would be required to account for GST on the cleaning fee as it corresponds to a service that is closely connected with taxable accommodation, which is a listed service.

An exception to the rule exists for closely connected services that are supplied by a marketplace operator to the recipient of the listed service. This is because the services are separate to the services provided by the underlying supplier. This is intended to exclude services such as a foreign exchange reserve that a marketplace operator may provide its customers.

Example 8: Reserving a foreign exchange rate

David is overseas-based and is looking for accommodation in New Zealand for an upcoming holiday. He uses an electronic marketplace for these purposes.

The marketplace operator offers a service to its customers that enables them to lock-in a foreign exchange rate. David is not sure when he will visit New Zealand but wants to reserve the foreign exchange rate that is available to him at the time he is browsing for accommodation.

This service is not closely connected with the supply of a listed service because the service is offered directly by the marketplace operator to David. The marketplace operator would not account for GST on the supply of this service under the rules for listed services. It may need to account for GST on the supply of this service to David under other GST rules.

A service would not be considered closely connected with a listed service if the service did not arise because of the listed service itself. The effect of this is that services which are not ancillary to a listed service, such as rental vehicle hire or a tourist attraction, would not be included within the scope of listed services and the marketplace operator would not account for GST on these supplies under the rules for listed services.

When marketplace operators are treated as suppliers

Amended section 60C provides that the operator of an electronic marketplace is treated as the supplier of listed services if the marketplace operator:

- authorises a charge for the supply of listed services to the recipient
- authorises the delivery of the supply of listed services to the recipient, and/or
- sets a term or condition under which the supply of listed services is made, whether directly or indirectly.

This applies whether the marketplace operator is a resident or non-resident for GST purposes in New Zealand. It also applies whether the underlying supplier of the listed services is a resident or a non-resident for GST purposes in New Zealand.

These are the same tests that apply to determine whether a marketplace operator is treated as the supplier of remote services supplied in New Zealand.

Example 9: Marketplace operator treated as the supplier of taxable accommodation

Chaz Intermediaries Ltd is a New Zealand tax resident and runs a website that connects accommodation hosts with guests. Hosts create an account on the website where they can upload photographs of their property, list dates that the property is available, and set a nightly rate.

Chaz Intermediaries Ltd offers this service for a fee that it charges hosts. Guests can book properties that are listed by hosts provided the property is available. Chaz Intermediaries Ltd connects the guest to a third-party payment processing portal which processes the payment for the booking.

Because Chaz Intermediaries Ltd authorises the charge for the supply of taxable accommodation, it is treated as the supplier of the accommodation to the guests.

Marketplace operators will not be treated as the supplier of listed services if neither of these tests are met. This means that a person that runs a website that contains a messaging board enabling a person to list properties available for rent may not be a marketplace operator.

Example 10: Website enables accommodation booking – website operator not a marketplace operator

Kraymond's List Ltd developed a smartphone app that lets users post community notices and classified advertisements for a small upfront listing fee. Several short-term accommodation hosts list properties available for rent on it. Guests can use the app to communicate with the hosts directly, although there are no rules preventing hosts and guests from communicating via other mediums such as email, phone, or other messaging apps, nor from posting links to listings on third-party websites.

Hosts manage property bookings directly, often through the messaging service offered by the app. Guests typically pay the hosts a deposit via internet banking transfer before staying in the property, and at the end of their stay, pay the balance of the booking. However, hosts can set their own policies as to whether they require a deposit to be paid upfront and, if so, how much the deposit is.

Aside from removing listings that are fraudulent or offensive, Kraymond's List Ltd does not moderate listings or intervene in disputes between hosts and guests.

Kraymond's List Ltd does not set any terms or conditions under which the supply of accommodation is made. It also does not authorise the charge for the supply of the accommodation. It is therefore not treated as the supplier of accommodation.

Listed services before 1 April 2024

The marketplace rules for listed services take effect on 1 April 2024. This means if a listed service is supplied through an electronic marketplace prior to 1 April 2024, the marketplace operator is not treated as the supplier of the services, and it would not account for GST on the sale of the services.

Example 11: Listed services purchased before 1 April 2024

Gerard and Nicole are based overseas. They purchase accommodation in New Zealand through an electronic marketplace in March 2024. The accommodation is booked for June 2024.

The marketplace operator is not treated as the supplier of the accommodation, and it therefore does not account for GST on the sale.

There are no special rules that determine the time of supply for listed services. The time of supply for listed services will therefore generally be the earlier of the time the marketplace operator issues an invoice, or the time any payment is received for the supply.

When multiple parties are involved in a supply of listed services

Section 60C(3) has been amended to apply in circumstances where it is necessary to determine which marketplace operator has the obligation to account for GST on a supply of listed services it is treated as making. Subsection (3) applies where multiple marketplace operators are involved in a single supply of listed services. Under these rules, it is the first marketplace operator that authorises the charge for the listed service or receives the consideration for the supply of the listed service, which is treated as the supplier.

When a marketplace operator is treated as the supplier of listed services, sections 8C(3) and 60(1C) apply. Under these rules:

- the person that provides the services through the electronic marketplace (the underlying supplier) is treated as having supplied those listed services to the operator of the electronic marketplace. These services are zero-rated under section 11A(1)(jc) and the underlying supplier therefore does not collect output tax on this supply.
- the operator of the marketplace receives the services from the underlying supplier and does not claim input tax for the services because the supply is zero-rated. The marketplace operator is also treated as supplying those same services to the recipient of the services. The supply of these services is standard rated where the services are performed, provided, or received in New Zealand. This means the marketplace operator is required to account for GST on the supply it is treated as making.

The obligation for the marketplace operator to account for GST on the supply it is treated as making applies in all circumstances provided the relevant tests are met (see *When marketplace operators are treated as suppliers* above for more information).

Whether a person is considered an operator of an electronic marketplace through which an underlying supplier makes a supply of listed services will depend on the specific facts. For instance, automated inventory tracking systems such as those used in the accommodation industry[2] would not be considered electronic marketplaces in and of themselves.

How marketplace operators account for GST on supplies of listed services they are treated as making

Section 8C(3) provides that section 60(1C) applies when a supply of listed services is made through an electronic marketplace. The effect of this is that, for a supply of listed services:

The underlying supplier is treated as making a supply to the operator of the electronic marketplace and this supply is zero-rated (under section 11A(1)(jc)) if the underlying supplier is GST-registered, or if the underlying supplier is not GST-registered the supply is not subject to GST.

The marketplace operator is treated as making this same supply, with the addition of GST at the standard rate of 15%, to the recipient of the listed services.

Where a marketplace operator has an agreement that entitles the underlying supplier to the consideration paid by the recipient of the listed services, it will need to consider whether its contracts need to be altered to allow it to retain, and own, enough of the funds paid by the customer so it can fund its GST liability in respect of the listed services.

For GST purposes, this would mean that the consideration paid for the supply that is treated as being made by the marketplace operator to the recipient of the listed services is more than the consideration paid by the marketplace operator for the deemed supply of listed services made by the underlying supplier to the marketplace operator under section 60C(1)(a). In such a situation, paying GST to Inland Revenue does not give rise to additional consideration for facilitation services the underlying supplier receives from the marketplace operator.

2 For example, a Central Reservation System or Computerised Reservation System (CRS), or a Global Distribution System (GDS).

Example 12: GST on a supply of listed services where marketplace operator is treated as supplier

A supply of listed services with a value of $115 including GST is made through an electronic marketplace.

For GST purposes, the marketplace operator is treated as the supplier under section 60C.

The parties have agreed the marketplace operator is entitled to retain enough of the funds from the recipient of the listed services to fund its GST liability (in this situation, $15). Therefore, the value of the supply from the perspective of the underlying supplier is $100. This applies whether the underlying supplier is GST-registered or not. If the underlying supplier is GST-registered, they would account for output tax on the supply at the rate of 0%. GST does not apply if the underlying supplier is not registered for GST.

The marketplace operator can use $15 of the $115 paid by the recipient of the listed services to satisfy its GST liability. The remaining $100, the GST-exclusive value of the listed services, is payable to the underlying supplier for its deemed supply to the marketplace operator.[3]

When services are performed, provided, or received in New Zealand

The GST Act has rules that determine where the place of supply for goods or services is. The general rules stipulate that goods or services are deemed to be supplied in New Zealand if the supplier is a resident in New Zealand, and goods and services are deemed to be supplied outside New Zealand if the supplier is a non-resident. These rules are contained in section 8.

Amendments to section 8 override the general rules. The amendments (to section 8(3)(c) and new section 8(3)(d)) ensure that a supply of listed services that is performed, provided, or received in New Zealand is treated as a supply made in New Zealand and will therefore be subject to GST. This applies even if the underlying supplier of a listed service is a non-resident (such could be the case for accommodation provided in New Zealand, as the underlying landowner could be a non-resident) or the marketplace operator is a non-resident.

Unlike the rules for remote services and distantly taxable goods, there are no special rules that enable a different GST treatment for listed services. This means that they will always be subject to GST at the standard rate when they are performed, provided, or received in New Zealand. It also does not matter if the recipient of the services is a non-resident. For example, a non-resident tourist staying in accommodation in New Zealand would be required to pay GST on their accommodation.

There are also no special rules that apply to determine whether listed services are "performed, provided, or received" in New Zealand. The ordinary meaning of these terms will apply to determine whether the services are listed services that would be subject to GST when provided through an electronic marketplace.

GST treatment of facilitation services and commissions related to listed services

Marketplace operators typically charge underlying suppliers a fee for facilitation services related to the supply of listed services, often in the form of a commission on the sale. "Facilitation services" involve connecting underlying suppliers with buyers.

The GST treatment of facilitation services will be subject to the ordinary GST rules if the supplier of the services (being the marketplace operator) is a tax resident in New Zealand. In this situation, the facilitation services will be subject to GST at the standard rate, regardless of whether the recipient (the underlying supplier of listed services) is registered for GST.

The GST rules for remote services apply to determine the GST treatment of facilitation services supplied by a person who is a non-resident for GST purposes. In this case, a supply of facilitation services is subject to GST at the standard rate if the supply is to a New Zealand-resident person who is not registered for GST. Under these rules, GST does not normally apply if the recipient of the services is a GST-registered person, although the marketplace operator can choose in this situation to treat the supply as zero-rated.

The following example sets out how GST applies in a situation where a marketplace operator is:

- treated as the supplier of listed services to a recipient (where GST applies at the standard rate of 15% if the services are performed, provided, or received in New Zealand), and
- supplying separate facilitation services to the underlying supplier of the listed services.

3 For simplicity, this example ignores the fees charged by marketplace operators for providing facilitation services to underlying suppliers.

Example 13: Marketplace operator supplying facilitation services to a GST-registered underlying supplier and treated as supplying listed services to another person

2K's Ride Services Ltd (2KRS) is an electronic marketplace through which underlying suppliers make supplies of listed services. It is not resident in New Zealand for GST purposes.

Wiremu provides ride-sharing services through 2KRS. He is registered for GST and has notified 2KRS of his GST registration.

Richeile also provides ride-sharing services through 2KRS and has notified the marketplace operator she is not registered for GST.

2KRS has an agreement with drivers that use 2KRS's app that entitles it to retain 20% of the total GST-exclusive fare for ride-sharing services that drivers supply to passengers using 2KRS's app. This 20% fee is the amount 2KRS charges for its facilitation services.

Two passengers purchase rides from Wiremu and Richeile through 2KRS for $57.50 including GST (a GST-exclusive value of $50).

Facilitation services

Because Wiremu is GST-registered, 2KRS can choose whether the facilitation services ($10) it provides to Wiremu are treated as supplied outside New Zealand, in which case, there are no associated GST obligations with the supply. Alternatively, it can choose to treat the supply of facilitation services as zero-rated, in which case it would include this in its GST return (in the "zero-rated sales" box).

Because Richeile has notified 2KRS she is not registered for GST, 2KRS is required to account for GST on the supply of its facilitation services to Richeile. It must include the facilitation services supplied to Richeile in the "Total sales and income" box of its GST return.

Listed services

2KRS is required to account for GST on the supply of listed services it is treated as making (that is, the rides provided by Wiremu and Richeile to their passengers).

The value of the listed service ($50) is not reduced by the value of the facilitation services ($10) supplied by 2KRS to Wiremu or Richeile.

Adjustments for supplies of listed services

The amendments treat the marketplace operator, instead of the underlying supplier, as the supplier of listed services. It follows that when adjustments for inaccuracies need to be made, marketplace operators will need to apply the rules as if they were the supplier of services, even though another person (an underlying supplier) is the contractual supplier of the services. This means that, in these circumstances, it is the marketplace operators (instead of the underlying suppliers) that must provide the supply correction information to the recipient and make the adjustments.

Section 25 applies when a GST-registered supplier returns too much or too little GST because of either a mistake, subsequent alteration to, or cancellation of a supply. This includes instances where, for example, the previously agreed consideration has been reduced through the offer of a discount or refund (whether partial or in full). In the situation where a marketplace operator has returned too much or too little GST to Inland Revenue as the result of an inaccuracy referred to in section 25(1) (such as an incorrect amount of consideration), section 25(2) provides that it should make an adjustment in its GST return when it is apparent that too much or too little GST has been returned.

GST-registered underlying suppliers

In most situations, the marketplace rules for listed services apply regardless of the underlying supplier's GST registration status. This means that for any listed services provided through an electronic marketplace, it is the operator of the marketplace that is responsible for collecting and paying GST to Inland Revenue.

In limited circumstances, certain underlying suppliers can opt-out of the marketplace rules. This enables them to continue accounting for GST on supplies of listed services they make through an electronic marketplace by including the supplies in their own GST returns. See *Opting out of marketplace rules* below for more information.

GST-registered underlying suppliers will continue providing their own GST returns. They will need to keep a record of what supplies are made through an electronic marketplace and what supplies are made directly to their customers. This is because the supply of listed services made through an electronic marketplace is zero-rated under section 11A(1)(jc) and therefore must be included in the zero-rated sales box in the GST return. Other supplies will continue being accounted for in the usual way.

GST-registered underlying suppliers will purchase or acquire goods and services they use to make supplies of listed services through an electronic marketplace. The process for deducting input tax for these goods and services does not change. GST-registered underlying suppliers will continue to deduct input tax on their expenses in their own GST returns in the usual way.

Example 14: Accounting for sales and expenses associated with listed services as a GST-registered underlying supplier

Manjula provides ride-sharing/ride-hailing services through an electronic marketplace. He is registered for GST because he also drives a taxi for a taxi company, and the company includes GST in its pricing which Manjula is required to use. Manjula has notified the marketplace operator that he is registered for GST.

Manjula pays for goods and services that enable him to provide his ride-sharing/ride-hailing services such as fuel, vehicle maintenance, and insurance. The total cost of these goods and services for the month is $3,450 including GST. Manjula can recover the GST component of these costs as an input tax deduction by including these expenses in his GST return.

Manjula earns $2,500 from providing ride-sharing/ride-hailing services through the electronic marketplace for the month. He also earns $5,000 that month from his activities conducted off the electronic marketplace.

To complete his GST return, Manjula includes:

- $2,500 of sales in the "Zero-rated supplies" box on his GST return. These are sales of listed services that Manjula is treated as making to the marketplace operator. By including the sales in the zero-rated sales box, he will not have an output tax liability on these sales. Instead, the marketplace operator is required to account for output tax on these sales.
- $5,000 of sales in the "Total sales and income" box in his GST return. These are the sales from Manjula's activities conducted off the electronic marketplace.
- $3,450 of costs in the "Total purchases and expenses" box in his GST return. He will then calculate input tax deductions of $450.

Flat-rate credit

(Sections 2 and the definition of "flat-rate credit", 8C, 20(3)(de), 20(3N), 20(3JD), 20(4E), and 60H of the GST Act, and section 141(1) and clause 3B, Part A, schedule 7 of the Tax Administration Act 1994)

The flat-rate credit is a credit available to underlying suppliers that are not registered for GST. The flat-rate credit represents the average amount of GST that underlying suppliers, if they were registered, would be able to recover as input tax on goods and services they purchase and use to make supplies of listed services. The prescribed amount for the credit is set out in section 20(3N).

For listed services that are taxable accommodation, ride-sharing/ride-hailing services, or delivery services for food and/or beverages, the prescribed amount is 8.5 percent of the value of the listed services. This percentage was determined with reference to the average amount of input tax deducted by GST-registered taxi drivers and holiday homeowners. The 8.5 percent rate represents the average amount of input tax these suppliers would be able to recover if they were registered for GST and accounting for input tax deductions. It does not consider those with greater expenses and purchases than sales, as it was assumed that in such circumstances, the underlying supplier would prefer to be registered for GST and would do so voluntarily.

The flat-rate credit is not available to GST-registered underlying suppliers. This is because GST-registered underlying suppliers will be entitled to deduct input tax for their actual expenditure. The flat-rate credit is also not available to a person in their capacity as an employee. This is because the employee of a marketplace operator who performs listed services as part of their employment duties is not an "underlying supplier".

If an underlying supplier considers the flat-rate credit inappropriate for their circumstances, they may choose to register for GST voluntarily. This will enable them to deduct input tax for their actual expenditure, but also means that they will need to account for GST on all supplies they make from their taxable activities (including at the zero percent rate on supplies of listed services made through an electronic marketplace where the marketplace operator is treated as the supplier of the services). This includes accounting for output tax on assets used principally for making taxable supplies in the event those assets are disposed of or the taxable activity ceases.

Operation of the flat-rate credit

Section 20(3)(de) requires marketplace operators that are treated as supplying listed services to deduct input tax for the flat-rate credit. The deduction is calculated based on the prescribed rate of the flat-rate credit for the relevant listed service that is set out in section 20(3N). It must be taken as a deduction if the underlying supplier of listed services has not notified the marketplace operator that the underlying supplier is registered for GST at the time of supply of the listed services. Marketplace operators are then required to "pass on" the flat-rate credit to underlying suppliers. They must also notify, at least monthly, underlying suppliers of the total amount of flat-rate credit that has been passed on.

Example 15: Basic operation of the flat-rate credit on supplies of listed services

Henry provides short-term accommodation through an electronic marketplace. The marketplace operator is responsible for collecting GST on these supplies.

Henry notifies the marketplace operator that he is not a GST-registered person.

Josie books accommodation from Henry through the electronic marketplace for $200 plus GST for the stay. The marketplace operator collects GST of $30 on the supply of accommodation they are treated as making to Josie.

The marketplace operator applies the flat-rate credit scheme knowing Henry is not a GST-registered person. This results in the marketplace operator calculating:

GST of $30 at 15% of the value of the supply of the accommodation, and

the input tax deduction of $17 for the flat-rate credit at 8.5 percent of the value of the supply of the accommodation.

The marketplace operator is required to deduct input tax of $17 from the $30 of output tax payable to Inland Revenue. It is also required to pass on the $17 to Henry as a flat-rate credit.

The marketplace operator must also pay the remaining $13 to Inland Revenue as the net GST payable on the supply of accommodation.

To enable marketplace operators to apply the flat-rate credit, section 60H(1) requires underlying suppliers to notify the marketplace operator of their name, tax file number (IRD number), and GST registration status. Section 60H(2) requires underlying suppliers to notify marketplace operators of any subsequent change to their GST registration status, as this would affect entitlement to the flat-rate credit.

Section 60H(4) provides protection to marketplace operators that have relied on information from underlying suppliers if it is later discovered that the marketplace operator should not have passed on the flat-rate credit to an underlying supplier that was registered for, or liable to be registered for, GST. In such circumstances, absent the rules set out in section 60H(4), the marketplace operator could have a deficiency of tax equal to the amount of the input tax deducted for the flat-rate credit. Instead, section 60H(4) provides that the deficiency in tax attributable to a taxable period that arises because of the marketplace operator relying on the information provided by the underlying supplier is treated as a reduction in the total output tax allocated to the taxable period.

Information requirements for underlying suppliers entitled to the flat-rate credit

To enable marketplace operators to apply the flat-rate credit scheme, it is necessary for them to know whether the underlying supplier of listed services is a GST-registered person.

Underlying suppliers are therefore required under section 60H(1) and (2) to notify marketplace operators of their name, tax file number (IRD number), and GST registration status. Underlying suppliers are also required to notify marketplace operators of any changes to their GST registration status as soon as practicable (that is, if they become a GST-registered person or cease to be a GST-registered person).

If an underlying supplier does not notify a marketplace operator that they have become registered for GST, this could result in the marketplace operator passing on the flat-rate credit which the underlying supplier is not entitled to. In these circumstances, the underlying supplier would be required to account for this as an output tax adjustment in its GST return. They may also be liable for shortfall penalties.

Conversely, if an underlying supplier ceases to be a GST-registered person but does not notify the marketplace operator of this change, the marketplace operator will not know to deduct input tax for the flat-rate credit and pass this on to them.

A person who has appropriate authority to act on behalf of an underlying supplier can also provide information about the underlying supplier's name, IRD number, and GST registration status.

Reporting the flat-rate credit

Marketplace operators are required to provide underlying suppliers with a statement showing the flat-rate credit passed on to them. Section 8C(6) requires this statement to be provided to underlying suppliers at least once a month. If a marketplace operator wants to provide information about the flat-rate credit to underlying suppliers more frequently than monthly, this is also permitted.

This requirement is necessary to ensure that GST-registered underlying suppliers who receive the flat-rate credit (which they are not entitled to) will be alerted to it. GST-registered underlying suppliers are required to account for any flat-rate credit they receive as output tax in their own GST returns. This reverses the benefit of the flat-rate credit for GST-registered persons who will be deducting input tax for goods and services related to their supplies under the usual GST rules.

The statements to be provided by marketplace operators to underlying suppliers should show the total amount of the flat-rate credit passed on to them for the month (or, if the marketplace operator has chosen to provide a statement more frequently, for that period). This information could be included in existing statements provided to underlying suppliers which show the total amount of consideration underlying suppliers are due, or have received, for services performed for the relevant period.

If a marketplace operator offsets other fees and charges for services it provided to an underlying supplier against the underlying supplier's flat-rate credit, the statement must still show the full amount of the flat-rate credit that was deducted as input tax by the marketplace operator in respect of the listed services made by the underlying supplier. In other words, the amount of the flat-rate credit reported to the underlying supplier should not be reduced or offset by other fees or charges.

Requirement to pass on the flat-rate credit

Marketplace operators that have taken a deduction of input tax for the flat-rate credit must then pass this on to the underlying supplier. This is required by section 8C(3)(b)(ii).

The GST Act does not explicitly set out a timing requirement for marketplace operators to pass on the flat-rate credit to underlying suppliers that have purported to be unregistered persons. This ensures there is sufficient flexibility to allow marketplace operators to pass on the flat-rate credit to underlying suppliers alongside other funds due to the underlying supplier (for example, the fare for the ride-sharing/ride-hailing services or the amount of the booking for the accommodation).

Disclosure of GST registration status by Inland Revenue

The Commissioner can, despite the confidentiality rules in the Tax Administration Act 1994 (TAA), provide information about a person's GST registration status to a marketplace operator to ensure the effective operation of the flat-rate credit scheme. The Commissioner can disclose this information under clause 3B, part A of schedule 7 of the TAA. Section 8C(5) sets out that if the Commissioner notifies a marketplace operator of an underlying supplier's GST registration status, the marketplace operator must act on this notification as soon as practicable.

Inland Revenue intend to explore creating a GST registration verification service for these purposes. Such a verification service could provide confirmation of an underlying supplier's GST registration status as recorded by Inland Revenue at the time of the query. For this service to function, marketplace operators would need to have collected the underlying supplier's name and tax file number (IRD number) as required under section 60H(1)(a).

The service would be useful for assisting marketplace operators in determining whether to take a deduction for the flat-rate credit. However, underlying suppliers are required to notify marketplace operators of their GST registration status for the purposes of the flat-rate credit scheme so the service would only be used to verify information that should have already been provided.

If the service provided verification that an underlying supplier was not registered for GST at the time the listed services were supplied, the marketplace operator would be able to take a deduction for the flat-rate credit and pass this on to the underlying supplier.

If the verification service showed the underlying supplier was registered for GST at the time the listed services were supplied, the marketplace operator would not apply the flat-rate credit scheme.

The verification service would enable the Commissioner to notify marketplace operators of the GST registration status of underlying suppliers in terms of section 8C(5). Once a marketplace operator is notified of an underlying supplier's GST registration status, they are required to act on this notification as soon as practicable. The effect of this is that marketplace operators should apply the flat-rate credit scheme based on information provided by the Commissioner's verification system.

Marketplace operators may choose not to use the GST verification system for the purposes of the flat-rate credit scheme. In such circumstances, marketplace operators will need to rely on the information they collect and maintain from underlying suppliers as to their GST registration status. Under section 60H(4), marketplace operators are protected from deficiencies of GST in their GST returns to the extent that any such deficiency arises because of information provided to them by an underlying supplier.

Requirements of GST-registered persons who receive the flat-rate credit

If a GST-registered person receives the flat-rate credit they must account for this as an output tax adjustment in their GST return. The output tax adjustment is required for the taxable period in which the flat-rate credit was received. These requirements are set out in section 20(3JD) and 20(4E).

Example 16: GST-registered person receives flat-rate credit and must make an output tax adjustment to reverse the benefit

In completing her GST return for the period ending 31 March 2025, Poppy realises she received flat-rate credits from a marketplace operator related to listed services she supplied through an electronic marketplace. Poppy identifies this by reviewing the statement she receives from the marketplace operator that informs her of her total flat-rate credit for the month of March.

Poppy became a GST-registered person in February 2025. She forgot to notify the marketplace operator of this change in her circumstances. Poppy is keen to correct the error. The total amount of flat-rate credits Poppy received for February and March was $6,000.

To correct this error, Poppy must include $6,000 as an output tax adjustment in her GST return for the taxable period ending 31 March 2025. The $6,000 of output tax will be offset by any input tax deductions that Poppy can take for the period.

A GST-registered person who receives the flat-rate credit will also have a tax shortfall equal to the amount of the flat-rate credit they received. Section 141(1) of the TAA provides that a tax shortfall may arise because of a provision in an Inland Revenue Act. In these circumstances, a tax shortfall arises because of section 8C(3)(c)(ii), which means the person could be liable for shortfall penalties. Having a tax shortfall does not mean that penalties will be imposed automatically. The Commissioner may consider making an assessment of shortfall penalties in cases where a person continuously misrepresents their GST registration status to claim amounts of the flat-rate credit that they are not entitled to.

Example 17: GST-registered person receives flat-rate credit resulting in a tax shortfall

Bradd is a registered person and provides taxable accommodation through an electronic marketplace. He has notified the marketplace operator that he is not a GST-registered person.

Bradd has a six-monthly taxable period. The only supplies Bradd makes is through an electronic marketplace. Between April 2024 and September 2024, Bradd makes supplies through the electronic marketplace equal to $46,000 excluding GST.

Bradd acquired goods and services that he used in making supplies through the electronic marketplace. The total value of these goods and services was $17,500 including GST. He deducted input tax of $2,282.60 in his GST return.

Because Bradd notified the marketplace operator that he was not a GST-registered person, the marketplace operator also passed on the flat-rate credit to Bradd for his listed services. The amount of flat-rate credit Bradd received totalled $3,910.

Bradd therefore has a tax shortfall equal to this amount and could be liable for a shortfall penalty.

If a GST-registered underlying supplier of listed services receives a flat-rate credit spanning multiple taxable periods (and therefore multiple GST returns), an output tax adjustment would need to be made in the GST return for each taxable period that the underlying supplier received the flat-rate credit. Section 20(4E) sets out the timing rules for the adjustments.

Example 18: GST-registered person receives flat-rate credit spanning multiple taxable periods

Marley is a GST-registered underlying supplier of listed services. He incorrectly receives the flat-rate credit as he had not notified the marketplace operator of his GST registration.

Marley has a six-monthly taxable period, providing GST returns for the periods covering 1 April to 30 September and 1 October to 31 March.

Marley receives the following flat-rate credits:

- $600 in February
- $400 in March
- $800 in April.

Marley becomes aware of his mistake and notifies the marketplace operator of his status as a GST-registered person at the end of April.

Marley is required to make an output tax adjustment of:

- $1,000 ($600 + $400) in his GST return for the taxable period ending 31 March, and
- $800 in his GST return for the taxable period ending 31 October.

Income tax implications of the flat-rate credit

The flat-rate credit is treated as excluded income for income tax purposes under section CX 1(c) of the Income Tax Act 2007. In this way it is treated the same as way as input tax payable under the GST Act to a GST-registered person.

Section DB 2(2B) of the Income Tax Act 2007 treats a person that is not registered for GST as if they were registered for GST for the purposes of determining deductions for income tax. This applies to the extent that the person would have a deduction for expenditure that is attributable to supplies of listed services that are made through an electronic marketplace.

This means that deductions for expenditure incurred for income tax purposes must be taken on a GST-exclusive basis if the expenditure is attributable to deriving income exclusively through an electronic marketplace. This is because the flat-rate credit is a proxy for input tax that would be deductible if the person was registered for GST, and GST-registered persons are unable to take a deduction for GST-inclusive expenditure for income tax purposes.

Expenditure related to income derived from other activities will continue being deducted on a GST-inclusive basis. A person may incur expenditure for goods and services that are used partly to derive income from sales through an electronic marketplace and partly for non-marketplace-based sales. In these circumstances, the person will have incurred expenditure with a mixed purpose, and they will only be able to take a deduction for income tax on a GST-inclusive basis for expenditure attributable to income they derive from activities that are not conducted through an electronic marketplace.

If a person has mixed purpose expenditure – being expenditure related to deriving income through an electronic marketplace and through other means – the person should undertake the following process to determine their total annual deduction for income tax purposes:

- Identify the GST-inclusive and GST-exclusive amount of mixed purpose expenditure for the income year.
- Determine what proportion of expenditure must be taken on a GST-exclusive basis by applying the calculation under the heading "Formula for determining GST-inclusive and GST-exclusive deductions for expenditure with a mixed purpose".
- Add deductions for expenditure incurred in deriving income that is not derived through an electronic marketplace.
- Include, in the total annual deduction, any amount deductible under the depreciation rules.

For persons not registered for GST, the value of depreciable property for depreciation purposes will continue to be calculated on a GST-inclusive basis (if GST applies).

The following paragraphs explain how to determine the proportion of expenditure to take as a deduction for income tax purposes on a GST-inclusive basis and on a GST-exclusive basis where the expenditure relates to both income derived through an electronic marketplace and not through an electronic marketplace.

Determining GST-inclusive and GST-exclusive deductions for expenditure with a mixed purpose

To determine the total GST-inclusive deductions for mixed purpose expenditure, it is necessary to determine the proportion of income derived from sales that are not made through an electronic marketplace. This can be established by completing the following formula:

$$\frac{a}{(a+b)} = c$$

Where:

a is the income derived from making sales not through an electronic marketplace for the income year, and

b is the income derived from making sales through an electronic marketplace for the income year. This is the GST-exclusive amount because GST output tax is not taxable income.

c is the percentage applied to the total amount of GST-inclusive expenditure for income tax purposes that had a mixed purpose.

Example 19: GST-inclusive deductions for mixed purpose expenditure

Calvin derives income from sales of accommodation he provides through an electronic marketplace and through a website he maintains himself (which is not an electronic marketplace as defined in the GST Act). Calvin is not registered for GST and is not liable for GST registration.

Calvin identifies he derived income for the 2024–25 income year from sales of accommodation of:

- $20,000 (excluding GST) through an online booking platform, and
- $8,000 through his own website.

Applying the formula above:

$$\frac{8{,}000}{8{,}000+20{,}000} = 28.57\%$$

Calvin can take a deduction equal to 28.57% of the GST-inclusive value of the expenditure incurred in deriving income from sales through an electronic marketplace and sales not made through an electronic marketplace.

Calvin would then need to add this to the GST-exclusive value of his remaining mixed purpose expenditure to determine his total deduction for income tax purposes. This is explained in the following paragraphs.

The remaining expenditure with a mixed purpose must be taken on a GST-exclusive basis. To determine the total deduction for expenditure on a GST-exclusive basis, the following formula can be applied:

$$(100\%-c)\times d$$

Where:

c is the percentage of GST-inclusive expenditure with a mixed purpose that can be taken as a deduction for income tax purposes, calculated on the previous page

d is the total amount of mixed purpose expenditure expressed on a GST-exclusive basis.

Example 20: Income tax deductions for mixed purpose expenditure

Calvin provides taxable accommodation through an online booking platform. He also advertises the accommodation himself through his own website. Calvin is not registered for GST or liable for GST registration.

The sales he makes through the online booking platform are listed services and the marketplace operator accounts for GST on these supplies. The sales he makes through his own website are not listed services and are not subject to GST.

For the 2024–25 tax year, Calvin identifies he made sales of:

- $20,000 (excluding GST) through an online booking platform, and
- $8,000 through his own website.

Calvin incurred the following expenses, all inclusive of GST, for the year:

- $4,000 of commissions charged by the online booking platform
- $3,500 of local council rates
- $1,200 for house and contents insurance, and
- $600 for repairs and maintenance.

For income tax purposes, Calvin would include in his income tax return:

- Income from rents of $28,000 ($20,000 excluding GST from online bookings and $8,000 from sales Calvin made directly), and
- Deductions of $8,284.67. The calculation of total deductions is explained below.

Calvin had deductions related to his own sales of $1,514.21. This is the total of the GST-inclusive amount for the local council rates, house and contents insurance, and repairs and maintenance. These deductions can be attributed to Calvin's activities outside of the electronic marketplace (that is, $8,000 / $28,000, being his sales through his own website divided by his total sales excluding GST).

Calvin had deductions related to his sales made through an electronic marketplace of $6,770.25 excluding GST. This is calculated as:

- 71.43% multiplied by his total mixed purpose expenditure excluding GST, plus
- the GST-exclusive amount of commissions charged by the online booking platform of $3,478.26. Calvin cannot claim the GST-inclusive amount of the total commissions ($4,000) as an income tax deduction because he received the flat-rate credit.

Effect of the flat-rate credit when person becomes registered for GST

If a person becomes registered for GST, for the period prior to GST registration, assets that they used to make supplies of listed services will be treated as having a non-taxable use for the purposes of the apportionment and adjustment rules.

Once registered for GST, the person may choose to perform an adjustment at the end of their adjustment period (their balance date) which reflects the new percentage of use that relates to making taxable supplies – if this new percentage is a permanent change which is likely to be maintained for the foreseeable future.

Information about the changes to the apportionment and adjustment rules is included onpage 62 of this *Tax Information Bulletin.* Further information is also available on Inland Revenue's website (keyword search: GST apportionment).

Opting out of marketplace rules

(Sections 60C(2BB), (2BC), (2BD), (2BE), and (2BF), 60H(3), and 85D of the GST Act)

Marketplace rules will generally treat the operator of an electronic marketplace that another person makes supplies through (the underlying supplier) as the supplier. This means that the marketplace operator becomes responsible for accounting for GST on these supplies.

Marketplace rules may not be appropriate for larger suppliers that already have established accounting systems and practices in place for managing compliance with their GST obligations. This is because marketplace rules could require these taxpayers

to change their existing accounting systems and practices which would increase compliance costs for limited benefit to tax collection and tax administration.

The marketplace rules for listed services therefore include provisions that enable certain underlying suppliers to "opt-out" of the rules. In certain circumstances, an underlying supplier can opt-out of marketplace rules by notifying the marketplace operator that they will remain responsible for their own GST obligations. This is available to underlying suppliers that are required to maintain a monthly or two-monthly taxable period, which is those that make taxable supplies of more than $500,000 in a 12-month period.

Some underlying suppliers may also be able to enter into an opt-out agreement with the marketplace operator. If an agreement was in place, these underlying suppliers would continue being responsible for their own GST obligations. Agreements can be entered into provided the underlying supplier meets specific criteria. If an underlying supplier stops meeting the criteria for an opt-out agreement, the agreement must be withdrawn. In these circumstances, the underlying supplier should notify the marketplace operator they no longer meet the criteria to opt-out of the marketplace rules.

Suppliers over $500,000 in a 12-month period

Underlying suppliers that are required to maintain a two-month or one-month taxable period under section 15 of the GST Act can unilaterally opt-out of the marketplace rules by notifying the marketplace operator that they choose to be liable for the payment of GST on supplies they make and will continue to remain responsible for all obligations under the GST Act.

Marketplace operators will not be required to verify that an underlying supplier meets this criterion. They will be able to rely on information they receive, by election, from the underlying supplier. This information must be retained by the marketplace operator in accordance with the general record keeping requirements for GST set out in section 75. This provides that records must generally be kept for seven years following the end of the taxable period to which they relate.

It is expected that only non-natural persons would be able to opt-out of the marketplace rules because they make more than $500,000 of supplies in a 12-month period.

Suppliers eligible to enter agreements to opt-out of marketplace rules

An underlying supplier can enter an opt-out agreement with a marketplace operator provided they:

- meet the requirements set out in a determination made by the Commissioner, or
- provide taxable accommodation and meet the 2,000-night threshold.

Criteria set out in a determination issued by the Commissioner

The Commissioner has the power under section 60(2BC) to issue determinations that set out the circumstances in which a person can enter into an opt-out agreement.

Before making a determination, the Commissioner is required to have regard to several factors. These factors, set out in section 60(2BD), are the compliance costs that would arise for underlying suppliers in making changes to their accounting systems and practices, and the size, scale, and nature of the services and activities undertaken by underlying suppliers.

The Commissioner has not issued a determination at the time of publication. If a determination is issued, it will be published, and any underlying supplier that meets the requirements set out in the determination would be able to enter into an opt-out agreement with a marketplace operator

The 2,000-night threshold

Underlying suppliers that supply taxable accommodation through electronic marketplaces may be able to enter an opt-out agreement provided they list more than 2,000 nights of accommodation on an electronic marketplace in a 12-month period. This also includes circumstances where the underlying supplier has a reasonable expectation that they can meet this requirement in the 12-month period.

Example 21: Reasonable expectation for more than 2,000 nights

Harris Hotels Ltd operates a multinational hotel chain. It runs a hotel business in Auckland, Christchurch, and Wellington.

Each hotel has 100 rooms. The rooms are available all-year round and are advertised on an electronic marketplace.

Harris Hotels Ltd therefore has a total of 109,500 nights of accommodation available through electronic marketplaces. This is calculated based on 300 rooms available for 365 nights.

It is not possible to aggregate accommodation nights across multiple electronic marketplaces for these purposes. This means that if a person has 1,000 nights available through one electronic marketplace and 1,500 nights available through another electronic marketplace, they would not be able to enter into an opt-out agreement under this test.

Example 22: More than 2,000 nights across multiple marketplaces – not eligible

Will and Nicole own six properties that they lease for short-term accommodation through multiple electronic marketplaces.

Five properties are available for rent all-year round through an electronic marketplace, Accommodation4U. This equates to 1,825 nights of accommodation available through Accommodation4U (5 x 365 nights).

The other property is available through another electronic marketplace. It is not available all-year round so Will and Nicole choose for this not to be advertised on Accommodation4U.

This means Will and Nicole are unable to enter an opt-out agreement with the marketplace operator for Accommodation4U based on having more than 2,000 nights of accommodation available in a 12-month period through the electronic marketplace.

Example 23: More than 2,000 nights on one electronic marketplace – eligible on other marketplaces

Heyes Hotels Co lists rooms available for rent through an electronic marketplace, A Co. It has 40 rooms available across its two New Zealand locations and these rooms are available all-year round. All rooms are listed through A Co. It therefore satisfies the criteria to enter into an opt-out agreement with A Co.

The owners of Heyes Hotels Co want to list rooms on another electronic marketplace, B Co. It wants to trial providing accommodation through B Co and is not able to commit to listing more than 2,000 nights in a 12-month period through B Co until it sees whether B Co improves Hayes Hotels Co's bookings.

Heyes Hotels Co can enter an opt-out agreement with B Co because it satisfies the 2,000-night criterion on another electronic marketplace, A Co.

Example 24: 2,000-night criterion not satisfied – nights available exceed 2,000 in aggregate, but not on an individual electronic marketplace

Lucy and Richard have six investment properties – three in Wanaka and three in Waiheke. The properties are available for short-term rental accommodation.

The Wanaka properties are available for booking through an electronic marketplace, Sam's Stays Ltd. The Waiheke properties are available for booking through another electronic marketplace, Ben's Baches Co.

All properties are available all-year round and in aggregate, the 2,000-night threshold is satisfied. However, because the properties are listed on separate electronic marketplaces, Lucy and Richard are not eligible to enter an opt-out agreement with the operators of Sam's Stays Ltd or Ben's Baches Co.

Marketplace operators are not required to monitor whether underlying suppliers that have entered into an opt-out agreement with them list more than 2,000 nights of accommodation available through them in each 12-month period.

If a person is a member of a group of companies, the 2,000-night threshold can be applied on a group basis. This means that, provided the group of companies satisfies the 2,000-night threshold, all members of the group can individually enter into an opt-out agreement with marketplace operators. This is provided for in section 60C(2BE). The definition of "group of companies" that applies for these purposes refers to the definition set out in the Income Tax Act 2007 which requires common voting interests of at least 66%.[4]

Further requirements for opt-out agreements

Provided underlying suppliers meet the criteria for an opt-out agreement as set out above, and the marketplace operator agrees to an opt-out, section 60C(2BB) contains further requirements before an agreement is valid. Under these rules:

- the documentation provided to the recipient of the services must identify the supply as being made by the underlying supplier and not the electronic marketplace, and
- there must be an agreement, with that agreement being recorded in a document, that the underlying supplier is liable for the payment of tax for supplies of listed services and will continue to remain responsible for their tax obligations under the GST Act. This includes the requirement to provide the recipient with taxable supply information, if required, and providing GST returns and paying GST to Inland Revenue.

If these requirements are not satisfied, the marketplace operator will be treated as the supplier of listed services and will therefore be required to account for GST on these supplies.

Transitional provision for supplies of listed services

Section 85D applies to enable eligible underlying suppliers to enter into an agreement with marketplace operators, or notify marketplace operators, that they are opting out of the marketplace rules. This provision allows eligible underlying suppliers to opt-out of the marketplace rules before they come into effect on 1 April 2024.

The Commissioner also has the power, from 31 March 2023 to issue determinations setting out criteria a person must meet if they wish to opt-out of the marketplace rules but do not meet the statutory criteria.

Consequential amendments

(Sections 5(11G), 8C, 10(7D), 15(6), 19K(3), 26AA, 51, 60, 60H, 75 and 77)

Several existing provisions affecting operators of electronic marketplaces have been amended to now refer to "listed services". These amendments are consequential in nature and reflect that the marketplace rules now apply to a new category of services supplied through electronic marketplaces.

GST registration

(Section 51)

The rules for listed services require marketplace operators to register for, and return, GST on supplies of listed services that are performed, provided, or received in New Zealand if the value of these supplies exceeds, or is expected to exceed, $60,000 in a 12-month period.

Non-resident marketplace operators can use a fair and reasonable method of converting foreign currency amounts to New Zealand dollars to determine whether they have exceeded the GST registration threshold. This is provided for in section 51.

Generally, the Commissioner is unable to allocate a tax file number (IRD number) to an offshore person, unless they have provided the Commissioner with evidence of their New Zealand bank account number. An exception to this requirement exists where the offshore person needs an IRD number solely because they are a non-resident supplier of goods or services under the GST Act. This exception applies for the purposes of non-resident suppliers of listed services that would not need to provide evidence of a New Zealand bank account number if the only reason for obtaining a tax file number is so they can comply with their GST obligations.

4 See section IC 3 of the Income Tax Act 2007.

Taxable supply information

(Sections 8C(3)(a)(i) and 19K(3))

The general rules for taxable supply information require the person making a taxable supply to another registered person to provide the recipient with taxable supply information for the supply. This enables the recipient of the supply to deduct input tax. Under the general rules, taxable supply information may not need to be provided if the consideration for the supply is below a prescribed threshold.

Despite the general rules for taxable supply information, section 19K(3) provides that for listed services, taxable supply information must be provided to the recipient of the listed services in all circumstances without the need for a request. The purpose of this is to ensure that the recipient of listed services will receive sufficient information enabling them to deduct input tax, if applicable, for listed services they receive. It is also intended to reduce compliance costs for marketplace operators by removing the need for them to have bespoke systems for responding to requests for taxable supply information.

The rules for taxable supply information are explained on Inland Revenue's website (search keyword: taxable supply information).

Marketplace operators are also treated as receiving supplies of listed services from underlying suppliers that operate through the electronic marketplace. No taxable supply information is required to be provided by underlying suppliers for these supplies under section 8C(3)(a)(i).

Taxable periods

(Section 15(6))

Section 15 specifies the taxable periods for GST-registered persons.

The general rules for taxable periods are explained on Inland Revenue's website.

Section 15(6) provides that a non-resident marketplace operator that is treated as the supplier of listed services will have a quarterly taxable period based on a first quarter ending on 31 March. This means that a non-resident marketplace operator that supplies listed services will have the following taxable periods and due dates:

Table 1: Taxable periods for non-resident marketplace operators

Taxable period	GST payment and return due date
1 January to 31 March	7 May
1 April to 30 June	28 July
1 July to 30 September	28 October
1 October to 31 December	28 January of the following year

Marketplace operators that are tax resident in New Zealand will be subject to the ordinary rules for taxable periods.

Bad debt deductions

(Section 26AA)

Marketplace operators may collect GST on a supply of listed services it is treated as making in one of two ways:

- The marketplace operator arranges for the payment from the recipient of the services to be split when the payment is processed, with the amount of GST and the marketplace operator's facilitation fee or commission remitted to the operator, and the sale price (net of GST and the amount of the marketplace's fee or commission on the sale) remitted to the underlying supplier of the services.
- The recipient of the services may pay the underlying supplier directly, and the marketplace operator collects the GST along with its fee or commission from the underlying supplier.

In the second scenario, the marketplace operator may at times be unable to collect the GST from the underlying supplier. To prevent marketplace operators in this situation from being liable for GST that they are unable to collect, section 26AA will allow them to claim a bad debt deduction if:

- the underlying supplier fails to pass on the GST paid to them for the supply; and
- the operator of the marketplace has written off all amounts owed to it in relation to the supply as a bad debt, including its fee or commission on the sale.

This rule will apply to a marketplace operator that is treated as the supplier of listed services if the underlying supplier is not an associated person under section 2A, and the marketplace operator:

- charges the underlying supplier a fee for making the supply through the marketplace
- accounts for GST on the supply and provides a return for the taxable period in which the supply was made
- has an agreement with the underlying supplier under which the underlying supplier is required to pay, from the consideration the underlying supplier receives from the recipient, an amount that includes the GST on the supply that the marketplace operator has accounted for, and
- the marketplace operator writes off as a bad debt the entire amount that the underlying supplier is required to pay (along with the entire amount of the marketplace's fee, if not already included in this amount).

Section 26AA(2) provides that the marketplace operator may deduct input tax equal to the amount of GST charged on the supply.

If the marketplace operator recovers an amount of the bad debt that was written off in an earlier taxable period, section 26AA(3) requires the marketplace operator to account for an amount of output tax that is a fraction of the amount of the input tax deduction taken earlier. This fraction is calculated by dividing the amount recovered by the total amount written off.

Record keeping

(Section 75(3F))

GST-registered persons can apply to the Commissioner for authorisation to keep records at a place outside New Zealand or in a language other than English.

Section 75(3F) overrides this requirement for a non-resident supplier of listed services. This enables non-resident suppliers of listed services to keep records outside of New Zealand or store them in a language other than English without the need for approval from the Commissioner.

Use of foreign currency

(Section 77(2))

Section 77(2) enables non-resident marketplace operators to account for GST on supplies of listed services they are treated as making in a foreign currency at the time of supply. This overrides the general rule that all amounts be expressed in New Zealand currency at the time of supply.

New Zealand resident agents

(Section 60(1A)(b))

A non-resident supplier of listed services may enter into an agency agreement with a New Zealand resident agent. If this applies, the agent (instead of the non-resident principal) is treated by section 60(1AB) as supplying listed services in the course of furtherance of the agent's taxable activity.

Vouchers

(Section 5(11G)(a))

Generally, the issue or sale of a token, stamp or voucher with a face value is treated as a supply of goods and services by the issuer or seller. This applies unless the supplier of the token, stamp or voucher treats the supply as arising on the redemption of the token, stamp or voucher for goods and services. If the supplier of the token, stamp or voucher treats the supply as arising on redemption, the person who redeems the token, stamp or voucher for goods and services is treated as making the supply at the time of redemption, rather than at the time the voucher was issued or sold.

Section 5(11G)(a) has been amended to refer to "listed services" in addition to distantly taxable goods and remote services. This enables the seller of a face value voucher to treat GST as applying on the redemption of the voucher if the voucher is (or could be) redeemed for listed services. This is consistent with how the GST rules for vouchers apply to remote services and distantly taxable goods.

Example 25: Seller of voucher opts to use redemption basis

Charles purchases a voucher with a face value of $100 from Smithy's Siestas Ltd, a popular electronic marketplace through which short-stay accommodation can be booked, as a gift for his daughter, Lucy. The voucher can be redeemed for short-stay accommodation purchased through Smithy's Siestas Ltd.

Smithy's Siestas Ltd chooses to treat the supply for GST purposes as a rising on the redemption of the voucher (instead of the sale of the voucher). This means that GST will apply when Lucy redeems the voucher for listed services, and not on the sale or issue of the voucher itself.

Lucy uses the voucher as a credit towards short-stay accommodation she purchases through Smithy's Siestas Ltd. Because Smithy's Siestas Ltd is treated as the supplier of the accommodation for GST purposes (rather than the underlying supplier of the accommodation), it is required to return GST equal to $13.04 (3/23 x $100) on the redemption of the voucher.

Discounts

(Section 10(7D))

Section 10(7D) contains a special valuation rule to deal with the situation where a marketplace operator provides discounts for remote services, distantly taxable goods, or listed services that it is treated as supplying under the marketplace rules.

This special valuation rule provides that where a marketplace operator is deemed to make a supply to a recipient who accepts an offer of a discount funded by the operator, the supply is for the discounted price. This means that the amount of GST that the marketplace operator is required to return on the supply is 3/23 of the total GST-inclusive amount paid by the recipient.

Example 26: Marketplace operator provides a discount for listed services provided by an underlying supplier

Kelvin is seeking accommodation for an upcoming trip in Kaikohe. He uses an electronic marketplace, Graeme's Getaways Ltd, to find an appropriate bed and breakfast that suits his needs for the weekend trip.

William owns a property in Kaikohe which is regularly booked through Graeme's Getaways Ltd. He sets the price as $250 per night plus GST. The GST-inclusive price is therefore $287.50 per night ($250 + $37.50 in GST).

Graeme's Getaways Ltd offers a discount of $10 per night on the accommodation, provided it is booked well in advance of the guest's arrival date. Kelvin accepts this offer, and so the final (GST-inclusive) price paid by Kelvin for the accommodation is $555. Graeme's Getaways Ltd pays for the discount, so William still receives the GST-exclusive consideration of $500.

Graeme's Getaways Ltd is required to calculate GST on the price paid by Kelvin ($555). It returns GST on the supply equal to $72.39 (3/23 x $555).

Cross-border workers

Flexible PAYE, FBT and ESCT arrangements

Sections CE 1(3B), CE 1F, RA 15, RD 23, YA 1 of the Income Tax Act 2007 and sections 23I, 23IB of the Tax Administration Act 1994

Amendments have been made to enable more flexible pay as you earn (PAYE) withholding tax, fringe benefit tax (FBT), and employer's superannuation contribution tax (ESCT) arrangements for employers of cross-border employees.

Background

The Income Tax Act 2007 (ITA) and the Tax Administration Act 1994 (TAA) impose obligations on persons who make payments subject to PAYE, FBT, ESCT (collectively referred to in this discussion as "the rules") as applicable. As the rules are strictly applied, in some circumstances the cost of compliance for employers of cross-border employees can be disproportionately high.

Cross-border employment arrangements take a variety of forms, including secondments, short-term business travel and remote working (where a person works in a different location to the employer's place of business). As the arrangements can be complicated, an employer may not correctly understand, or be able to meet, their New Zealand payment and tax obligations even though they are trying to comply. Strictly, breaches of the rules require a voluntary disclosure to report underpaid tax to Inland Revenue and correct the tax position for each affected employer and/or employee.

Key features

The amendments acknowledge that employees working in New Zealand for a non-resident employer are in different compliance circumstances to employees of resident employers. The proposed amendments establish a more flexible framework intended to enable compliance with the rules in a more cost-effective and timely manner, subject to limitations to prevent abuse.

The amendments:

- Provide a definition of a "cross-border employee" for the purpose of the rules.
- Enable a 60-day grace period to apply where a cross-border employee breaches the conditions of an exemption from the rules or receives an unexpected PAYE income payment.
- Provide the employer with an ability to apply to the Commissioner of Inland Revenue for a bespoke PAYE arrangement in special circumstances.
- Repeal the PAYE bond provision.

Effective date

Sections CE 1(3B) and CE 1F(1)–(4) and YA 1 (definition of a "cross-border employee") and the amendment to section 23I came into effect on 1 April 2023.

Sections CE 1F(3B)–(3E), RA 15(4B) and section 23IB come into effect on 1 April 2024.

Section RD 23 is repealed with effect from 1 April 2024.

Detailed analysis

New sections CE 1(3B) and CE 1F provide for the treatment of PAYE income payments made to a cross-border employee. The policy is to achieve greater flexibility in the employment-related tax settings where they apply to all employers of cross-border employees, where those employees receive employment income from abroad. Flexibility will apply more broadly than the shadow payroll rules – it will extend to those who are on local payrolls and those who make arrangements to pay for themselves. The new sections also clarify that these payments can include an amount paid after a person has left New Zealand for services provided by the employee while they were in New Zealand.

Existing section CE 1(3B) (Persons on a shadow payroll) has been relocated to new section CE 1F(2).

Definition of a "cross-border employee"

Proposed new section CE 1F(4) defines a "cross-border employee" as follows:

- Where a person provides a service in New Zealand, an employee of a non-resident employer
- Where a person provides a service outside New Zealand, a resident employee.

The definition extends to arrangements outside of formal secondments where a person provides services for or on behalf of a non-resident. This can include persons who work remotely in New Zealand for their non-resident employer.

Compliance within a 60-day grace period

New section CE 1F(3B)–(3E) enable an employer to meet or correct their PAYE, FBT and ESCT obligations within a 60-day grace period where they have taken reasonable measures to manage their employment-related tax obligations, and the employee is present in New Zealand for a period during which the employee has:

- breached a threshold for exemption under section CW 19 of the ITA,
- breached a threshold for exemption under a relevant double taxation agreement, or
- received an unexpected PAYE income payment.

The 60-day grace period runs from the earlier of the date of the breach or payment (as applicable) or the date on which the employer could reasonably foresee that a breach or payment would occur. During the 60-day grace period the employer must make a reasonable effort to meet or correct the underpayment of tax.

The policy intent is to reduce the need for a voluntary disclosure in circumstances where despite the employer's efforts to manage their New Zealand employment-related tax obligations, a tax liability in respect of a cross-border employee's remuneration has arisen. Instead, the correction of the underpaid tax can be made via existing systems.

Example 27: Arthur King

Kamelot Insurance plc is a United Kingdom listed company. Arthur King, a United Kingdom tax resident, is seconded to work in New Zealand for Kamelot Insurance (NZ) Ltd, for the period 1 March 2024 to 30 June 2024, to assist with the local implementation of Excalibur, a new IT system. Arthur will remain paid by the United Kingdom company which will also bear the cost of his work in New Zealand. The United Kingdom and the New Zealand companies expect that Arthur's remuneration will be exempt from New Zealand tax under the New Zealand–United Kingdom Double Taxation Agreement.

Arthur arrives as planned on 1 March 2024 to begin work on Excalibur.

Kamelot's project management team meet every two weeks to track the progress of Excalibur. This includes reviewing the project's staffing and other resources. By mid-June it is clear that the project will not be completed by 30 June, and the revised completion date is pushed out to 31 July. The project management team agree that Arthur will stay on until the project is complete. By 26 July, the project management team realise that the completion date will be no earlier than 15 September 2024.

The new completion date means that Arthur's employment income is not exempt from New Zealand tax as the 183-day condition for exemption under the double taxation agreement will not be met. The underpaid period runs from 1 March 2024.

Kamelot must correct the underpayment of New Zealand taxes no later than 23 September 2024 (60 days after 26 July, when management realised that the project will last for more than 183 days). The correction will be made via an employment information return.

Example 28: Gwennie Vere

Gwennie Vere, a NZ tax resident, is employed by Kamelot Insurance (NZ) as a marketing manager. On 1 May 2024 Gwennie takes up a 24 month secondment to Kamelot Insurance (Australia) Pty. It is anticipated that Gwennie will be non-resident in New Zealand throughout the secondment.

Unfortunately, Gwennie's father becomes ill and she decides to return to New Zealand, informing the company on 26 July 2024 and returning to New Zealand two weeks later. She continues to work in her Australian role from New Zealand until a replacement is found. Kamelot New Zealand decides that as the secondment did not proceed as expected, it will "catch up" her tax position via the New Zealand payroll. It has 60 days from 26 July 2024 to meet the underpayment of New Zealand tax. The underpaid period runs from 1 May 2024 when Gwennie started to be paid by the Australian company. The correction is made via an employment information return.

Example 29: Tristram Kernow

Tristram Kernow is an employee of Kamelot Insurance plc who is currently seconded to New Zealand to work for the New Zealand company. Kamelot uses a global provider to co-ordinate payments for expatriates around the world. Tristram's salary is paid monthly and his remuneration is processed via the global provider for New Zealand tax purposes. In July 2024 all employees are paid an off cycle fixed bonus, in recognition of Kamelot Insurance plc achieving financial targets. Unfortunately, this payment is not picked up in time for the global processing round which results in the New Zealand tax not being processed in time. However, under the grace period, Kamelot has 60 days from the receipt of the bonus payment to pay the New Zealand tax due via an employment information return.

Annual PAYE arrangements

Section RA 5 of the ITA provides that a person who makes a PAYE income payment, pays an employer's superannuation cash contribution or provides a fringe benefit must either withhold and pay, or pay, the amount of tax due under the rules. Section RA 15 provides the payment dates for interim and other tax payments, including PAYE, FBT and ESCT.

New section RA 15(4B) enables an employer of a class of cross-border employees to apply to the Commissioner for an agreement that the tax due for a PAYE income payment may be made by 31 May following the end of the tax year. New section 23IB of the TAA ensures that the employment income information is due at the same time.

An annual PAYE agreement would only be made where 'special circumstances' exist. Applicants would need to establish the basis for seeking an annual arrangement for payment. Inland Revenue will develop guidance to clarify the types of scenarios that would qualify for annual payments of tax.

Repeal of the employer's PAYE bond

Section RD 23 of the ITA allowed an employer or PAYE intermediary to apply to the Commissioner to be released from a withholding obligation for a PAYE income payment by providing a bond or other security for the amount that would otherwise be required to be withheld. The provision was little used in practice and has been repealed.

PAYE, FBT and ESCT integrity measures

Sections CE 1(3B), CE 1F(3), (4), RD 62B, RD 71B of the Income Tax Act 2007 and sections 23I, 120B and 141ED of the Tax Administration Act 1994

Amendments have been made to clarify the application of the PAYE withholding tax, FBT, and ESCT rules in cross-border employment arrangements. The amendments aim to clarify and make the rules more certain.

Background

The ITA and the TAA impose obligations on persons who make payments subject to PAYE withholding tax, FBT or ESCT. The changes made aim to address a number of concerns, in particular that the rules did not adequately reflect the ways in which work is changing and that the rules were uncertain and difficult to apply in practice.

The operational statement *Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations*[5] clarified that these obligations arise for an employer with a sufficient presence in New Zealand. The sufficient presence test is a fact-based determination of whether the employer has made themselves subject to New Zealand law. A sufficient presence can include an office, address for service or a single employee who performs contracts in New Zealand on behalf of the non-resident employer. Where the non-resident employer has a sufficient presence in New Zealand, the employer has PAYE, FBT and ESCT obligations for their employee or employees.

Employers and their advisors raised concerns that the test could be difficult to apply. If an employer wrongly assesses itself as not having a sufficient presence in New Zealand and on that basis does not perform its obligations under the rules, it will need to pay the underpaid tax, penalties and interest to Inland Revenue.

Existing rules require an employee to pay PAYE directly to Inland Revenue, where an employer does not have a sufficient presence in New Zealand. However, prior to the amendments, no equivalent rules existed for FBT and ESCT.

The amendments are intended to mitigate the uncertainty which may arise when applying the sufficient presence test, and to address the requirement to pay and report FBT and ESCT where an employer does not have a sufficient presence in New Zealand.

Key features

The amendments:

- make a safe harbour available to non-resident employers who wrongly assess their liability under the rules, where the conditions of the safe harbour are met
- provide that, where a non-resident employer does not have an obligation under the rules, liability for FBT and ESCT obligations may transfer to a cross-border employee working in New Zealand if the employer and employee agree that the employee is liable.

Effective date

The amendments came into effect on 1 April 2023.

Detailed analysis

Safe harbour for non-resident employers

New sections 120B(bb) and 141ED(1B) of the TAA give effect to the safe harbour provision for non-resident employers. Whether employment-related tax obligations exist for a non-resident employer will usually be clear: the employer will have a New Zealand permanent establishment, trading presence, or enter into and perform contracts in New Zealand.

The safe harbour protects the employer from paying penalties and interest. However, in line with general principles it cannot protect the employer from payment of the underlying tax, unless this has been paid by another person. The existence of the safe harbour does not relieve the non-resident employer of their obligation to determine whether they have a New Zealand employment-related tax obligation. The intention of the safe harbour is to mitigate the effect of an incorrect decision about compliance in situations where the existence of an obligation is unclear and the risk to New Zealand's revenue base is low.

The safe harbour is only available where the non-resident employer has:

- incorrectly concluded that they do not have a PAYE income payment obligation in New Zealand
- either two or fewer employees present in New Zealand, or pays $500,000 or less of employment-related taxes, in the income year, and
- within 60 days of the relevant failure to withhold or pay, taken reasonable measures to manage their New Zealand employment-related tax obligations.

New section 141ED is a corresponding amendment for the purposes of late filing penalties under section 139A or late payment penalties under section 139B of the TAA.

5 Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations (ird.govt.nz)

The sections restrict access to the safe harbour to non-resident employers who have considered their New Zealand employment-related tax obligations, albeit that they reached an incorrect conclusion. The employee, payment and time conditions are intended to protect the integrity of the tax base.

What will constitute "reasonable measures" will vary depending on the facts and circumstances of the case. "Reasonable measures" could include seeking New Zealand tax advice, using systems to monitor employee business travel and developing international employee mobility policies. Where the situation has arisen due to a permanent remote work arrangement in New Zealand, "reasonable measures" could include documenting that the employee is required to manage their New Zealand tax affairs.

Example 30: Valhalla Inc - business travellers

Valhalla Inc is an overseas incorporated company that provides software services to clients around the world. Valhalla has a contract with a New Zealand client to perform services in New Zealand. This will involve staff travelling to and from New Zealand.

The project team manager seeks advice about New Zealand tax obligations from Human Resources. They note that the business trips will involve no more than two staff members per trip and expect that the employment income associated with these trips will be exempt from New Zealand tax under the applicable double taxation agreement. The Human Resources team considers the information available on Inland Revenue's website and concludes that Valhalla does not have any New Zealand employment-related tax obligations.

Several months later, Valhalla's Finance team review the project and realise that it has created a permanent establishment for Valhalla. This means that Valhalla has a sufficient presence in New Zealand for the purpose of complying with New Zealand's employment-related tax obligations and must register as an employer (unless it makes another arrangement for the discharge of those obligations). Further they note that an employee, Val Kyries, has exceeded 183 days in New Zealand and that employment-related taxes are due. This amount due is $25,000.

Provided that Valhalla pays the tax due within 60 days of the failure to withhold and pay the employment-related taxes, Valhalla is entitled to the safe harbour in respect to its employment-related obligations as:

- at the time of the initial decision it had considered whether it had a New Zealand employment-related tax obligation
- although several employees were present in New Zealand, less than $500,000 in employment-related tax is due for the income year
- it had taken reasonable measures to manage its New Zealand employment-related tax affairs by undertaking research, reviewing the project and monitoring employee travel.

Example 31: Valhalla Inc - relocation

This is an alternative scenario to the preceding example. Thor is an employee of Valhalla Inc. He decides to relocate to Wanaka to pursue his love of skiing. Thor mostly worked from home in Australia and decides it will make no difference if he works from New Zealand. As a result, he decides to move without informing his manager or the Human Resources team. His view is that he will demonstrate that the arrangement is workable before asking if it can continue.

After six months, Thor mentions to his manager that he is now living in Wanaka. His manager is concerned about the implications and contacts the Human Resources and Finance teams. The respective teams conclude that this is a breach of their remote working policy, but that Thor's actions did not constitute a permanent establishment in New Zealand. Nevertheless, they are concerned that it is not clear whether or not his activities constitute a sufficient presence in New Zealand.

As Thor is a valuable employee, management decide to formalise the arrangement. In the terms of the relocation agreement they document that Thor is responsible for New Zealand employment-related taxes. Thor accepts these terms.

Provided that Valhalla acted to address the position within 60 days of a failure to withhold and pay, it is entitled to the benefit of the safe harbour as:

- it met the employee/employment-related tax condition of the safe harbour,
- it has taken "reasonable measures" as it has a remote working policy, it considered its New Zealand tax position, and it agreed with Thor that he is responsible for the payment of taxes due as a result of remote working.

Ability to transfer FBT and ESCT obligations from a non-resident employer to an employee working in New Zealand

Sections RD 4(4) and RD 21 provide that where an employer does not withhold PAYE, the employee must pay the required tax and provide the relevant employment income information. This includes cross-border employees whose non-resident employer does not have a New Zealand employment-related tax obligation, for example persons who work in New Zealand, remotely from their employer's workplace in another country and where the employer does not have a sufficient presence in New Zealand. Operationally, employees who are responsible for their own taxes on wages and salary manage their tax affairs via the IR 56 mechanism.

It is necessary to provide rules that ensure the payment of FBT and ESCT so that all elements of remuneration are subject to equivalent taxation.

New sections RD 62B and RD 71B of the ITA respectively prescribe the FBT and ESCT implications when a cross-border employee provides employment services in New Zealand. The provisions are intended to ensure that where a non-resident employer does not have New Zealand employment-related tax obligations, the liability can be transferred to an employee to pay and report for FBT and ESCT purposes.

New section RD 62B applies where a cross-border employee receives a fringe benefit in relation to a period when they are providing employment services in New Zealand. The policy intent is that the employer bears the primary liability for the payment and reporting of fringe benefits. However, where the employer and employee agree in a document that the employee is liable for employment-related tax obligations the employee must treat the value of the fringe benefit as a PAYE income payment and pay the PAYE due. The employer must aid the employee by providing the necessary information to calculate the value of the benefit. Payment and reporting will be undertaken by the employee via the IR 56 mechanism.

New section RD 71B applies where an employer's superannuation cash contribution or an employer's contribution to a foreign superannuation scheme is made for a cross-border employee who is providing employment services in New Zealand. As in section RD 62B, the policy intent is that the employer bears the primary liability for the payment and reporting of the employer's superannuation contributions. However, the employer and employee may record in a document an agreement that the employee is liable to pay and report ESCT. The employer must aid the employee by providing the necessary information to calculate the value of the benefit. Payment and reporting will be undertaken via the IR 56 mechanism.

Example 32: Lancelot Knight

Lancelot Knight is an employee of Circular Tables, a design partnership based in the United States. Lancelot inherits a property in Queenstown and decides that he wants to make a lifestyle change and live and work from Queenstown. Circular Tables does not have a New Zealand presence and has no intention of entering the New Zealand market. However, as Lancelot is a skilled designer, the partnership would like to retain him. They agree that Lancelot can pursue his quest for a life in Queenstown provided "we don't have to be involved".

Lancelot moves to Queenstown. He applies for an IRD number and approaches Inland Revenue for advice about whether he should complete a tax return for his income. He is told that he should register under IR 56 to pay tax on his employment income. Lancelot registers and makes his first payment under IR 56. This payment is a lump sum which includes two payments of employment income received prior to his registration for IR 56.

Example 33: Freyja

Wotan Industries is an overseas incorporated company which provides software services to clients around the world. Freyja, an employee of Wotan, decides for personal reasons to relocate to New Zealand and agrees with her managers that she will work for Wotan from New Zealand.

At the time of the relocation, Freyja is the sole employee working in New Zealand. Her work has no necessary connection to New Zealand (that is, it does not need to be done from New Zealand, nor is it for New Zealand clients). Her work will not result in a permanent establishment for Wotan Industries in New Zealand.

Wotan determines that it does not have a sufficient presence in New Zealand. As such, Wotan decides it will not register as an employer in New Zealand for tax purposes. Instead, her manager agrees that Freyja will be responsible for the payment of taxes on her employment income and record this agreement as a condition of the transfer.

Freyja is paid monthly. In addition to a salary, Wotan pays a monthly employer superannuation contribution to its pension scheme (which is a foreign superannuation scheme for New Zealand tax purposes). Wotan also pays an annual medical insurance premium to the provider of Freyja's choice. Freyja chooses a New Zealand medical insurer.

Wotan Industries' responsibility is to provide the amounts paid to the foreign superannuation scheme and medical insurer to Freyja. Freyja's responsibility is to include the amounts paid in her IR 56 returns and pay the taxes due. The annual payment of medical insurance will be included as PAYE income, as Freyja is not required to file and pay FBT. The monthly superannuation contributions will be captured as subject to ESCT in her IR 56 return.

Flexible NRCT payment arrangements

Sections 24HB and 141GC of the Tax Administration Act 1994

New sections 24HB and 141GC introduce a nominated person approach and enable more flexible arrangements for paying non-resident contractors tax (NRCT) by providing a 60-day grace period.

Background

The ITA and the TAA impose obligations on persons who make contract payments (payers) to non-resident contractors to withhold NRCT, a tax on certain schedular payments. In practice, unforeseen factors may impact the performance of the contract and mean that NRCT should have been withheld, although it had not been. Under current law, the correction is made by a voluntary disclosure. This process can be complex, costly and time-consuming. The strict nature of the rules also may not work well for certain types of business models that commonly use non-resident contractors. The proposed amendments modernise the application of the rules to support a more flexible approach.

Key features

New section 24HB enables a non-resident contractor to nominate a person resident in New Zealand to meet its New Zealand tax obligations.

New section 141GC introduces flexibility into the NRCT rules by allowing a 60-day grace period for correcting NRCT payments.

Effective date

The new sections will come into effect on 1 April 2024.

Detailed analysis

Introducing a nominated taxpayer approach to NRCT

New section 24HB confirms that a non-resident contractor may enter into an arrangement with a person resident in New Zealand in relation to the non-resident contractor's New Zealand tax obligations. The section clarifies that the nominated taxpayer facility under section 124F is available to non-resident contractors. The intention is to simplify the process of meeting NRCT obligations.

The nominated taxpayer is permitted to discharge the non-resident contractor's obligations on its behalf. Where this option is chosen the non-resident contractor must not submit returns for the relevant tax types or social policy entitlements.

Where the nominated person is a party to the arrangement the nominated person may also provide a compliance history for the purposes of obtaining an NRCT exemption under section RD 24 of the ITA.

Each person in the arrangement is jointly and severally liable for the amount of tax.

Example 34: Polder Reclamations NV

Whaihanga is a New Zealand resident infrastructure agency which is responsible for the strengthening of sea defences in the Auckland region.

Polder Reclamations NV is a Dutch engineering company that specialises in land reclamation and the construction of sea walls. Polder is engaged by Whaihanga to supply consultant engineers at different stages over the course of a five year project. The activities will be ad hoc. Polder does not expect that the activities of its employees will constitute a New Zealand permanent establishment for the Dutch company. Windmill NV is an associated Dutch company that will be undertaking the construction of the new sea walls. Windmill will set up a local subsidiary for the duration of the project.

Polder and Windmill enter into an agreement that Windmill will be responsible for the employment-related tax compliance obligations that arise for Polder's engineers working in New Zealand. Polder nominates Windmill to act for them for the purposes of PAYE, FBT and ESCT under section 124F of the TAA for the five year period. Windmill must therefore discharge Polder's PAYE, FBT and ESCT obligations and will be liable (jointly with Polder) for that tax if it is not paid.

Compliance within a 60-day grace period

New section 141GC introduces a 60-day grace period for a payer to meet or correct their NRCT obligations where:

- the payer makes a schedular payment to a non-resident contractor, and
- at the time the payment was made it was not clear that withholding would be required (for example, where the payer intended to rely on the 92-day threshold), and
- some, or all, of the tax is unpaid at the tax due date, and
- the payer can demonstrate they have taken reasonable measures in relation to the tax obligations for the schedular payment.

The grace period would run from the earliest of the date of the breach and the date on which the employer could reasonably foresee a breach will occur. Introducing this flexibility is intended to allow underpayments of NRCT to be remedied without attracting penalties or interest, provided the payer can demonstrate they have made reasonable enquiries or took reasonable steps to confirm the thresholds would not be exceeded. If this correction is not made within the 60 days, normal procedures for correction of the underpayment apply.

Example 35: Steel Strengtheners (NZ) Ltd

Steel Strengtheners (NZ) Ltd has been engaged by Whaihanga to provide reinforcing steel products to be used in the Auckland seawall project. To meet the project's requirements Steel Strengtheners decides to contract with a specialist welder from Australia. The intention is that this stage of the project will take 12 weeks. Steel Strengtheners relies on the 92-day rule in section RD 8(b)(v) of the ITA to exempt the welder's contract payment from withholding.

Unfortunately, in week 10 Steel Strengtheners is informed that the arrival in New Zealand of a key component has been delayed by two weeks. This means that the work could not be completed in the original 12-week timeframe. By the end of week 12 it is clear to the project management team that the 92-day threshold will be breached before the work is complete. The 60-day grace period to correct the withholding position starts at the end of week 12.

Exemptions for withholding NRCT

Section RD 24 of the Income Tax Act 2007 and sections 24H and 24HB of the Tax Administration Act 1994

The amendments are intended to improve the flexibility of non-resident contractor's tax (NRCT) exemptions by:

- enabling exemptions to have retroactive effect
- enabling an associated New Zealand entity to establish a good compliance history for a non-resident contractor, and
- repealing the NRCT bond provision.

Background

An exemption from withholding NRCT can be obtained under section RD 24 of the ITA. Exemptions are available if one or more of the conditions are met.

If an exemption is granted, this is notified by the Commissioner of Inland Revenue under section 24H of the TAA and applies to future payments only.

Key features

The amendment to section 24H enables an exemption to be granted retroactively for up to 92 days before the date of the application for exemption.

New section 24HB enables a non-resident contractor to use the compliance history of the nominated person under or a party to an arrangement to satisfy the contractor's New Zealand tax affairs to form the basis of a good compliance history for the purpose of obtaining an exemption from NRCT.

Section RD 24(b) of the ITA (the bond condition) is repealed.

Effective date

The amendments will come into effect on 1 April 2024.

Detailed analysis

Enabling NRCT exemptions to have retroactive effect

The amendment to section 24H of the TAA allows exemptions from withholding NRCT to have retroactive effect. This would mean that if the exemption is issued after the date of the first contract payment, the exemption can cover payments made before its issue date. This retroactive period would be limited to the 92 days before the person applied for the exemption.

Example 36: Canute ApS

Whaihanga enters into a contract with Canute ApS, a Danish company that specialises in standardised "block" building techniques. Canute will provide staff to supervise the installation of quick block walls in areas identified as at risk of sudden erosion. Canute has taken advice that confirms it is able to seek exemption from withholding from its contract payments on the basis that it will not receive assessable income in New Zealand under the terms of the New Zealand–Denmark Double Taxation Agreement. Canute is entitled to exempt status which could cover payments made up to 92 days before the application for exempt status is made.

Enabling associated New Zealand entities to form a basis for good compliance history

A non-resident contractor with no prior presence in New Zealand cannot establish a 'good compliance history' for the purpose of obtaining an exemption. This approach does not work well for all business models. For example, where separate project entities are created for each contract undertaken, each new entity cannot establish two years of good compliance history even though they may be associated with an entity in New Zealand that has met the two-year condition.

New section 24HB(4) enables a nominated person or another party to an arrangement for meeting New Zealand tax compliance obligations to provide the non-resident contractor with a good compliance history for the purpose of obtaining an NRCT exemption under section RD 24.

Each person in the arrangement is jointly and severally liable for the amount of tax.

Example 37: Polder Reclamations NV

The background is described in the Nominated Taxpayer example above.

After a couple of years working for the Waihanga project, Polder is successful in obtaining further work in other parts of New Zealand. To co-ordinate this work, Polder sets up a branch in New Zealand. As Polder has not previously had a presence in New Zealand, withholding from contract payments is required. However, as Polder has an existing arrangement with Windmill, the actions of Windmill are capable of forming a compliance history for exemption purposes.

Repeal of the NRCT employee bond provision

The NRCT rules provide that a non-resident contractor may apply for an exemption certificate on the basis that they have provided a bond or other security for the income tax payable for a contract payment.

This provision is rarely used in practice and has been repealed.

Employer contributions to foreign superannuation schemes

Section RD 65 of the Income Tax Act 2007

An amendment to section RD 65 enables flexibility in the taxation of employer contributions to foreign superannuation schemes where those contributions are made for the benefit of a cross-border employee.

Background

Currently, under section CX 13 of the ITA, a fringe benefit arises when an employer contributes to a superannuation scheme for the benefit of an employee. The contribution is generally taxed under FBT rules unless it qualifies as an "employer's superannuation cash contribution". Employer's superannuation cash contributions are payments in money to KiwiSaver schemes or to a superannuation fund. This means FBT generally only applies to contributions to other superannuation arrangements, including foreign superannuation schemes.

In practice, some employers of cross-border employees are required to file FBT returns and pay FBT simply because the employer's contribution is made to a foreign superannuation scheme. The employee may not receive any other benefits that would be subject to FBT. As such, FBT treatment creates compliance costs in filing FBT returns that might not otherwise be required.

Key features

The amendment enables greater flexibility in the taxation of cash contributions to foreign superannuation schemes, bringing that treatment closer to the treatment of cash contributions to KiwiSaver schemes and superannuation funds.

FBT treatment under section RD 37 is the default treatment for contributions to a foreign superannuation scheme. However, an employer may choose to apply ESCT treatment to cash contributions to a foreign superannuation scheme. This includes contributions to sickness, accident, or death benefit funds within that scheme (so that apportionment of the contribution is not required).

Under section RD 68, an employee may agree with the employer to treat an employer's superannuation cash contribution as salary or wages to be taxed under the PAYE rules. By bringing employer's cash contributions to foreign superannuation schemes into ESCT, it is intended that PAYE treatment is available.

Effective date

The amendments will come into effect on 1 April 2024.

FBT obligations and 'trailing payments'

Section CX 26 of the Income Tax Act 2007

The amendment clarifies that payments to an employee for services provided in New Zealand that are made after the employee has ceased to live and/or work in New Zealand should not trigger a FBT liability for fringe benefits provided overseas except to the extent the fringe benefits relate to the time spent working in New Zealand.

Background

Fringe benefits, such as health insurance or a vehicle, may be provided by an employer to their employees. Section CX 26 excludes fringe benefits provided to an employee in a quarter or income year from FBT unless the employee receives a taxable PAYE income payment in that period. Some employees will receive a payment, such as a cash bonus relating to their time working in New Zealand, after they have ceased to work here or to be a New Zealand tax resident. These are known as trailing payments and are, correctly, taxable PAYE income payments in New Zealand.

Trailing payments can pose a problem where employees receive fringe benefits abroad. This is because the previous section can be read as meaning that New Zealand tax obligations can be triggered on any fringe benefits provided at the time the trailing payment is paid to the employee. This could include fringe benefits provided abroad and unrelated to time spent working in New Zealand.

Key features

The amendment to section CX 26 is intended to clarify that fringe benefits received by an employee after they have ceased to work in New Zealand and/or ceased New Zealand tax residence are subject to FBT only to the extent such benefits relate to a period of work in New Zealand. Consistent with policy intent, the trailing payment itself remains a PAYE income payment.

Effective date

The amendments will come into effect on 1 April 2024.

Example 38: Gawain Green

Gawain Green, an employee of Kamelot, successfully completed his three-year secondment to New Zealand on 22 October 2024. He took a few days holiday in New Zealand then travelled directly to Melbourne to start a new secondment on 1 November 2024. His Australian secondment remuneration package includes use of a company car, medical and travel insurance. His employer also pays for a trip home to Wales every calendar year.

Kamelot's annual bonuses are paid in February each year. In 2025, Gawain is awarded a cash bonus. A portion of this bonus is taxable in New Zealand as PAYE income. However, this payment does not result in an FBT liability for the company car, insurance or 2025 home leave trip as these are paid in connection with his secondment to Australia.

Clarifying the status of non-resident entertainers

Section YA 1 of the Income Tax Act 2007

The definition of "non-resident contractor" in section YA 1 of the ITA is amended to exclude a "non-resident entertainer" and to clarify the provisions that apply to non-resident entertainers.

Background

Schedular payments, such as those received by non-resident entertainers, are usually subject to withholding tax. Schedule 4 of the ITA provides the withholding rates for schedular payments.

Sections RD 8(1)(b)(v) and (vi) of the ITA exclude payments to non-resident contractors from the definition of a "schedular payment" if they meet certain day-count or monetary thresholds.

Interpretation Statement IS 10/04 Non-resident contractor schedular payments outlines that, while the term "non-resident contractor" is broad enough to include a "non-resident entertainer", these two categories should be considered separately. This is because, under both domestic law and tax treaties, non-resident entertainers are treated differently from non-resident contractors

This ambiguity around the breadth of the term "non-resident contractor" can lead to confusion and could mean that:

- the applicable withholding rate in schedule 4 of the ITA is not immediately apparent, and
- non-resident entertainers could be incorrectly viewed as entitled to the exclusions from withholding for non-resident contractors in sections RD 8(1)(b)(v) and (vi) of the ITA.

Effective date

The amendment will come into effect on 1 April 2024.

Dual resident companies

Loss grouping, consolidation, and imputation credit rules

Sections FM 31, FN 4, IC 5, IC 7, IZ 7B, LK 1, OB 2, and YA 1 of the Income Tax Act 2007

The Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Act 2023 contains changes to allow dual resident companies to be eligible to offset income tax losses against the profits of other group companies, be a member of a consolidated group and to retain their imputation credit account (ICA) balance in certain situations.

Background

In March 2019, in response to an Australian High Court judgment, the Australian Tax Office (ATO) issued new technical interpretations of Australia's corporate tax residence rules. In particular, new guidance was provided on how to apply the central management and control (CMAC) test, a key element for determining whether a company has tax residence in Australia. The revised view of the CMAC test was retrospectively applied from 15 March 2017, although to date the ATO has adopted a transitional compliance approach where it is not currently applying resources to review the residence status of companies in certain situations.

This new interpretation effectively meant that companies with Australian directors could now be an Australian tax resident, even if the company's commercial activities are exclusively carried on outside of Australia. This change may affect New Zealand companies with Australian-based directors, potentially making them a tax resident in both countries (referred to as being a "dual resident company").

As part of the October 2020 Federal Budget, the previous Australian Government announced that it intended to enact retrospective legislation to effectively return the CMAC test back to its original interpretation. This legislation has not yet been enacted.

Under New Zealand's tax rules, there are several beneficial tax regimes that do not apply to dual resident companies. These amendments include dual resident companies in three of these beneficial tax regimes. This will benefit taxpayers that are tax resident in both New Zealand and another jurisdiction, while maintaining the integrity of the underlying rules.

Key features

The amendments allow:

- Companies that are dual resident to offset their tax losses against the profits of another company in the same group.
- A dual resident company to be a member of a consolidated group of companies for income tax purposes. This includes where the company's residence tie-breaks to another country under a double tax agreement (DTA) (referred to as a "DTA non-resident company").
- Companies that change their tax residence from New Zealand to Australia, or vice versa, to automatically retain their accumulated ICA balance.

Effective date

The amendments apply retrospectively from 15 March 2017.

Detailed analysis

Loss grouping

Section IC 7(2) of the Income Tax Act 2007 (the ITA) has been repealed.

Originally this section required that a New Zealand resident company must not be either a company that is treated under a double tax agreement as not resident in New Zealand or liable for tax in another jurisdiction for the duration of the commonality period.

The repeal of section IC 7(2) means a company that is both a New Zealand tax resident and a tax resident in another jurisdiction can now offset its losses against the profits of another company in the same group of companies for New Zealand tax purposes. This is provided the company still satisfies the other requirements in section IC 7, including that it is either incorporated in New Zealand or carrying on a business through a fixed establishment in New Zealand.

The restriction for dual resident companies was previously required due to risks of these companies claiming a deduction for the same expense in more than one jurisdiction. The hybrid and mismatch rules introduced in 2018 effectively remove this risk, so it is possible to loosen the loss grouping (and consolidation) rules.[6]

Sections IC 5(1)(b) and LK 1 of the ITA have been amended because section IC 7 no longer has a residence requirement.

Example 39: Loss grouping rules after 15 March 2017

New Zealand resident company, ABC Limited, is a tax resident in both New Zealand and Australia. In the 2021–22 income year, ABC Limited has a net loss of $100,000. ABC Limited has common voting and market interests of 75% with DEF Limited, a New Zealand resident company.

For the 2022–23 income year, ABC Limited had net income of $0, with carried forward losses from the previous year of $100,000, and DEF Limited had net income of $100,000. ABC Limited wishes to make available its accumulated tax loss of $100,000 to DEF Limited. ABC Limited elects to transfer its accumulated tax loss to DEF Limited.

While ABC Limited is a dual resident company, under the proposed amendments the dual residence restriction would not apply from 15 March 2017, and therefore, the tax loss could be transferred from ABC Limited to DEF Limited.

Commonality periods starting before 15 March 2017

New sections IC 5(8) and IZ 7B have been introduced to ensure that the pre-amendment dual residence restriction requirements are applied to commonality periods that begin before 15 March 2017 where the tax losses arose in a tax year after the 1990–91 tax year.

This means that for calculating a commonality period that began before 15 March 2017 and continued after 15 March 2017 (for losses incurred after the 1990–91 tax year), the prior dual residence restriction in section IC 7(2) only apply up to 15 March 2017 and cease thereafter. Consequently, to offset a tax loss that arose before 15 March 2017, either of the two companies may still be a dual resident company, provided that the period of dual residence started after 15 March 2017.

The loss grouping rules require a "loss" company and a "profit" company to maintain a common ownership (common voting and market interests of at least 66%) over a period. The commonality period encompasses the commencement of the income year in which the loss company incurs the loss to the end of the income year in which the loss is used by the profit company.

Example 40: Commonality period that began before 15 March 2017

Since the 2014 income year, a New Zealand resident company, Rose's Flowers Limited, has had common voting and market interests of 80% with Zoë's Pots Limited. In the 2016 income year, Rose's Flowers Limited incurs a net loss of $50,000.

In 2019, Rose's Flowers Limited becomes a tax resident in Australia, as well as New Zealand.

In the 2024 income year, Zoë's Pots Limited has net income of $50,000 and Rose's Flowers Limited has net income of $0. Rose's Flowers Limited wishes to make available its accumulated tax loss of $50,000 to Zoë's Pots Limited. While Rose's Flowers Limited is a dual resident company, under the proposed amendments the dual residence restriction would not apply after 15 March 2017.

For the purposes of the commonality period, as long as neither company was dual resident before 15 March 2017, then Rose's Flowers Limited (as the "loss" company) would be able to be a dual resident company after 15 March 2017, even if the tax loss arose before 15 March 2017. Therefore, Rose's Flowers Limited could offset its $50,000 tax loss against Zoë's Pots Limited's net income. However, if Rose's Flowers Limited had become dual resident in 2016 instead, then it would not be able to offset that loss.

6 For further details of the hybrid and branch mismatch rules, refer to Tax Information Bulletin Vol 31, No 3, April 2019.

Consolidation rules

The foreign resident restrictions in sections FM 31(1)(b) and (e) of the ITA are repealed. This means a company that is both a New Zealand tax resident and a tax resident in another jurisdiction is now able to be a member of a consolidated group of companies. As noted above for the loss rules, the risk that the dual resident company restriction was preventing is now addressed by the hybrid and branch mismatch rules.

Example 41: Consolidation rules after 15 March 2017

Since its incorporation on 1 April 2010, GB Limited has been a tax resident in New Zealand and a member of a consolidated group for income tax purposes. On 1 August 2018, GB Limited also became resident in Australia under Australian tax law.

While GB Limited is now a dual resident company, under the proposed amendments the requirements in section FM 31(1)(b) and (e) would no longer apply from 15 March 2017. Consequently, GB Limited could continue to be a member of the New Zealand consolidated group after becoming an Australian tax resident on 1 August 2018.

Imputation credit accounts

New section OB 2(3B) of the ITA requires a company to maintain an ICA when a New Zealand resident company's tax residence tie-breaks to Australia under the New Zealand/Australia DTA. That is, the company will be required to maintain an ICA as an Australian ICA company, meaning that it would not be required to follow the election process currently set out in section OB 2(3).

Section OB 2(3B) does not apply where a New Zealand resident company becomes non-resident under a DTA other than with Australia.

Balance at the point of becoming an Australian ICA company

Section OB 2(3B) ensures a company's ICA balance, at the point of becoming an Australian ICA company, is preserved and consequently any accumulated imputation credits up until the point of becoming an Australian ICA company are retained by the company.

It is appropriate in this instance for these credits to be retained and available for use in the future. This is because the same shareholders would own the company before and after the company has become a DTA non-resident company with Australia, meaning they bore the economic cost of the tax that generated the imputation credits. This is consistent with the overall approach of allowing both New Zealand and Australian tax resident companies to maintain an ICA.

An Australian ICA company's residence reverts to New Zealand

Section OB 2(8) ensures an Australian ICA company's ICA balance, where it became an Australian ICA company by way of the double tax agreement, will be preserved if the company's residence changes back to New Zealand under the New Zealand/Australia DTA.

Definitions

The relevant definitions in section YA 1 of the ITA have been amended.

The definition of "Australian ICA company" now includes the situation where the company is required to maintain an ICA because it was treated as an Australian tax resident under the New Zealand/Australia DTA.

The definition of "ICA company" no longer refers to an election being made for a company to be an Australian ICA company.

Example 42: Company becomes an Australian ICA company after 15 March 2017

Southern Crux Limited was incorporated in New Zealand on 1 February 2000. From 1 April 2019, directors of Southern Crux Limited started to exercise control of the company while in Australia and the company became Australian resident under Australian tax law.

While Southern Crux Limited is resident in both New Zealand and Australia under their respective tax laws, under the New Zealand/Australia DTA the company is treated as being solely resident in Australia.

Under the amendments, this change in residence would mean Southern Crux Limited automatically became an Australia ICA company and would continue to be required to maintain an ICA. The company's pre-existing ICA balance from when it was an ICA company would be retained and carried forward.

Imputation groups

Amendments to the eligibility rules for imputation groups in section FN 4(1)(d) of the ITA means an Australian ICA company, either by way of election or DTA, can be a member of an imputation group.

Integrity issues with dividends and corporate migration rules

Sections CD 1, CD 14, CD 26, CD 43, CW 10, EE 31, FL 1, FL 2, FL 3, OB 62, RA 6, RA 18, RF 2, RF 2C, RF 9, RF 11BB and YA 1 of the Income Tax Act 2007, and sections 3, 25E, 25G, 25M and 29 of the Tax Administration Act 1994

Integrity issues were identified regarding the domestic dividend exemption and the corporate migration rules, involving New Zealand resident companies where their residence tie-breaks to another jurisdiction under a double tax agreement (DTA). These issues gave rise to situations where companies may derive income or pay dividends without the anticipated New Zealand income taxation by changing their tax residence,[7] and obtaining tax relief, under a DTA.

Issues related to tax residence are fact specific and can be complex to resolve. Taxpayers can obtain certainty on the tax treatment of particular arrangements by applying for a ruling from Inland Revenue's Tax Counsel Office. Taxpayers are also able to seek a determination from a competent authority to determine residence for DTA purposes.[8]

Background

The amendments address integrity issues involving the domestic dividend exemption and corporate migration rules in relation to dual resident companies.

Domestic dividend exemption

In general, a dividend paid between members of a wholly owned group of New Zealand resident companies is exempt income under section CW 10 of the Income Tax Act 2007 (ITA). Previously, this domestic dividend exemption would have also applied to dividends paid to a New Zealand resident company that is also resident overseas under the tax laws of another country (referred to as a "dual resident company"), including where the company's residence tie-breaks to another country under a DTA (a DTA non-resident company).

In some cases, a DTA would have prevented the application of non-resident withholding tax (NRWT) when a dividend was paid by a DTA non-resident company to a non-resident. This was because the dividend was treated as being paid between two non-New Zealand residents under the DTA. As a result, a dividend could be paid offshore through a DTA non-resident company without the intended application of NRWT.

7 The Commissioner has previously released Interpretation Statement, IS16/03: Tax Residence, which provides details of New Zealand's tax residence tests, including situations involving double tax agreements. Additional information published by Inland Revenue on tax residence can be found at https://www.ird.govt.nz/international-tax/business/tax-residency-status-for-companies.

8 For more details, see https://www.ird.govt.nz/international-tax/business/tax-residency-status-for-companies.

Corporate migration rules

The corporate migration rules in subpart FL of the ITA apply when a company ceases to be a New Zealand tax resident. They result in a deemed liquidation, disposal of assets and distribution to shareholders for tax purposes. This process can give rise to an income tax or NRWT liability for the emigrating company.

Previously, the corporate migration rules would not have applied when a New Zealand resident company became a DTA non-resident company. This would have resulted in New Zealand losing taxing rights on income and distributions made to non-residents due to the application of a DTA, even though there was no change in the company's tax residence under domestic law. This significantly undermined the effectiveness of the existing corporate migration rules.

Key features

The amendments address integrity issues involving New Zealand resident companies where the residence tie-breaks to another country under a DTA.

In particular, the amendments:

- remove the exemption in section CW 10 of the ITA (the domestic dividend exemption) for certain dividends paid to New Zealand resident companies whose residence tie-breaks to another country under a DTA, and
- extend the rules in subpart FL of the ITA (the corporate migration rules) to certain companies whose residence tie-breaks from New Zealand to another country under a DTA.

Effective date

The amendments came into effect on 30 August 2022.

Detailed analysis

Domestic dividend exemption

The amendments remove the domestic dividend exemption for certain dividends paid to a DTA non-resident company and require NRWT to be withheld. A two-year period is provided for the dividend payer to meet this NRWT obligation. However, if the DTA non-resident company becomes a New Zealand tax resident under the relevant DTA during this period, and the dividend recipient does not itself pay a dividend, the dividend would again be treated as exempt and there would be no NRWT obligation. This is intended to protect taxpayers where the change in DTA residence was inadvertent, and where the New Zealand residence under the DTA is restored before a NRWT benefit is obtained. Further rules ensure that the amendments are generally limited to situations where there is a genuine risk of NRWT leakage to the tax base.

Changes to the domestic dividend exemption

The scope of the domestic dividend exemption is reduced so that it no longer exempts certain dividends paid to a DTA non-resident company.

However, to ensure the new rules are targeted towards the dividends of greatest concern, the limitation to the domestic dividend exemption would not apply in any of the following circumstances (see new section CW 10(1)(f)(i) to (iv) of the ITA):

- Where the dividend recipient is dual resident in New Zealand and Australia, and is treated as being Australian resident under the New Zealand/Australia DTA (section CW 10(1)(f)(i)).
- Where all shareholders of the dividend recipient would be entitled to a full exemption from NRWT under an applicable DTA if they received a dividend from the dividend recipient (that is, if a dividend was on-paid to the shareholders) while the dividend recipient was not a foreign company (as defined in section YA 1 of the ITA[9]) (section CW 10(1)(f)(ii)).
- Where the total dividends received by the recipient from the payer is less than $1 million in each 12-month period that includes the date the recipient derives the dividend (section CW 10(1)(f)(iii)).

9 A foreign company is a company that is either not resident in New Zealand under our domestic law, or is not treated as resident in New Zealand under an applicable DTA.

- If, within a two-year period of the dividend recipient receiving the dividend, the company's tax residence changes so that it is no longer a "foreign company" and it has not paid a dividend while it was a foreign company (section CW 10(1)(f)(iv)).

The first bullet point reflects that, in the case of companies that are dual resident in Australia and New Zealand, New Zealand retains the ability to impose NRWT on any on-paid dividend by a DTA non-resident company under the New Zealand/Australia DTA. Therefore, dividends paid to a DTA non-resident company that is resident in Australia are unlikely to give rise to an integrity risk of the kind that the changes seek to address. Given that the most common dual resident company scenario involves Australia residence, this particular exclusion from the changes will ensure the domestic dividend exemption will still be available in the majority of dual residence situations.

The second bullet point acknowledges that there is no risk to the New Zealand tax base (that is, no NRWT would be payable) if the dividend-receiving company immediately on-paid the dividend to its own shareholders, assuming the company was not a foreign company at the time, and its shareholders would have qualified for full tax relief from New Zealand tax under a DTA.

The third bullet point is a *de minimis* rule and reduces the impact of the changes on smaller businesses.

The fourth bullet point addresses a situation where the dividend recipient's residence only temporarily tie-breaks to another jurisdiction under a DTA (for example, due to a change in application of another country's tax laws). This is achieved by providing a two-year period for the tax residence of the dividend recipient to be changed back to New Zealand. However, it is only applicable if the dividend recipient does not pay a dividend while being a DTA non-resident company, as a dividend paid during that time to the DTA non-resident company and on-paid could be completely relieved from NRWT due to the application of a DTA. If a dividend recipient on-pays a dividend in this scenario, the NRWT payable would be calculated under new section RF 11BB, which is discussed in more detail below.

It is envisaged that the various limitations noted above would mean the majority of dividends paid between New Zealand resident companies within a wholly-owned group of companies would continue to be entitled to the exemption in section CW 10 of the ITA.

In addition, new section CW 10(1B) of the ITA would provide that the domestic dividend exemption would also generally be available to the extent a dividend is fully imputed. This acknowledges that fully imputed dividends paid by a wholly-owned New Zealand tax resident company to its non-resident parent company would generally have NRWT applied at a rate of 0% (under section RF 11B of the ITA).

Example 43: DTA relief

NZ Limited is a New Zealand tax resident company and is wholly owned by DR Limited. DR Limited is a resident in both New Zealand and the United States of America (US) under their respective domestic tax laws. DR Limited's residence tie-breaks to the US under the New Zealand/United States of America DTA.

DR Limited is wholly owned by US Corp, a US tax resident company listed on the New York Stock Exchange. US Corp has held shares in DR Limited for more than 12 months.

On 30 June 2023, NZ Limited pays an unimputed dividend of $2 million to DR Limited.

The dividend paid to DR Limited meets the exemption requirements of new section CW 10(1)(f)(i) of the ITA as:

- the shareholder of DR Limited, US Corp, is tax resident in the US, and
- assuming DR limited was a New Zealand tax resident for the purposes of applying the New Zealand/United States of America DTA, a dividend it paid to US Corp would not be taxable in New Zealand due to article 10(3) of the New Zealand/United States of America DTA.

Example 44: Fully imputed dividend

Bob's Books Limited is a New Zealand tax resident company. It is wholly owned by Pete's Publishing Limited, which is a tax resident in both New Zealand and the United Kingdom (UK) under their respective domestic tax laws. Under the New Zealand/United Kingdom DTA, Pete's Publishing Limited is treated as being a tax resident in the United Kingdom.

On 1 July 2024, Bob's Books Limited pays a fully imputed dividend consisting of cash of $1,080,000 and imputation credits of $420,000.

Because the dividend is fully imputed, as calculated under section RF 9 of the ITA, and assuming the other relevant criteria of new section CW 10(1B) of the ITA are met, the dividend will be exempt under section CW 10 of the ITA.

Example 45: Partially imputed dividend

Assume the same facts as in example 44.

On 31 May 2025, Bob's Books Limited pays a net dividend of $1.44 million and attaches imputation credits of $280,000.

Applying the formula in section RF 9 of the ITA, $720,000 of the net dividend would be treated as being fully imputed. Accordingly $720,000 of the dividend would not be subject to NRWT under new section CW 10(1B) of the ITA.

The remaining $720,000 of the net dividend would not be treated as unimputed. Accordingly it would not meet the requirements of new section CW 10(1B) of the ITA. Therefore, that $720,000 may be subject to NRWT under the amendments.

Dividend rules

As noted above, the changes would provide taxpayers with the opportunity to correct their tax residence within two years to ensure the domestic dividend exemption applied. To cater for this, a two-year deferral of income would be applied to those dividends within the scope of the proposed changes to the domestic dividend exemption.

New section CD 1(3) of the ITA would modify the income year that a dividend is allocated to, if it is derived by a DTA non-resident company, and the requirements of sections CW 10(1)(b) to (d), (5), and (6) of the ITA are met.

This income is deferred to the "DRCD deferral date", which is defined in new section RA 6(2) of the ITA as the second anniversary of the date on which the dividend was paid.

NRWT obligations for dividends

A dividend paid to a DTA non-resident company is equivalent in some respects to a dividend being paid to a non-resident company. This is because, once a dividend is paid to a DTA non-resident company, New Zealand may lose its right to tax the on-payment of that dividend to another company. For this reason, it is considered appropriate for the NRWT rules to apply to a dividend paid to a DTA non-resident company.

The NRWT obligation, including payment, and imputation credit account implications apply on the DRCD deferral date under new section RA 6(5) of the ITA. These changes ensure that NRWT is only payable following the DRCD deferral date and not when the dividend is actually paid, as well as ensure that credits and debits to a company's ICA occur on the DRCD deferral date.

To ensure a dividend paid to a DTA non-resident company is subject to the NRWT rules, new section RF 2(1)(b) of the ITA expands the definition of "non-resident passive income" to include any dividend, other than an investment society dividend, having a source in New Zealand that is derived by DTA non-resident company.

However, if the dividend was exempt income, new section RF 2(2BA) of the ITA would exclude the dividend from being non-resident passive income.

New section RF 11BB of the ITA provides a special set of rules for certain dividends paid to dual resident companies in certain situations that present a limited risk to the New Zealand tax base. For this section to apply, the following must apply:

- the dividend paid to the dual resident company is not fully imputed
- the dividend payer is in the same group of companies as the recipient at the time the dividend is derived

- the dividend payer is not a "foreign company"[10]
- the dividend payer is not a company that can only derive exempt income
- requirements in subsection (5) and (6) are met
- the exclusions in section CW 10(1)(f) (referred to above) are not met, and
- before the DRCD deferral date, the dividend recipient is treated as a New Zealand resident under a DTA (that is, the dividend recipient is New Zealand under domestic tax law and is not a DTA non-resident company).

In this scenario, the amount of NRWT is the lesser of:

- the NRWT payable in the absence of section RF 11BB, and
- the NRWT on the unimputed portion of any dividends paid by the recipient while it was DTA non-resident.

The application of section RF 11BB will effectively limit the amount of NRWT payable on a dividend to a DTA non-resident company to the extent of any actual NRWT leakage if that company's residence reverts to New Zealand under the DTA.

Retrospective attachment of imputation credits

The dividend integrity amendments may result in situations where companies pay dividends with the understanding that the recipient is resident in New Zealand under a DTA, but the recipient is subsequently determined to be a DTA non-resident company. This outcome may arise despite enquiries by the dividend payer and an honestly held belief that the recipient was resident in New Zealand under the relevant DTA. In some cases, if the taxpayer understood the dividend would be subject to NRWT, it would have attached imputation credits to the dividend to reduce/eliminate any NRWT liability.

The ITA already provides a limited range of situations where imputation credits can be retrospectively attached to dividends. The ability to retrospectively attach imputation credits has been extended under section OB 62(1)(c) to include situations where a dividend is paid under section CD 1(3) (that is, where certain dividends are paid by DTA non-resident companies). This will allow imputation credits to be retrospectively attached to any dividends when the payer subsequently discovers that the recipient is a DTA non-resident. This in turn will mean that NRWT will not be payable on the dividends under the amendments, as they will be treated as fully imputed.

Correcting incorrect tax returns

If a dividend payer has returned resident withholding tax (RWT) on a dividend to a DTA non-resident company, but is later determined to have been required to pay NRWT under the amended rules, it may make a request to the Commissioner to correct the return and refund the incorrectly paid RWT.[11]

Consequential adjustments

The Act includes several consequential amendments that:

- update references in sections RF 2C and RF 12G of the ITA as a result of changes to section RF 2,
- update references in section RF 9 as a result of the changes to section RF 11BB,
- insert the relevant definitions in section YA 1 of the ITA,
- insert a definition of "DRCD deferral date" in section 3 of the Tax Administration Act 1994 (TAA), and
- amend sections 25G and 29 of the TAA to reflect that a dividend paid under new section CD 1(3) is paid on the DRCD deferral date.

Corporate migration rules

New Zealand's corporate migration tax rules ensure that companies that migrate their tax residence from New Zealand (and therefore cease being tax resident under New Zealand's domestic law) pay tax on all their unrealised income. These rules reflect the limited ability for New Zealand to tax non-resident companies.

However, similar issues arise for New Zealand tax resident companies if they become non-resident under a DTA. For example, where a DTA non-resident company pays a dividend to a non-resident, that dividend may be relieved from New Zealand

10 A foreign company is a company that is either not resident in New Zealand under our domestic law, or is not treated as resident in New Zealand under an applicable DTA.

11 More details of how to amend incorrect returns can be found at https://www.ird.govt.nz/updates/news-folder/amending-returns.

taxation under a DTA. Similarly, a DTA can relieve a DTA non-resident company from taxation on certain types of income (such as income from sources outside New Zealand).

Given that the tax effects of non-residence under a DTA are very similar to those of a company ceasing being a tax resident under New Zealand's domestic law, the corporate migration rules have been amended so that they are also triggered immediately before a New Zealand tax resident company becomes and remains DTA non-resident.

New section FL 3

The Act inserts new section FL 3 of the ITA into the corporate migration rules. The purpose of section FL 3 is to bring into scope certain companies that are still tax resident under domestic law but which become DTA non-resident.

Section FL 3 will treat a New Zealand tax resident company as migrating from New Zealand immediately before it becomes a DTA non-resident company on or after 30 August 2022 where one of the following events (known as a "triggering event") listed in section FL 3(1) occurs:

- the company becomes a DTA non-resident company and claims relief from taxation of income under a DTA, or
- the company receives a determination from a competent authority that it is DTA non-resident and does not become New Zealand resident under the DTA within two-years of the determination.

These triggering events will generally therefore only apply in situations where deliberate decisions have been made for a company to be DTA non-resident. This would include a situation where the Commissioner agrees to amend a previously filed income tax return under section 113 of the Tax Administration Act 1994, following a request by a taxpayer, to reduce the income of the taxpayer due to relief under a DTA on the basis that the taxpayer is DTA non-resident.

The amendments defer the application of the corporate migration rules for up to two years from the date the relevant company becomes DTA non-resident. This provides an opportunity for taxpayers to remedy any inadvertent residence changes. If a DTA non-resident company's residence reverts to being a New Zealand resident for the purposes of applying the relevant DTA and neither of the triggering events listed in new section FL 3(1) have occurred, then section FL 3 will not apply to the company.

Under section FL 3(2), when one of the triggering events occurs, the DTA non-resident company will be treated as disposing its assets and making a distribution to its shareholders immediately before it became a DTA non-resident company (as is the case under the ordinary corporate migration rules). Section FL 3(3) treats each shareholder of the DTA non-resident company as being paid a dividend equivalent to the amount they would be entitled to if the company went into liquidation. These provisions ensure that New Zealand can tax the accumulated income and taxable gains of the company before it becomes a DTA non-resident company and the DTA restricts or removes those taxing rights.

Example 46: Company claims relief on the basis it is DTA non-resident

Software Limited is a New Zealand tax resident company.

On 15 May 2024, Software Limited is acquired by SaaS Inc, a US resident company. Following the change in ownership, there is an immediate change in the directors of Software Limited and decisions related to the effective management of the company are undertaken in the US.

In its income tax return for the 2025-26 income year, Software Limited only includes income related to its permanent establishment in New Zealand and does not return foreign sourced income related to its offshore operations. This triggers the event in section FL 3(1)(a) of the ITA, as Software Limited is claiming relief under a DTA on the basis it is treated under the New Zealand/United States of America DTA as not being a New Zealand resident. As a result, Software Limited is subject to the deemed disposal, liquidation and distribution provisions of section FL 3(2).

Example 47: Company continues to be DTA non-resident after receiving a competent authority residence determination

Cloud Services Limited is a New Zealand resident company that provides IT cloud storage services. On 1 October 2023, several directors of Cloud Services Limited relocate to the United Kingdom to investigate potential new markets and commercial partners. It was anticipated that this project would take up to nine months.

The directors exercising control of Cloud Services Limited while in the UK resulted in the company becoming UK resident under UK domestic law from 1 October 2023. Cloud Services Limited approached the competent authority in the UK to obtain a residence determination.

On 1 September 2024, the UK competent authority issued a determination that Cloud Services Limited is a resident in the UK under the residence tie-breaker test in the New Zealand/United Kingdom DTA.

On 1 September 2026, the directors of Cloud Services Limited were still residing in the UK and exercising control from the UK. Therefore, on 1 September 2026, there has been two years since the issue of a competent authority residence determination and Cloud Services Limited remains DTA non-resident. Under section FL 3, assuming no other triggering event in proposed section FL 3(1) has occurred previously, section FL 3(1)(c) would apply, and Cloud Services Limited would be treated as migrating immediately before becoming a DTA non-resident company on 1 October 2023.

Example 48: Changes following competent authority residence determination

Manufacturing Limited undertakes manufacturing activities in New Zealand and Australia and is a resident in New Zealand under domestic law. It's board of directors are physically located in New Zealand and Australia, with the New Zealand based directors attending board meetings via video conference.

Given the uncertainty where the place of effective management of Manufacturing Limited is carried out, an application is made to the New Zealand competent authority on the residence of Manufacturing Limited under the New Zealand/Australia DTA.

On 29 December 2024, a competent authority determination is issued that the residence of Manufacturing Limited under the New Zealand/Australia DTA is in Australia. During the 2025 calendar year, changes are made to the decision-making process of Manufacturing Limited (including holding in person board meetings in New Zealand) to ensure the residence of Manufacturing Limited tie-breaks to New Zealand under the DTA. A new competent authority determination is obtained in 2026 that states that Manufacturing Limited is resident in New Zealand under the New Zealand/Australia DTA from 1 October 2025. Manufacturing Limited continues to calculate and return New Zealand tax through the whole period on the basis that it is a New Zealand resident under the DTA, and so does not claim any relief under that DTA.

Given that the residence of Manufacturing Limited has reverted to New Zealand under the applicable DTA within a two-year period of receiving the competent authority determination that it was non-resident under the DTA, and the company has not claimed any relief from New Zealand tax under a DTA, the migration rules in section FL 3 of the ITA do not apply to create a deemed disposal, liquidation and distribution.

The income from a migration under sections FL 3 arises immediately before the change in residence for the purpose of the DTA. This means New Zealand can still tax that income under the DTA on the basis that the company was a New Zealand resident.

For the purposes of paying tax on this income, Section FL 3(4) and (5) include income allocation rules for the DTA non-resident company and its shareholders respectively. The income derived by the company from a deemed disposal, liquidation and distribution is allocated to the income year in which the relevant triggering event occurred. Similarly, a migration dividend arising under section FL 3 is treated as being paid to the shareholder(s) of the company at the time the relevant triggering event occurred. The relevant shareholders that are treated as receiving the dividend are those at the time immediately prior to the company becoming DTA non-resident, as opposed to the shareholder(s) at the time the relevant triggering event occurs.

Retrospective attachment of imputation credits

Section OB 62 of the ITA provides that imputation credits can be retrospectively attached in certain situations, including when section FL 2 (the standard corporate migration provision) applies to an emigrating company. The ability to retrospectively attach imputation credits has been extended to dividends arising under section FL 3.

Under section FL 3(2), the company is treated as making a distribution of money as a dividend immediately prior to being treated as a DTA non-resident company. In determining the timing of the imputation debit to the DTA non-resident company, the dividend is treated as being paid immediately prior to the company being treated as DTA non-resident company. This should ensure that the dividend is treated as being paid while the company is eligible to maintain and imputation credit account and is able to attach imputation credits to the dividend.

Amendments to sections FL 1 and FL 2

Section FL 1(1) of the ITA has been amended to provide that the subpart also applies where a company is treated under a DTA as not being a New Zealand tax resident. Section FL 1(2) is also amended to include a reference to a triggering event occurring after a company becomes DTA non-resident, so that the tax effects set out in section FL 1(2) also apply for the purposes of section FL 3.

Section FL 2 of the ITA has also been redrafted to better reflect the situations in which it will apply. However, the substance of the section remains unchanged.

Change in definition of time of emigration

The definition of "time of emigration" in section YA 1 of the ITA has been amended to include the situation where a New Zealand resident company becomes a DTA non-resident company.

Consequential adjustments

References in sections CD 14, CD 26, CD 43, EE 31, OB 62 and RA 18 of the ITA have been updated to include new section FL 3. Updates have also been included in sections 25E, 25M and 29 of the TAA to include proposed new section FL 3.

GST apportionment and adjustment rules

The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 makes changes to the GST apportionment and adjustment rules that would reduce the compliance costs they impose on businesses and better align them with current taxpayer practices. The main changes include:

- introducing a principal purpose method for goods and services acquired for $10,000 or less (GST exclusive) that allows a registered person to claim a full GST input tax deduction (instead of apportioning the deduction based on the percentage taxable use)
- no subsequent adjustments are made for goods or services acquired for $10,000 or less
- reducing the number of adjustment periods that GST-registered persons need to monitor their percentage actual use of assets and make annual adjustments to ten years for land and two years for goods and services acquired for between $10,000 to $20,000 (GST exclusive), and
- allowing GST-registered persons to elect to treat certain goods that have mainly private or exempt use, such as dwellings, as if they only had private or exempt use. This means no input tax deduction is claimed when purchasing the goods, and no output tax is charged when the goods are sold.

Background

To ensure GST is not a cost on business production, businesses can claim input tax deductions on purchases of goods and services they use to make taxable supplies. However, where the asset is used both to make taxable supplies and for non-taxable use, such as a van delivering packages during the week and used privately in the weekend, the taxpayer can only deduct a percentage of the total input tax deduction. The deduction is based on their estimate of the percentage of taxable use. This is known as apportionment. Apportionment ensures GST is collected on the asset's non-taxable use.

Once a business has claimed an input tax deduction based on their estimated taxable use, they are generally required to monitor their actual use of the asset over time. If the estimate is inaccurate, they must account for this difference in their GST return at the end of each adjustment period (tax year). This is known as an adjustment or change in use.

The previous GST apportionment and adjustment rules were complex and imposed high compliance costs. For example, the apportionment rules apply to all goods and services acquired by registered persons. This imposed undue compliance costs for low-value assets, such as computers, phones, and tools, which often only have a minor amount of private or exempt use.

Also, the previous rules could generate large and unexpected GST liabilities. For example, if a registered person sold an asset (for example, land or a dwelling) that they had used a small percentage of to make taxable supplies (for example, as a home office or workshop), the sale could be a taxable supply. However, such disposals would often not be taxable supplies if a different ownership structure had been used, for example, owning the asset through a company, partnership or trust that was separate to the registered person using part of the asset in their taxable activity.

To address these issues, reforms have been made to reduce business compliance costs, better align the rules with current taxpayer practices, and improve fairness between different types of ownership structures.

Key features

The amendments have made the following key changes:

- For goods and services acquired for $10,000 or less (GST exclusive), there is a new principal purpose method in sections 20(3CB) and (3CC) of the Goods and Services Tax Act 1985 (GST Act). This method allows a registered person to claim a full GST input tax deduction for goods or services that they acquired for the principal purpose of making taxable supplies. This is instead of applying the apportionment or adjustment rules. If a registered person chooses not to apply the principal purpose method, they will be required to continue to apply the general apportionment method to all their purchases of $10,000 or less for at least 24 months. Registered persons who have agreed an alternative apportionment method with Inland Revenue should continue to apply the alternative method.
- No subsequent adjustments are made for goods or services acquired for $10,000 or less.
- The number of adjustment periods that GST-registered persons need to monitor their percentage actual use of assets and make annual adjustments is reduced to ten years for land and two years for goods and services acquired for between $10,000 and $20,000 (GST exclusive).

- Sections 6(3)(e) and 91 allow GST-registered persons to elect to treat certain assets that have mainly private or exempt use, such as dwellings, as if they only had private or exempt use. The goods cannot have been acquired or used for the principal purpose of making taxable supplies and the person cannot have claimed GST deductions for the cost[12] or capital improvements to the goods. When the goods are subsequently sold or disposed of, the registered person can elect for the sale of those goods to not be considered part of their taxable activity.
- In contrast, the disposal of an asset for which a registered person has previously claimed taxable use is deemed to be a taxable supply under sections 5(16) and (16C). In addition, where the Commissioner of Inland Revenue (Commissioner) considers a registered person has increased their non-taxable use of goods or services and then applied the wash-up rule in section 21FB in contemplation of the sale of the goods or services or ceasing their taxable activity, the disposal of the relevant asset is deemed to be a taxable supply.
- The wash-up rule in section 21FB can now apply when there has been any permanent change in use and at the end of the adjustment period in which the change of use occurred.
- Amendments to sections 20(3E), (3EB), 21(4) and (4B) allow Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply. Inland Revenue can also publish certain alternative apportionment methods considered acceptable to use by certain GST-registered persons and the circumstances in which they can be used.
- The special mixed-use asset rules in sections 20(3JB) and 20G of the GST Act, which apply to certain holiday houses, boats and aircraft with private, taxable and at least 62 days vacant use during the owner's tax year, will be repealed from 1 April 2024. GST input tax deductions and adjustments can instead be calculated using the general GST apportionment rules that apply to other assets. Persons previously applying the rules in sections 20(3JB) and 20G for mixed-use assets may choose to continue to use this method for taxable periods commencing on or after 1 April 2024 as the Commissioner considers it to be an acceptable method of adjustment for mixed-use assets. The Commissioner will publish this method before 1 April 2024 as an approved alternative adjustment method as allowed by Section 21(4B)(c).
- Section 61B of the Tax Administration Act 1994 enables Inland Revenue to prescribe an information disclosure for certain GST-registered persons who acquire land, ships or aircraft they intend to use to make taxable supplies.

Effective date

Most of the changes have effect for goods and services supplied, or adjustment periods beginning, on or after 1 April 2023. The exceptions to this are noted below:

- The amendments to allow GST-registered businesses to elect to treat the supply of certain goods, with mainly private or exempt use, as a non-taxable supply generally have effect for supplies made on or after 1 April 2011. This is retrospective so it aligns with previous GST positions taken and ensures affected businesses do not incur additional GST and compliance costs.
- Remedial amendments to the definition of "actual deduction" in the wash-up calculation in section 21FB of the GST Act and the definition of "percentage actual use" in section 21G have effect on 30 June 2014, which is the date that section 21FB was first introduced.
- The amendments to the asset value thresholds determining the number of years that post-acquisition adjustments are required take effect on1 April 2023.
- The amendments to sections 20(3E), (3EB), 21(4) and (4B) of the GST Act to allow Inland Revenue to approve a wider range of agreed apportionment methods and publish approved apportionment methods take effect on 1 April 2023.
- The repeal of the mixed-use asset rules in sections 20(3JB) and 20G of the GST Act have effect for a registered person's first adjustment period beginning on or after 1 April 2024.

12 If the goods were acquired as a zero-rated supply, the registered person must have returned output tax for the amount of GST they would have been charged if the supply had been standard-rated (15%).

Detailed analysis

Principal purpose method for goods and services acquired for $10,000 or less

Sections 20(3CB) to (3CH) of the GST Act provide a principal purpose method that allows a registered person to claim a full input tax deduction for a supply of goods and services acquired for $10,000 or less (excluding GST) for the principal purpose of making taxable supplies.

Principal purpose is intended to have the same meaning in section 20(3CC) as the reference to principal purpose used in the pre-2011 GST Act definition of "input tax". The principal purpose is the main, primary, or fundamental purpose. This does not necessarily equate with more than 50 percent taxable use.

Example 49: Goods acquired for $10,000 or less with a principal purpose of making taxable supplies

Phil is a GST-registered contractor who acquires a laptop for $3,000 (plus $450 GST) for the principal purpose of making taxable supplies, although he may also use it occasionally for private use.

Because the laptop was acquired for $10,000 or less (GST exclusive) and for a principal purpose of making taxable supplies, Phil can claim a full input tax deduction for the $450 GST he paid on acquisition in his next GST return.

If a supply of goods or services is acquired for $10,000 or less (excluding GST) but not for a principal purpose of making taxable supplies, a registered person is not typically able to claim an input tax deduction for the acquisition of the good or service.

Example 50: Goods acquired for $10,000 or less with mostly private use

Amy acquires a car for $9,000 (plus $1,350 GST) for the principal purpose of private use, but she may also use it occasionally in her business to make taxable supplies (estimated 20 percent taxable use by kilometres travelled).

Because the car was acquired for $10,000 or less (GST exclusive) and not for a principal purpose of making taxable supplies, Amy is unable to claim an input tax deduction on acquisition or make any subsequent adjustment for the 20 percent taxable use.

It is expected that most registered persons will use the principal purpose method. If they elect to use it, they will need to apply it to all goods and services they acquire for $10,000 or less.

The general apportionment rules continue to apply for higher value purchases when the good or service is used by the registered person to make both taxable and non-taxable supplies, such as exempt supplies or for private use.

When the acquired goods or services can be identified as being exclusively used for making taxable supplies, making exempt supplies or private use, the registered person should directly attribute and either claim a full input tax deduction (if only taxable use) or no deduction (if only non-taxable use).

When apportionment is required, the general apportionment method requires the registered person to apportion input tax deductions and make adjustments based on the percentage (e.g. time, space or value) of the good or service that is used to make taxable supplies.

Choosing not to use the principal purpose method

If a registered person would prefer not to use the principal purpose method for purchases of $10,000 or less, they can instead choose to continue to apply the general apportionment method to all their inputs. This may be because it is simpler for them to use the general apportionment rules for all their purchases, rather than two different methods.

If they choose not to use the principal purpose method, they must do this for a minimum period of 24 months. The 24-month period applies from the first date that the registered person files a tax position in a GST return where they have elected not to use the principal purpose method. They then cannot apply the principal purpose method for other input tax deductions claimed in their GST returns for the next 24 months. Once those 24 months have passed, they can choose to start using the principal purpose method for their subsequent purchases of $10,000 or less, or they can again elect out of using it for the next 24-month period.

Example 51: Electing not to use the principal purpose method for 24 months

Property Co purchases certain inputs, such as vehicles and leasing an office space, that it uses to make both taxable supplies of commercial leases and exempt supplies of residential tenancies. Property Co has established an apportionment method for tracking its percentage of taxable use of these inputs and would prefer not to change from this method to a principal purpose method for goods and services that are newly acquired for $10,000 or less. In its GST return filed on 29 May 2023, Property Co takes input tax deductions for all its expenses (including goods and services acquired for $10,000 or less in the taxable period since 1 April 2023) based on the general apportionment rules rather than using the principal purpose method. Property Co cannot apply the principal purpose method until at least 29 May 2025 when 24 months have elapsed since it first elected not to apply the principal purpose method.

In early 2025, Property Co has sold most of its properties that it used to make exempt supplies and decides it would now be simpler to begin using the principal purpose method for newly acquired goods and services purchased for $10,000 or less and chooses to do this in its GST returns that are filed after 29 May 2025.

Some registered persons have agreed to use an alternative apportionment method with Inland Revenue. In these cases, the registered person should continue to use the agreed alternative apportionment method (to the inputs that this agreement applies to) rather than apply the principal purpose method. This is provided for by section 20(3CB) not applying to a person who has agreed an apportionment method with the Commissioner under section 20(3E), 20(3EB), 21(4), or 21(4B).

Registered persons can choose to use an alternative apportionment method that has been agreed between Inland Revenue and an industry association of which the person is a member. They can also choose to use an alternative apportionment method that has been published by the Inland Revenue and made available for persons in their circumstances to use. In such cases, the agreed method would apply instead of the principal purpose method. This is provided for by sections 20(3EB) and 21(4B).

Required number of adjustment periods

Adjustments are no longer made for goods or services valued at $10,000 (excluding GST) or less. This means that once a registered person has claimed an input tax deduction at the time these goods or services were acquired (or when they first use the goods or services to make taxable supplies), they cannot make subsequent adjustments based on the actual use of those goods or services.

Adjustments are still required at the end of a registered person's adjustment period (tax year) for goods or services valued at more than $10,000. The required minimum number of adjustment periods are displayed in the following table. They depend on whether the goods are land and on the value of other types of goods or service (other than land).

Table 2: Required number of adjustment periods

Value of good or service, excluding GST	Required number of adjustment periods (Balance dates since acquisition or first taxable use)
$10,000 or less	No adjustment to the input tax deduction taken when the goods or services were acquired.
$10,001 to $20,000	Two
$20,001 to $500,000	Five
$500,000 or more	Ten
Land (regardless of the value of the land)	Ten

Alternatively, a registered person can use the number of adjustment periods equal to the estimated useful life of the asset as set by the Commissioner in the Tax Depreciation Rates Determinations.

For goods or services acquired for more than $10,000, the above requirements are a minimum limit, which means the registered person can elect to make annual adjustments for a higher number of adjustment periods, if they would prefer to do so.

If the registered person sells the asset in the course or furtherance of their taxable activity or has a deemed disposal because they cease their taxable activity, they may still need to make a final adjustment under section 21F, which provides an additional input tax deduction to account for their non-taxable use of the asset.

Example 52: Required number of adjustment periods

Belinda bought a car for $18,400 (including $2,400 GST) in February 2021.

Belinda was initially working as employee of a surveying business, but in August 2021, she decides to start her own surveying business and registers for GST.

As she will now be using the car to make taxable supplies, she makes annual adjustments at the end of each adjustment period (her tax year) to claim a percentage of the GST she paid for the car based on the percentage she has used it to make taxable supplies. She calculates this percentage by measuring the kilometres travelled for her GST-registered business as a percentage of the total kilometres travelled by the car since she purchased it in February 2021.

Belinda has made GST adjustments for two adjustment periods (ending on 31 March 2022 and 31 March 2023) for the car, which was valued for more than $10,000 and less than $20,000 (GST exclusive) when she bought it. Her taxable use of the car at the end of 31 March 2023 was 77 percent, which means she has claimed input tax deductions totalling 77 percent of the $2,400 GST she paid when she bought the car.

From 1 April 2023, Belinda is not required to make further adjustments for the car at the end of her tax year as she has already made adjustments for two adjustment periods. Although she could choose to continue to make adjustments at the end of each tax year, she decides not to do so.

Belinda sells the car in May 2024 for $9,200 (including $1,200 GST). She makes a final adjustment under section 21F to claim a further input tax deduction of $276 (0.15 x 9200 x (1-0.77)). Belinda returns $1,200 output tax and claims a $276 input tax deduction in her next GST return following the sale of the car.

Election to treat supply of certain goods as non-taxable supply

Section (6)(3)(e) has been added to the list of activities that are not a taxable activity in the GST Act. This provision allows registered persons to elect to treat the sale of goods that were not acquired or used for the principal purpose of making taxable supplies as not part of their taxable activity. This means a sale of qualifying goods is not in the course or furtherance of the registered person's taxable activity so would not be a taxable supply (and therefore not subject to GST).

This aligns the GST rules with current practices for GST-registered persons who may own goods, such as private dwellings, that are principally for private or exempt use, but who may also use the goods for a small percentage of the time or use a small percentage of the goods to make taxable supplies. These GST-registered persons may not have considered these goods to be part of their taxable activity and therefore not included GST positions for acquiring, using, or disposing of them in their GST returns.

The rule is limited to goods (and not services) as it is intended to be used for tangible assets, such as land, dwellings or vehicles, which are likely to have minimal use in making taxable supplies, rather than intangibles, such as brands or intellectual property, which are likely to have a mainly taxable use when acquired by registered persons.

The rule deems the sale or disposal of the goods (including a deemed disposal because the person ceases to carry out a taxable activity) not to be a taxable supply. Where land or dwellings are provided by way of a lease, the GST treatment of the lease is determined under other GST rules, such as whether the lease is consideration for an exempt supply of accommodation in a dwelling or for a taxable supply of services.

To qualify as a supply that is not in the course or furtherance of the person's taxable activity, the goods must satisfy the following requirements outlined in section 6(3)(e):

- No previous input tax deductions were claimed by the registered person for the goods under section 20(3) before the goods were sold.
- The goods were not acquired for the principal purpose of making taxable supplies.
- The goods were not used for the principal purpose of making taxable supplies.
- The goods were not acquired as zero-rated supplies under section 11(1)(m) or (mb), or if they were acquired as a zero-rated supply, the recipient has made an output tax adjustment for the nominal GST component under section 20(3J)(a)(iv).

These requirements are explained below.

No input tax deductions under section 20(3)

The first requirement is that the registered person cannot have claimed a deduction under section 20(3) for the supply of goods before the goods are sold. If they have claimed a deduction for the goods under section 20(3), the sale of the goods by the registered person will generally be a taxable supply. The exception is if the goods were acquired before 1 April 2023 and the registered person applies the transitional rule in section 91 before 1 April 2025 (the transitional rule is further explained in a later section).

The relevant deductions that the registered person may have claimed under section 20(3) could include:

- an input tax deduction under section 20(3)(a) or (b) at the time the goods were acquired
- a subsequent deduction under section 20(3)(e) after applying the adjustment rules to the goods at the end of the person's adjustment period, or
- deductions under section 20(3) for other goods and services that were acquired and became an integral part of the goods that are sold. Integral part means the goods would be considered incomplete or unable to function without the item.

When determining if inputs that the registered person claimed an input tax deduction for became an integral part of the goods being sold, it may be useful to consider if the input represents capital expenditure for income tax purposes and whether it is a separate capital item for income tax depreciation. Further guidance on these concepts is available in *Interpretation Statement: IS 12/03 Income tax – deductibility of repairs and maintenance expenditure – general principles and Interpretation Statement IS 10/01 Residential Rental Properties—Depreciation of Items of Depreciable Property.*

The registered person will still be able to satisfy the requirement if they claim input tax deductions for inputs that did not become an integral part of the goods that are sold, such as overheads, repairs and maintenance, or operating costs. They would not satisfy the requirement if they claimed deductions for inputs that made a substantial capital improvement to the goods.

Example 53: Dwelling with minor use in registered person's taxable activity

Rebecca is a registered person who acquired a dwelling that was not a zero-rated supply when it was acquired. She did not claim deductions under section 20(3) for the cost of acquiring the dwelling or any subsequent capital improvements to the dwelling. Although part of the dwelling is used to run Rebecca's taxable activity of farming, the dwelling's principal purpose is a private residence. Rebecca claimed input tax deductions for certain overheads and operating costs, such as insurance, utilities, and local authority rates, based on the percentage that these services were used to make taxable supplies.

When Rebecca sells the dwelling, she can elect to treat the sale as a supply that is not in the course or furtherance of her taxable activity (not subject to GST on sale).

Example 54: Dwelling where deductions are claimed for taxable use

Vincent is a registered person who acquired a dwelling for $920,000 from an unregistered person. Vincent intends to use 20 percent of the dwelling (a dedicated office) to make taxable supplies for his GST-registered consulting business. He therefore claims an input tax deduction of $24,000, which is 20 percent of the GST fraction of the purchase price. He later spends $23,000 (including GST) on substantial renovations (for example, building a new internal wall, replacing the electrical wiring, and upgrading to double-glazed windows) to improve the office, which he uses exclusively to make taxable supplies for his consulting business. Vincent claims a deduction for the $3,000 of input tax paid for the renovations.

The dwelling would not meet the requirements of section 6(3)(e) because relevant deductions were taken for the goods under section 20(3). A deduction was claimed on acquisition, and deductions were also claimed for substantial improvements that became an integral part of the dwelling that is eventually sold.

Because the dwelling is partly used to make taxable supplies, it will be a taxable supply when sold. Vincent can claim an additional deduction under section 21F for the non-taxable percentage use of the consideration he receives when he sells the dwelling. In this case, the office used to make taxable supplies comprised 20 percent of the use of the dwelling, so the non-taxable percentage use is 80 percent. If Vincent sold the dwelling for $1.15m, he would return the output tax of $150,000 but could claim an adjustment under section 21F for an additional deduction of $120,000. The net GST he would return on the sale would therefore be $30,000.

Example 55: Business use of a home garage

Charlie has a GST-registered business hiring bicycles. Because she has run out of storage space in her retail shop, she begins to use her home garage to store some of her hire bikes. She does not claim input tax deductions for part of the acquisition cost of her house, even though it is now partly used (the garage) to make taxable supplies.

Charlie claims input tax deductions for purchasing bike hooks and shelving that she attaches to her garage and uses to store the hire bikes and related equipment in her garage. These items do not form an integral part of her dwelling.

Because Charlie has not claimed input tax deductions for any costs that became an integral part of her dwelling, and the dwelling was acquired and used for the principal purpose of a private residence, she can choose to treat the sale of the dwelling as not being made in the course or furtherance of her taxable activity (and therefore not subject to GST on the sale).

Not acquired for principal purpose of making taxable supplies

The goods cannot have been acquired for the principal purpose of making taxable supplies.

Principal purpose is intended to have the same meaning as when "principal purpose" was previously used in the pre-2011 GST Act definition of "input tax". Previous public guidance on the meaning of "principal purpose" has defined this as being the main, primary or fundamental purpose and that it does not necessarily equate with a more than 50 percent test.

Not used for principal purpose of making taxable supplies

During the time the registered person owned the goods, they cannot have been used by the person for the principal purpose of making taxable supplies. In other words, the primary use of the goods, from the time the person acquired them until their disposal, must be a non-taxable use, that is, a private or exempt use.

In the case of dwellings, the private use will often be as an owner-occupied home. Some holiday houses may also have a principally private purpose if they are mainly used for their owner's private recreation. Other types of holiday houses may instead be primarily used to provide taxable supplies of short-stay accommodation to paying guests. A dwelling used for worker accommodation could have a principal purpose of providing an exempt supply of accommodation in a dwelling (if the dwelling is a principal place of residence for occupants who have quiet enjoyment of the dwelling).

The goods will not satisfy the test in section 6(3)(e) if their principal purpose involves the registered person selling those types of goods as their taxable activity. For example, if a property developer builds or develops a house for sale, the sale of the house would remain a taxable supply. Trading stock that is sold by a business would also remain a taxable supply.

Not acquired as a zero-rated supply, or the recipient has made an output tax adjustment for the nominal GST component

Certain goods may have been acquired by a registered person as a zero-rated going concern under section 11(1)(m) or as a zero-rated supply of land under section 11(1)(mb). These goods will only satisfy section 6(3)(e) if the registered person has made an output tax adjustment equal to the nominal GST component and this adjustment has been made after 1 April 2023 and before the goods being sold or disposed of.

For section 11(1)(m) to apply, the registered person who acquires the goods must acquire a taxable activity, or part of a taxable activity, that is a going concern at the time of supply and capable of continuing as a going concern. For section 11(1)(mb) to apply, the registered person must acquire land with the intention of using it to make taxable supplies.

In most cases, when a GST-registered purchaser acquires land or business assets that qualify for zero-rating under section 11(1)(m) or (mb), they will be acquiring these goods for the principal purpose of making taxable supplies.

However, in other cases, the purchaser's taxable use of the goods, while sufficient for the supply of the goods to qualify as a zero-rated supply under section 11(1)(m) or (mb), may be minor and secondary to their non-taxable (exempt or private) use of the goods.

To accommodate these cases, the registered person can return an amount of output tax under section 20(3J)(a)(iv) equal to the full nominal GST amount as calculated by section 20(3J)(a)(i).

If the registered person makes this output tax adjustment, the exclusion under section 6(3)(e) for goods acquired as zero-rated goods no longer applies. Although the person acquired the goods as a zero-rated supply, making the output tax adjustment puts them in the same position as a person who acquired standard-rated or secondhand goods and did not claim an input tax deduction on acquisition.

Example 56: Acquiring a holiday home as a zero-rated supply of land

Gavin is a registered person who acquires a holiday home from another registered person. Gavin's principal purpose for acquiring the holiday home is to use it for his own private recreation (and not as his principal place of residence).

However, because Gavin also intends to use the holiday home for a secondary and more minor purpose of making taxable supplies of guest accommodation, he acquires the holiday home as a zero-rated supply under section 11(1)(mb) for $1m (rather than a standard-rated supply of $1m plus $150,000 of GST, which would have been the price had section 11(1)(mb) not applied to the supply).

If Gavin intends to use section 6(3)(e) to make his future disposal of the holiday home a non-taxable supply, he can choose to return output tax of $150,000, being the full amount of the nominal GST component, in his next GST return after acquiring the holiday home. If he does this, section 6(3)(e) could then be satisfied to deem the future disposal of the holiday home as not being made in the course or furtherance of Gavin's taxable activity. Gavin would therefore not be required to charge GST on that disposal.

Alternatively, Gavin can choose to return the smaller amount of $105,000 output tax under section 20(3J) based on his 70 percent expected non-taxable use of the holiday home at the time he acquires the holiday home. However, if he does this, a future disposal of the holiday home would not satisfy section 6(3)(e) as he would not have returned the full amount of the nominal GST component on acquisition of the zero-rated supply of land.

Electing to use section 6(3)(e)

The registered person elects to use section 6(3)(e) by taking a tax position of not charging GST at the time they sell (or otherwise dispose of) the qualifying goods and not accounting for a taxable supply of the goods in their next GST return.

The registered person will not generally have to disclose to, or notify, the Commissioner that they have made the election to apply section 6(3)(e). Instead, they would simply not account for GST on the asset (by not claiming deductions for the secondary taxable use and not returning output tax on disposal).

Note, however, there is a requirement for a registered person to notify the Commissioner if they intend to apply the transitional rule in section 91 for certain goods acquired before 1 April 2023. This transitional rule allows the registered person to make an output tax adjustment before 1 April 2025 for taxable use that was previously claimed and is explained below.

Effective date of section 6(3)(e)

Section 6(3)(e) generally has effect for taxable supplies made on or after 1 April 2011. This retrospective application date means that if a registered person has previously taken a tax position consistent with the requirements of section 6(3)(e), that tax position is now correct. This could include a person having treated their dwelling as not being part of their taxable activity even though it may have been partly used to make taxable supplies.

However, in cases where an assessment has already been made for a taxable supply before 30 August 2022, that is, the registered person has returned output tax on goods they sold or disposed of before that date, the supply of those goods remains a taxable supply.

For goods that a registered person sells or disposes of between 30 August 2022 and 1 April 2023 that would qualify as non-taxable supplies under section 6(3)(e), the registered person can amend their GST position to apply section 6(3)(e). In these cases, the person may have initially taken a GST position that treated the sale of the goods as a taxable supply and claimed a deduction for non-taxable use of the asset under section 21F at the time they sold the goods. If they subsequently wanted to apply section 6(3)(e), the fact that they initially may have claimed a deduction under section 21F for their percentage of non-taxable use at the time they sold the goods would not disqualify them from applying section 6(3)(e). This is because the condition in section 6(3)(e) only refers to deductions taken before selling the relevant goods. Their amended GST position would have to reverse out any deduction taken under section 21F as that section would no longer apply once the sale of the goods was changed to be a non-taxable supply under section 6(3)(e).

The amendments to sections 6(3)(e)(iv) and 20(3J), allowing a registered person to make an output tax adjustment for the full nominal GST component of goods acquired as zero-rated land or a zero-rated going concern so that the acquisition is no longer treated as a zero-rated supply, have effect for taxable periods beginning on or after 1 April 2023.

Transitional rule for certain goods acquired before 1 April 2023

Section 91 provides a transitional rule that allows a registered person to return an amount of output tax for certain goods acquired before 1 April 2023 that cannot qualify for the main rule in section 6(3)(e).

The transitional rule applies for the 24-month period between 1 April 2023 and 1 April 2025.

Section 91 applies when a registered person has acquired goods before 1 April 2023 and previously claimed a deduction under section 20(3) for the goods or acquired them as zero-rated supplies.

Provided the relevant goods were not acquired or used for the principal purpose of making taxable supplies, the registered person can elect to notify the Commissioner before 1 April 2025 and return a certain amount of output tax in their next GST return.

The amount of output tax the registered person returns is equal to either the previous taxable use that was claimed for the goods (where deductions have been claimed under section 20(3)) or, in those cases where the goods were acquired as a zero-rated supply, the current taxable use percentage of the goods multiplied by the nominal GST component.

If a registered person applies section 91 and returns the relevant output tax amount, a future disposal of the relevant goods is not a taxable supply. This is unless the registered person later chooses to claim a deduction under section 20(3) for any taxable use of the goods after applying section 91.

Consequential amendments to sections 5(15) and 21(2)

A consequential amendment to section 21(2) ensures that a registered person does not need to monitor their actual taxable use and make adjustments at the end of their adjustment period for any goods for which they apply the rules in section 6(3)(e) or 91. This reflects the fact that to apply these new rules the person treats the goods as though they had no taxable use of the goods. No adjustments are necessary when a person has no taxable use of their goods.

The amendment to section 21(2) has effect for supplies made on or after 1 April 2011 other than supplies for which an assessment has been made before 30 August 2022.

Consequential amendments are also made to section 5(15). Section 5(15) applies if a person makes a supply of real property (land) that includes a principal place of residence (such as the person's home). It provides that the principal place of residence is treated as a separate (and usually non-taxable) supply to the supply of other parts of the real property, such as farmland or business premises, which may be a taxable supply. The amendments expand the scope of section 5(15) so it also applies to a supply of real property that includes goods the registered person has elected to treat as a non-taxable supply under section 6(3)(e) or 91. The non-taxable supply of these goods is treated as a separate supply to the supply of any other real property.

The relevant goods will usually be a dwelling. For example, the person's principal place of residence, a second house that is not any person's main home, a holiday house or a dwelling used to provide temporary worker accommodation.

Section 5(15)(c), relating to section 6(3)(e), has the same retrospective effective date as section 6(3)(e) itself. It has effect for supplies made on or after 1 April 2011 other than supplies for which an assessment has been made before 30 August 2022.

Section 5(15)(d), relating to section 91, has the same effective date as section 91, that is, 1 April 2023.

Example 57: Dwelling deemed to be separate supply to farmland

Francis is a GST-registered farmer who owns a farm that includes a farmhouse.

After some years, Francis buys a second farm and moves his principal place of residence to the newer and larger farmhouse on this new farm. He continues to operate both farms for several years.

Francis eventually decides to sell his old, original farm. Throughout the time Francis owned the original farmhouse, its principal purpose was non-taxable private use, even though it was also partly used in his farming business and to provide taxable supplies of accommodation to paying guests or workers.

Francis uses a property valuer to determine the value of the farmhouse and curtilage and then applies section 6(3)(e) so that the sale of the farmhouse and curtilage is a non-taxable supply that is a separate supply to the rest of the farmland. The sale of the rest of the farmland is a zero-rated supply as it is sold to another registered person who will use the farmland to make taxable supplies.

Deeming the disposal of an asset to be a taxable supply

Under the GST Act, supplies of goods or services by a registered person in the course or furtherance of their taxable activity are taxable supplies. This includes selling or otherwise disposing of assets used by the registered person in their taxable activity.

A person's taxable activity includes anything done in connection with the beginning or ending of that activity, including a premature ending. However, even with this broad definition, it may be unclear whether the disposal of an asset, such as land, is a taxable supply when the registered person is no longer using the asset to make taxable supplies, or when they previously claimed they had a taxable use of the asset but did not in fact use the asset to make any taxable supplies.

New sections 5(16) and 5(16C) clarify that the disposal of such goods and services are taxable supplies.

An asset for which a registered person has previously claimed a taxable use

Section 5(16) applies to goods and services that a person has previously claimed a taxable use for, even though the person is not using the goods or services in the course or furtherance of their taxable activity at the time the goods or services are disposed of.

Section 5(16C) deems the disposal of these goods and services to be made in the course or furtherance of a taxable activity carried on by the person (a taxable supply). The disposal could be the sale of the relevant goods or services to another person, or it could be a deemed disposal under section 5(16C)(b) because the person ceases to be a registered person.

In cases where a person ceases to be a registered person, section 10(7A) deems the relevant assets to be disposed of at market value immediately before the time the person ceases to be a registered person. This is the same valuation rule that applies when a registered person ceases to carry out a taxable activity and has a deemed disposal of all the goods and services that previously formed part of the assets of their taxable activity under section 5(3).

The definition of "registered person" includes a person who is liable to register for GST. This means that the deeming rule in section 5(16C) also applies to a person who has previously deregistered from GST but becomes liable to register for GST because of the application of the section and the fact they are making taxable supplies of more than $60,000 in a 12-month period (including the consideration received for the section 5(16C) taxable supply).

There are three ways a person may have previously claimed a taxable use for the relevant goods or services:

- by claiming an input tax deduction for taxable use under section 20(3)
- by acquiring the goods or services from another registered person as a zero-rated supply of land under section 11(1)(mb), or
- by acquiring the goods or services as a zero-rated supply of a taxable activity (that is, a business) as a going concern under section 11(1)(m).

The deeming rule will not apply in situations where the registered person has previously returned an amount of output tax on the goods or services equal to or greater than either the deductions taken for the relevant goods or services under section 20(3) or the nominal GST component under section 20(3J) in the case of a supply that was acquired by them as a zero-rated supply of land or a going concern.

The person could have previously returned this amount of output tax because of one or more of the following circumstances:

- The person deregistered for GST and returned output tax on the market value of the asset (which was higher than the acquisition cost) under section 5(3).
- Section 20(3J) applied, and the registered person's percentage intended use for making taxable supplies was nil at the time they acquired the supply, which was initially treated as a zero-rated supply of land or a going concern. For example, at the time of supply the person initially planned to use the land to make taxable supplies, but once they acquired the land their plans changed, and they would only have private or exempt use of the land.
- The wash-up rule in section 21FB was applied by a registered person who had total non-taxable use, and therefore they repaid an amount of output tax equal to their earlier deductions or nominal GST component for their earlier taxable use.
- The registered person applied the transitional rule in section 91 for qualifying goods acquired before 1 April 2023 and notified the Commissioner and returned output tax equal to the previous deductions (or nominal GST component) claimed for their taxable use of the goods.

Example 58: Output tax adjustment equal to previous deductions taken

Scott is a registered person who acquired a dwelling for $1.15m in 2022 from an unregistered person. Scott intends to use 20 percent of the dwelling (a dedicated office) to make taxable supplies for his GST-registered consulting business. He claims an input tax deduction of $30,000, which is 20 percent of the tax fraction of the purchase price.

During 2023, Scott finds he is no longer using his home office as he prefers to work from his client's offices and a co-working space he has started to lease. He makes an output tax adjustment of $30,000 at the end of his next adjustment period to reflect the fact he no longer uses his home office to make taxable supplies.

Scott uses the wash-up rule in section 21FB to make this adjustment as he now has zero percent taxable use of his dwelling and expects this to remain the case for the foreseeable future.

Alternatively, if Scott had still expected to continue to have some taxable use of his dwelling (such as using his home office to make taxable supplies on certain days of the week), and this was not the principal purpose of the dwelling, he could choose to apply the transitional rule in section 91 for goods acquired before 1 April 2023. To apply the transitional rule, he would need to make the $30,000 output tax adjustment before 1 April 2025 and notify the Commissioner that this output tax is because he intends to apply section 91.

In 2026, Scott sells the dwelling and as he has already made output tax adjustments to return the full amount of input tax deduction he originally claimed ($30,000), section 5(16) will not apply. Instead, Scott can treat the sale as not being made in the course or furtherance of his taxable activity, either because it is no longer used in his taxable activity, or because he has applied the transitional rule in section 91.

Section 5(19) of the GST Act is repealed as it has been superseded by the new section 5(16). Section 5(19) provided an election that a registered person could use before 1 August 1996 to pay output tax on a dwelling for which the person had previously claimed deductions under section 20(3) to ensure a future disposal of the dwelling would not be subject to the deeming rule in section 5(16). The new section 5(16) means that a disposal of such a dwelling will not be deemed to be a taxable supply, provided the registered person who applied the section 5(19) election has not claimed a subsequent deduction under section 20(3) for a taxable use of the dwelling since returning the output tax in 1996.

Assets sold after a non-taxable wash-up is performed

Section 21FB of the GST Act applies when a person changes their taxable use of an asset permanently to a new percentage use. If a person's use becomes fully non-taxable, the asset may no longer be used in the course or furtherance of the person's taxable activity and therefore its subsequent sale or disposal is not a taxable supply.

This provides a potential opportunity for tax avoidance. For example, registered persons could try to minimise their output tax liability on assets, such as land, that are used to make taxable supplies but which they plan to sell soon. The output tax that needs to be returned under section 21FB on a change to non-taxable use is based on the full input tax deduction that could have been claimed for the GST charged on the asset *at the time it was originally acquired.* This means that for appreciating assets, such as land, the output tax liability from claiming a change of use and applying section 21FB may be significantly less than the output tax that would be charged *at the time of disposal* if the asset was sold as a taxable supply.

To address this risk, section 5(16B) provides that the deeming rule in section 5(16C) also applies in circumstances where the Commissioner considers the registered person has increased their non-taxable use of the goods or services and then applied section 21FB in contemplation of the sale of the goods or services or of ceasing their taxable activity.

If section 5(16B) applies, the disposal of the relevant asset is deemed by section 5(16C) to be made in the course or furtherance of a taxable activity carried on by the person (that is, it would be a taxable supply). The disposal could be the sale of the relevant goods or services or a deemed disposal under another deeming rule (such as section 5(3), which deems the disposal at market value of any assets held by a person who ceases to be a registered person).

The amendments to sections 5(16), (16B) and (16C) have effect for goods and services supplied on or after 1 April 2023.

Expanding the ability to use the wash-up rule for permanent change in use

The wash-up calculation in section 21FB has been amended with effect for adjustment periods beginning on or after 1 April 2023. It can now be applied:

- at the end of a registered person's current adjustment period, and
- for any new permanent percentage use.

Under the previous section 21FB, which applied before 1 April 2023, the registered person had to have 100 percent taxable use or 100 percent non-taxable use of an asset for the remainder of their current adjustment period and all the following adjustment period (tax year).

The wash-up rule in section 21FB can now be applied at the end of the adjustment period in which the permanent change in use occurred. This may be particularly relevant for persons who have acquired assets before registering for GST that they then begin using to make taxable supplies.

Example 59: Adjustment for asset acquired before registering for GST

In July 2023, Sam buys a small van for $23,000 (including GST of $3,000) to start a part-time business moving furniture a few days a week.

His business grows and he registers for GST in November 2023.

Since registering for GST, he uses the van exclusively for making taxable supplies in his furniture-moving business and expects this 100 percent taxable use to continue for the foreseeable future. Sam applies the wash-up calculation in section 21FB to claim an input tax adjustment for $3,000 at the end of his current adjustment period, which ends on 31 March 2024. He claims this adjustment in his GST return for the period ending 31 March 2024.

The wash-up rule has also been amended to allow it to be used for any permanent change to a particular fixed percentage use. For example, if a registered person's use of a particular good or service permanently changes to 50 percent taxable use and they expect this percentage to remain stable for the foreseeable future, they can now perform the wash-up calculation.

Example 60: Permanent change in use

Tōtara is a registered person that acquires an apartment building for $23m from an unregistered person. Tōtara will use 80 percent of the building to make exempt supplies of accommodation in a dwelling and lease the remaining 20 percent to Rimu under a commercial lease. Rimu is a registered person who uses these apartments to supply commercial accommodation of hotel units and serviced apartments. Tōtara claims a deduction for 20 percent of the $3m input tax on acquisition ($0.6m).

After 24 months, Tōtara negotiates a long-term commercial lease to supply 50 percent of the building to Rimu for making taxable supplies of commercial accommodation. This results in a permanent change to 50 percent of the apartment building being supplied by Tōtara for making taxable supplies for the foreseeable future.

The new permanent percentage use is 50 percent and the actual use in the previous adjustment period was 20 percent, a difference of 30 percent additional taxable use. Under section 21FB, Tōtara can make an adjustment at the end of their adjustment period (on their next annual balance date) to deduct $0.9m, which is equal to 30 percent of the $3m input tax on acquisition. They would include this adjustment in their first GST return filed after the end of their adjustment period.

After applying section 21FB, the registered person would not make any further adjustments in future adjustment periods unless their actual use changed from their new percentage taxable use of the goods or services. This outcome is provided for by section 21(2)(ac) of the GST Act.

Remedial amendments to the wash-up rule in section 21FB

Assets that were zero-rated when they were acquired

A remedial amendment has been made to the definition of "actual deduction" in section 21FB to ensure the formula in the previous section 21FB correctly accounts for land acquired as a zero-rated supply. The amendment clarifies that if a registered person changes their use of land to 100 percent non-taxable use, they will have an output tax adjustment equal to the nominal GST component that they previously benefited from by paying a reduced amount of consideration when they acquired a zero-rated supply of land. For example, they acquired the land for $1m plus zero GST instead of $1m plus $150,000 GST, so their nominal GST component is $150,000.

The remedial amendment takes effect on 30 June 2014, which is the date the wash-up calculation in section 21FB was originally introduced.

Remedial amendment to definition of "percentage actual use"

A remedial amendment has been made to the definition of "percentage actual use" in section 21G to clarify that after the wash-up rule in section 21FB has been applied, the registered person should only measure their percentage actual use from the date the wash-up calculation was performed, rather than the date they acquired the asset.

The amendment ensures the earlier adjustment taken under section 21FB is properly accounted for when the person makes a final adjustment either on disposal under section 21F or because they had to make a subsequent annual adjustment because their percentage use had changed since they applied the wash-up calculation. The remedial amendment takes effect on 30 June 2014, which is the date the wash-up calculation in section 21FB was originally introduced.

Alternative apportionment methods

The apportionment and adjustment rules allow registered persons to apply to the Commissioner to agree an alternative apportionment method. This is intended to reduce compliance costs, as an alternative apportionment method could produce similar GST outcomes to the default apportionment rules but with lower compliance costs.

Previously, there was a requirement that the alternative apportionment method "have regard to the tenor" of the default apportionment rules and formula. The default apportionment and adjustment rules require a person to apportion deductions based on their intended taxable percentage use or actual use in the current adjustment period, even though their current use may be temporary and incidental to their ultimate use of the goods or services.

This requirement prevented the Commissioner from agreeing to some methods that may simplify the apportionment and adjustments required but use a different approach to the default apportionment and adjustment rules.

To accommodate a wider range of methods, the previous requirements in sections 20(3E), (3EB), 21(4) and (4B) that the alternative method "have regard to the tenor of" the default apportionment rules and formula have been removed. The new sections retain the more general requirement that the alternative method provides "a fair and reasonable method" of apportionment or calculating adjustments.

Sections 20(EB)(b) and 21(4B)(b) allow an industry association to agree a method with the Commissioner on behalf of their members.

Sections 20(EB)(c) and 21(4B)(c) allow the Commissioner to publish certain alternative apportionment methods considered acceptable to use by certain registered persons and the circumstances in which they can be used. Instead of developing and agreeing their own bespoke method with the Commissioner, registered persons could reduce their compliance costs by choosing to apply a published method if it applies to their circumstances.

The amendments to allow the Commissioner to agree to, or publish, alternative apportionment methods take effect on 1 April 2023.

Repealing the mixed-use asset rules in sections 20(3JB) and 20G

The mixed-use asset rules in sections 20(3JB) and 20G add the complexity of another potential formula but have limited application. The rules only apply to certain assets, such as holiday homes, aircraft, and boats, and only when their use is a mixture of private days, taxable days and at least 62 unused days.

In addition, many of the holiday homes that would otherwise become subject to these mixed-use asset rules could become excluded from a registered person's taxable activity due to the operation of sections 6(3)(e) and 91 (discussed above), which allow registered persons to elect for mainly private or exempt assets to be treated as if they only had non-taxable use.

The mixed-use asset rules in sections 20(3JB) and 20G will therefore be repealed from 1 April 2024.

This means that GST input tax deductions and adjustments for mixed-use assets can instead be calculated using the same general apportionment and adjustment rules that apply to other assets.

These general rules will allow an apportionment percentage to be calculated based on days of taxable use. This is a similar method to the current formula in section 20G, but the calculation is less prescriptive, and it is not limited to the set of "mixed-use assets" described in section DG 3 of the Income Tax Act 2007. Alternatively, the general rules also allow for other ways of calculating the percentage of taxable use, such as based on the value of the taxable supplies as a percentage of the total use, where total use is the value of the taxable supplies plus the open market value of the non-taxable use (i.e., private use by the owner).

The repeal of sections 20(3JB) and 20G has effect from the registered person's first adjustment period beginning on or after 1 April 2024. This means that if, on 31 March 2024, a registered person has begun an adjustment period for a mixed-use asset to which section 20G applies, they will continue to use section 20G until the end of that adjustment period. At their first adjustment period beginning on or after 1 April 2024, they can either:

- begin to use the general adjustment rules in sections 21 and 21A, which as explained above, allow for a wider range of ways to calculate the percentage of taxable use; or
- choose to continue to apply to the mixed-use asset, the adjustment method which was outlined in the former sections 20(3JB) and 20G.

This is because section 21(4B)(c) allows the Commissioner to publish certain approved alternative adjustment methods and the persons who can choose to use that method. Prior to 1 April 2024 the Commissioner will publish an approved adjustment method accepting that registered persons who have applied the rules in sections 20(3JB) and 20G to a mixed-use asset prior to 1 April 2024 can choose to continue to apply to the mixed-use asset, the method of adjustment which was outlined in the former sections 20(3JB) and 20G for a taxable period that commences on or after 1 April 2024. Note the published method will also outline any other groups of persons who may appropriately use the method.

Information disclosure for GST-registered persons purchasing land, ships, or aircraft they intend to use to make taxable supplies

Section 61B of the Tax Administration Act 1994 provides the Commissioner with the ability to prescribe a new information disclosure to apply when a GST-registered person acquires land, a ship, or an aircraft with the intention of using it to make taxable supplies.

"Land" is defined in section 2 of the GST Act 1985, "ship" has the meaning set out in section 2 of the Maritime Transport Act 1994, and "aircraft" has the meaning set out in section 2 of the Civil Aviation Act 1990.

The information disclosure will assist Inland Revenue to better monitor and promote compliance by registered persons who have previously claimed large input tax deductions (or acquired zero-rated land) but no longer appear to be proceeding with, or carrying on, a taxable activity (for example, they have been continuously filing GST returns with no or low sales).

Section 61B(1) enables the Commissioner to prescribe and adjust the specific requirements to ensure the rules are practical and effective. It allows the Commissioner to set (and adjust) what information would be reported and the form and deadlines for the disclosure, including the start date for the first disclosure period.

The information required to be disclosed could include the amount of consideration paid for the asset, the initial amount of GST input tax deducted on purchase (or the nominal GST amount that would otherwise have been charged if the asset was purchased from another registered person as a zero-rated supply of land or a going concern), and a statement of how the asset will be used to make taxable supplies.

Section 61B(2) allows the Commissioner to exempt certain types of registered persons from being required to disclose the information if they are considered by the Commissioner to represent a low risk of using the relevant asset for a private or exempt use. For example, the exemption could be designed to define certain categories of registered persons who have a well-established business of making taxable supplies of land development, commercial leasing, or dealing in aircraft or pleasure craft, whether by themselves or through associated persons.

Before implementing an information disclosure requirement, Inland Revenue will work with GST practitioners and software developers to test the proposed design (including the specific information that would be disclosed, the timing and format of the disclosure and which groups or assets should be exempt as they represent a low risk) to ensure it is well-targeted and practical. Because of the further design and testing required and the need to provide sufficient time for affected businesses and accounting software providers to update their systems, it is expected that the earliest possible implementation date to apply the new disclosure rules will be for land, pleasure craft or aircraft acquired on or after 1 April 2024.

Further information

More information about GST apportionment and adjustment is available at GST adjustments for business, private and exempt use (ird.govt.nz)

Other policy items

Fringe benefit tax exemption for certain public transport fares

New section CX 19C, section CX 9

New section CX 19C provides a fringe benefit tax (FBT) exemption for certain employer subsidised public transport fares as well as for employer subsidised fares that are also partly funded by the Total Mobility Scheme. This is done by excluding these subsidies from being fringe benefits. In both cases the employer needs to be subsidising the fare mainly for the purposes of their employees' travelling between their home and place of work.

Background

Prior to introducing this public transport exemption, contributions an employer made to their employee's public transport costs for travel between home and the workplace in the form, for example, of providing a monthly ticket or a loaded electronic ticketing card, were generally an unclassified fringe benefit (see sections CX 2(1)(b)(ii), CX 37, and RA 5(1)(b) of the Income Tax Act 2007 (ITA)). FBT applied unless the benefit fell below certain de minima.[13]

A concern was that this treatment was non-neutral relative to that applying to employer-provided on-premises car parks, which are largely exempt from FBT under the general exemption for on-premises benefits. Broadening the coverage of FBT to include these car parks, as a way of improving the neutrality of the FBT rules, had proved to be problematic in the past mainly due to concern about the potential compliance costs and safety issues. Acknowledging these difficulties, the Tax Working Group recommended aligning the FBT treatment by also exempting public transport subsidies from FBT.

The new exemption produces a more neutral FBT outcome between the options of travelling to and from work by car and travelling by the more environmentally friendly mode of public transport.

Key features

- Employers do not need to pay FBT on eligible public transport benefits they provide to their employees.
- The public transport fare subsidy needs to be provided for the main purpose of the employee travelling between their home and work.
- The exemption covers public transport fares for a bus service, rail vehicle, ferry, and cable car.
- The exemption does not cover travel by taxi, air travel and shuttle.
- Employer subsidised fares for travel between home and work are also exempt from being a fringe benefit when they are part funded by the Total Mobility Scheme. This includes travel by modes such as a taxi or shuttle.
- These exemptions do not apply to situations where the employer has paid an allowance or has reimbursed the employee's public transport costs, as they are outside of the FBT rules and instead are subject to income tax through the PAYE system.

Effective date

The amendments came into effect on 1 April 2023 and apply to employer fare subsidies provided on and after 1 April 2023.

Detailed analysis

Public transport

The exemption covers public transport fares for a bus service, rail vehicle, ferry, and cable car. Rail vehicle has the same meaning as in section 4(1) of the Railways Act 2005, which includes any potential future light rail.

13 FBT does not currently apply if the value of all unclassified benefits provided falls below the standard de minima. Unclassified benefits are exempt from FBT when the taxable value of the benefit provided to each employee is $300 or less per quarter per employee and the total taxable value of all unclassified benefits provided by the employer over the past four quarters is $22,500 or less.

On-demand services are included in the FBT exemption, where the service is part of a public transport provider's network and is subject to a public transport fare. On-demand services are increasingly being offered by public transport providers in areas of lower demand. These public transport services are booked and service a set area, rather than having a set timetable and route. Standard public transport fares apply.

Air transport, taxis, shuttles and other services that people share access to that are provided by service providers with a physical and/or digital infrastructure network (such as ridesharing and ride-hailing) are not covered by the exemption.

Total Mobility Scheme fares

Employer-subsidised fares for trips that are also part funded by the Total Mobility Scheme are exempt from FBT under new section CX 19C (1)(b) if they are provided for the main purpose of travelling between home and work.

The Total Mobility Scheme is a nationwide scheme administered by regional councils and Waka Kotahi to support people who have a disability that makes it difficult for them to use public transport. Total Mobility Scheme customers pay 50% of the cost of travel (for example, by shuttle or taxi with a wheelchair hoist). The regional council reimburses the registered transport operator directly for the remaining 50% of the cost up to a specific maximum amount.

Mainly for purpose of travelling between home and work

The public transport and Total Mobility Scheme exemption applies to relevant fringe benefits that the employer provides "mainly for the purposes of an employee travelling between their home and place of work". This "mainly" test acknowledges that some other incidental private travel may also occur without being disqualified under the fringe benefit exemption and is intended to avoid the need to apportion and keep detailed track of the actual time spent or distance travelled on incidental private travel. For the purposes of the fringe benefit tax exemption, it is sufficient if employers take appropriate steps to ensure the public transport fares are provided mainly for travelling between home and the place of work.

Example 61: Exemption applies - Monthly bus pass provided for commuting

Stephanie's business is relocated from an area with plenty of available car parking to an inner-city location with very limited car parking but within short distance of a train station and multiple bus stops. Stephanie offers her employees a relocation incentive in the form of a monthly public transport pass. Travel on the provided pass is mainly for travel between home and work. Employees who take up the offer are required to meet with a staff member where the conditions of use are explained. The employee is required to sign a declaration that they will use the employer issued pass mainly for commuting to and from work.

This is sufficient to meet the section CX 19C requirement that the employer provides the public transport fares "mainly for the purposes of an employee travelling between their home and place of work".

Interaction between FBT and PAYE/income tax

When an employer pays an allowance to an employee towards their public transport costs or reimburses an employee for their public transport costs, this does not fall within the FBT rules and is not covered by the FBT exemption for public transport. Instead, the allowance or reimbursement falls under the employment income rules, is taxed in the hands of the employee and is subject to PAYE.

If an employer wants to take advantage of the FBT exemption for public transport it is important to ensure how they provide their employees with public transport fares is covered by the FBT rules.

Determining whether FBT or PAYE applies can be complex in some circumstances. The distinction is not specific to the new public transport FBT exemption. Inland Revenue has published general guidance on the distinction, for example in the IR409 Fringe Benefit Tax Guide.

Example 62: Exemption applies – Employer arranges to pay the public transport provider directly

Coast City hospital has a problem with parking congestion on the hospital precinct. To address this issue the hospital is introducing a programme of subsidised public travel to and from work and pays for 50% of the public transport fares.

Participating hospital staff enter into an agreement with their employer to be issued with an electronic travel card that has to be used mainly for travel to and from work. The employer has an agreement with Coast City Public Transport (CCPT) and gets billed 50% of the cost of public transport fares accrued on the card registered under the subsidy programme, with the employee being billed the remaining 50%.

Usage of the cards are spot audited and Coast City Hospital notices that while a staff member's card use shows predominantly trips during the work week to and from the bus stop near the hospital, it has also been used a couple of times during the weekend for bus trips to a popular beach and once to a stop near a shopping centre. The staff member explains this as still being consistent with the card being used mainly for between home and work commuting.

As Coast Hospital pays CCPT directly for travelled fares, the exemption in section CX 19C applies and Coast Hospital does not have to pay FBT on the subsidy they provide. The few times the staff member has used the card for trips other than between his home and the hospital do not disqualify the exemption, as the card was provided "mainly for the purposes of travelling between the home and place of work".

Example 63: Exemption does not apply – Employer reimburses employees' public transport costs for commuting

Before introducing their subsidy programme as described in example X above, Coast City Hospital was looking at reimbursing employees for 50% of their public transport costs to and from work instead of entering into an arrangement to be billed by CCPT directly. Participating employees would provide proof of the cost of public transport trips for commuting to and from work and the Coast City Hospital would reimburse 50% of the costs by paying the amount into the employees' bank accounts.

The reimbursement would not be a fringe benefit and would not qualify for the exemption. The reimbursed amount would be employment income in the hands of the employee, with tax being withheld through the PAYE system.

Example 64: Exemption does not apply – Employer pays a public transport allowance

Coast City University (CCU) has limited parking for employees. There is a long waiting list for employees to be allocated a parking spot on the university grounds.

To help with the staff on-site parking issue, CCU offers employees not on the list and those that have not been allocated a parking spot a weekly public transport allowance of $45, paid with the fortnightly pay.

The allowance does not qualify for the fringe benefit exemption and is employment income in the hands of the employee, with tax being withheld through the PAYE system.

Interaction with section CX 9 (Subsidised Transport)

The current provisions for certain subsidised transport in sections CX 9, RD 33 and YA 1 "subsidised transport" continue to apply to situations that fall outside the application of the public transport exemption in new section CX 19C; for example, where employees of an airline company are provided with free or discounted air travel. A consequential amendment to section CX 9 clarifies its relationship with new section CX 19C.

Fringe benefit tax exemption for certain vehicles including bicycles and scooters and certain vehicle share services

New section CX 19D, section CX 9

New section CX 19D applies to certain self-powered and low-powered vehicles such as bicycles, electric bicycles, push-powered scooters, electric scooters, and some app-based vehicle-share services. The provision of these vehicles is not a fringe benefit and therefore fringe benefit tax does not apply when the employer provides these benefits for the main purpose of commuting between home and the place of work.

Background

Employers can provide on-premises car parks to their employees largely without FBT applying, under the general FBT exemption for on-premises benefits. This can be a sizeable benefit to employees given the rental cost of car parks in major urban areas.

A further exemption (new section CX 19D) was added by Supplementary Order Paper 322 to achieve a more neutral tax outcome between active or more environmentally friendly forms of transport and commuting to work by car. It may also have certain health benefits, reduce congestion, and reduce carbon emissions. It therefore supplements the other new fringe benefit exemption, discussed earlier, for employer-subsidised public transport fares.

Key features

- Employers do not have to pay fringe benefit tax for providing their employees with a bicycle, an electric bicycle, a push-powered scooter, an electric scooter, and/or any other vehicle declared under section 168A of the Land Transport Act 1998 to be a mobility device or not a motor vehicle.
- The FBT exemption also applies if the employer helps pay for certain vehicle share services for any of these modes of transport.
- The employer needs to provide these vehicles, or the vehicle-share service for the main purpose of the employee travelling between their home and place of work for the exemption to apply.
- The exemption does not apply where an employer pays an allowance for the costs or reimburses the employee's costs incurred for the listed vehicles or qualifying vehicle-share services. This is because allowances and reimbursements do not fall under the FBT rules but instead are subject to income tax through the PAYE system and are taxed in the hands of the employee.
- New section CX 19D contains a regulation making power that allows for specifying the maximum allowable purchase cost of the vehicles and any other requirements for the vehicles covered by the exemption.

Effective date

The amendments came into effect on 1 April 2023 and apply to fringe benefits provided on and after 1 April 2023.

Detailed analysis

Qualifying vehicles and vehicle-share services

New section CX 19D excludes the following self-powered and low-powered vehicles from being a fringe benefit when an employer provides these to their employee:

- a bicycle
- an electric bicycle
- a scooter
- an electric scooter
- any other vehicle declared under section 168A of the Land Transport Act 1998 to be—
  - a mobility device, or
  - not a motor vehicle.

New section CX 19D also excludes a benefit from being a fringe benefit if it involves the use of any of the above vehicles through a vehicle-share service. A vehicle-share service is defined for the purposes of the new exemption to mean a transport service that allows users to hire one of the vehicles for a point-to-point trip, through a mobile communication device.

Although not specified in the legislation, there is an expectation that employers should not need to provide relevant vehicles, where the ownership of the vehicle passes to the employees, more frequently than in accordance with the estimated useful life of the relevant vehicle. The estimated useful life of bicycles and e-bicycles is five years, and the estimated useful life of e-scooters is four years. There will be extraordinary circumstances, such as theft or where the vehicle has been destroyed, where this will not be possible.

Main purpose of travelling between home and place of work

The exemption applies when the employer provides the benefit "for the main purpose of the employee travelling between their home and place of work". This "main purpose" requirement acknowledges that some other incidental private use may also occur without being disqualified under the fringe benefit exemption. It is intended to avoid the need to apportion and keep detailed track of the actual time used or distance travelled on incidental travel other than between home and work. For the purposes of the exemption, it is sufficient if employers take appropriate steps to ensure the vehicles or use of vehicle-share services are provided mainly for travelling between home and the place of work.

Example 65: Exemption applies – Employees use pool bicycles to commute to work

Coast City University is committed to enhancing the health and wellbeing of their staff and to reducing their climate change impacts. Because of this, the university has a pool of bicycles. These can be booked by employees on a weekly basis to be used to commute between home and work. As part of the booking process, employees are required to sign a declaration that they will use the bicycles mainly for commuting between home and work.

This is sufficient to meet the section CX 19D requirement that the employer provides the bicycles "for the main purpose of the employee travelling between their home and place of work". Other private use does not lead to disqualification from the exemption provided that the other use is not the main use of the bicycle. Coast City University, or its employees, are not expected to keep detailed records of time spent cycling or kilometres travelled for the purpose of the "main purpose" requirement.

Interaction between FBT and PAYE/ income tax

Employers and employees should be aware that allowances and reimbursements are not covered by the FBT exemption. When an employer reimburses their employee for the cost of a qualifying vehicle or pays an allowance towards the cost, this does not fall within the FBT rules. Instead, the allowance or reimbursement falls under the employment income rules, is taxed in the hands of the employee and is subject to PAYE.

Salary sacrifice for fringe benefits is not specific to bicycles and scooters, but it may be possible, in some cases, without giving rise to FBT or income tax. As the tax outcome would be very fact specific and dependent on the contractual terms between the employer and the employee, employers should seek professional advice on this matter.

More generally, if an employer wants to take advantage of the FBT exemption under s CX 19D it is important to ensure the way they provide their employees with a vehicle or subsidise their use of a vehicle-share service is covered by the FBT rules with a crucial factor being who has the legal liability for the costs.

Determining whether FBT or PAYE applies can be complex in some circumstances. The distinction is not specific to the new FBT exemptions. Inland Revenue has published general guidance on the distinction, for example in the IR409 Fringe Benefit Tax Guide.

Example 66: Exemption applies – Employer subscribes to an e-bicycle service

Coast City Airport has no nearby car parking options for staff and public transport is not always accessible. To ease transport problems and costs for employees travelling to and from work at the airport, Coast City Airport is looking to offer the use of e-bicycles to employees through Coast City Bikes' subscription service. Coast City Airport would subscribe to the e-bicycle service at a weekly rate and get billed by Coast City Bikes. Participating employees would receive a subscription service e-bicycle from Coast City Airport. An agreement between the employer and the participating employee would set out further details, including that the subscription service e-bicycle is provided for the main purpose of the employee travelling between their home and place of work.

As Coast City Airport has the legal relationship with Coast City Bikes, including the liability to pay for the subscription service, the exemption in section CX 19D(1) applies and Coast City Airport does not have to pay FBT on the provision of the e-bicycle to employees.

Example 67: Exemption does not apply – Employer pays an allowance for cost of vehicle share-service

Coast City Computer Consulting's (CCCC) business premises are located in an area where e-scooters are hireable on a short-term basis, locked and unlocked via apps. Most employees of the small company have expressed interest in using an e-scooter to travel from home to work. CCCC thinks supporting this would be a good way for CCCC to support staff wellbeing, may be a "perk" that could help with retaining staff and may contribute to reducing climate change impacts. CCCC thinks it would be the simplest, fastest, and fairest option to pay a monthly "e-scooter allowance" towards the cost of getting to and from work by e-scooter to all employees. Employees could use the apps on their smart phones and the employee's own credit card as the payment method to use the e-scooters.

The allowance does not qualify for the fringe benefit exemption and is taxed as employment income in the hands of the employee, with tax being withheld through the PAYE system.

Regulation making power for setting maximum cost and other requirements

This exemption includes a regulation-making power that enables the Minister of Revenue to recommend to the Governor General maximum allowable purchase costs and other requirements of the vehicles covered by the exemption.

There are no regulations at present. Any future regulations made under the provision will be notified in the New Zealand Gazette.

Relationship with section CX 9

As with the fringe benefit exemption for public transport (new section CX 19C), section CX 9 dealing with fringe benefits related to subsidised transport, has been amended to exclude section CX 19D.

Overseas donee status

Section YZ 5 and schedule 32 of the Income Tax Act 2007

The following charities have been granted overseas donee status from 1 April 2022, unless otherwise specified:

- Anglican World Aid (Aotearoa) Limited, from 11 April 2022 – the date the charity was created
- Cotton On Foundation Limited
- Engineers Without Borders New Zealand Inc
- Family for Every Child New Zealand Trust
- Forest for People Limited
- Heilala Vanilla Foundation, from 15 January 2022 – the date of the volcanic eruption near Tonga – until 1 April 2026
- Joyya Trust

- New Zealand for UNHCR (United Nations High Commissioner for Refugees), from 15 February 2022 – the date the charity was created as a replacement for UNHCR (with the latter removed from schedule 32 on 1 April 2023)
- Pacific Island Food Revolution Limited, from 1 April 2022 to 1 April 2027
- Solomon Islands Medical Mission Charitable Trust.

GST status of legislative charges

Sections 2, 5(6BB), 5(6EC) to 5(6EE), 81B and 90 of the Goods and Services Tax Act 1985

The amendments provide for a standardised GST treatment of charges, including fees and levies, payable under legislation.

Background

New Zealand's GST system includes within the base the activities carried out by the public sector (including government agencies) and the not-for-profit sector. Government agencies and not-for-profit organisations are sometimes authorised by legislation to collect charges, including fees and levies, from specified groups of persons. The revenue from these charges is used to enable government agencies, and not-for-profit bodies to supply goods and services. Often the GST treatment of these charges is clear and unambiguous. However, when this is not the case, the lack of general rules in the Goods and Services Tax Act 1985 (GST Act) can result in confusion and has resulted in inconsistent GST treatments being applied to different charges with similar characteristics.

The term "charge" is used to describe a liability to pay money and is intended to be broad-ranging. It includes fees and levies. A "legislative charge" is therefore a liability to pay money that is imposed by legislation (including Acts and regulations, such as Orders in Council). Common examples of legislative charges are fees paid to government agencies or other bodies for the renewal of a licence or for a registration. While legislation sometimes indicates the GST treatment of legislative charges by including references to GST, the GST treatment of legislative charges is ultimately determined with reference to the provisions of the GST Act itself.

When there has been debate about the GST treatment of specific legislative charges, governments have often introduced legislation that provides for the GST treatment of those specific legislative charges. While this approach provides certainty for specific legislative charges, it lacks transparency, creates uncertainty, and has resulted in an inconsistent and incoherent application of GST to legislative charges.

New sections 5(6EC) to 5(6EE) of the GST Act provide general rules for the GST treatment of legislative charges. These new sections remove the need for piecemeal amendments to be made to the GST Act to ensure appropriate GST outcomes for specific charges and provide a greater degree of certainty over the GST treatment of legislative charges.

Key features

The key features of the amendments are:

- New provisions that provide for the GST treatment of charges payable under legislation and including exclusions for charges in the nature of fines, penalties, interest, and general taxes.
- A new schedule to the GST Act that will list non-taxable legislative charges (that is, charges that are not subject to GST).
- A transitional regulation-making power that enables the Minister of Revenue to recommend an Order in Council to add charges to the new schedule of non-taxable legislative charges.
- The repeal of provisions providing for the GST treatment of specific legislative charges as they have been superseded by the new general provisions.
- Taxpayers and the Commissioner of Inland Revenue are prevented from amending historic GST assessments in a way that would result in outcomes inconsistent with the new general provisions.

Effective date

The new general rules for legislative charges are effective for:

- legislative charges that come into force on or after 1 July 2023, and
- all other legislative charges from 1 July 2026.

The repeal of the provisions for specific legislative charges takes effect on 30 June 2026.

The amendments that prevent amendments to historic assessments took effect on 30 August 2022.

The transitional regulation-making power took effect on 1 April 2023 and ends on 30 June 2026.

Detailed analysis

GST treatment of legislative charges

The new rules for legislative charges mirror existing rules in the GST Act that determine the GST treatment of government grants and subsidies paid to GST-registered persons. These rules provide a general rule and include exceptions. They also include a schedule of non-taxable grants and subsidies. The new provisions for legislative charges follow a similar approach.

New section 5(6EC) supplements the ordinary GST rules for determining when there has been a supply of goods and services, and provides that a charge, including a fee or a levy, payable under legislation is treated as consideration for a supply of goods and services. This is the general rule. A legislative charge will generally be subject to GST at the standard rate under section 8(1) of the GST Act, but it may be zero-rated or exempt under section 11, 11A or 14 if the requirements of the relevant provision are satisfied.

New section 5(6ED) excludes charges that are, or are in the nature of, fines, penalties, interest, and general tax from the general rule. These amounts are therefore not treated as consideration for a supply of goods and services and are not subject to GST under the general rule. Whether a legislative charge is, or is in the nature of, a fine, a penalty, interest, or a general tax will depend on the specific characteristics of that charge. These types of legislative charges are excluded from the general rule because they do not typically represent consideration for a supply of goods or services.

New section 5(6EE) provides a definition of "general tax" for these purposes. For a charge to be a "general tax", it must be:

- a charge in the nature of a tax
- imposed by a "tax law", and
- not earmarked in legislation for a particular purpose or function.

Examples included in the GST Act provide that income tax is a "general tax" and a levy used to fund the performance of regulatory functions is not.

The definition of "tax law" in section 3(1) of the Tax Administration Act 1994 (TAA) applies for these purposes. Broadly, this definition refers to the Inland Revenue Acts and to Orders in Council and other regulations made under empowering provisions in an Inland Revenue Act.

Schedule of non-taxable legislative charges

A new schedule of non-taxable legislative charges has been added to the GST Act.

If a legislative charge is included on the schedule, it is not subject to GST under the new provisions that provide for the GST treatment of legislative charges.

As a transitional measure, the Minister of Revenue may recommend an Order in Council be made to add a charge, or a class of charge, to the new schedule. Before making a recommendation for an Order in Council, the Minister must be satisfied that the charge should be non-taxable, having regard to whether making the charge non-taxable is consistent with the approach taken for other charges with similar characteristics.

An Order in Council made to add a charge to the non-taxable schedule of legislative charges would be made under new section 90 of the GST Act. No Orders in Council can be made adding charges to the schedule after 30 June 2026, and section 90 will be repealed on that date.

The purpose of section 90 and the schedule is to ensure that charges that should not be subject to the new general rules can be identified during the transitional period—1 July 2023 to 30 June 2026—and classified as non-taxable before the new general rules take effect for all legislative charges from 1 July 2026. At the date of enactment of the amendments, no charges had been identified for inclusion on the schedule.

The schedule will operate in an equivalent way to the schedule in the Goods and Services Tax (Grants and Subsidies) Order 1992. That Order contains a schedule of non-taxable government grants and subsidies and is amended from time to time by amending Orders in Council made under section 5(6E) of the GST Act.

Limitation on amending assessments

New section 81B of the GST Act prevents the Commissioner of Inland Revenue and taxpayers from amending historic GST assessments to achieve outcomes that are inconsistent with the new provisions for legislative charges. This limitation overrides the rules for amending assessments in sections 113 and 113A of the TAA and section 25 of the GST Act.

Transitional implications

The new provisions apply to any legislative charge that comes into force on or after 1 July 2023. They apply to all legislative charges from 1 July 2026.

The effect of this is that when new legislation is introduced, or new regulations (for example, Orders in Council) are made, that include a charge that comes into force after 1 July 2023, the new sections providing for the GST treatment of legislative charges need to be considered.

Example 68: Legislative charge renewed after 1 July 2023 but before 1 July 2026

The Ministry of Examples is responsible for administering a legislative charge that has not been subject to GST. The amount of the charge is set out in an Order in Council.

A decision is made to increase the amount of the legislative charge. This involves the making of a new Order in Council that sets out the new amount of the charge.

The new charge will come into force by Order in Council after 1 July 2023.

The new rules in the GST Act that provide for the GST treatment of legislative charges will need to be considered. If the charge is not added to the non-taxable schedule of legislative charges, it will be treated as consideration for a supply of goods and services and therefore will be subject to GST.

The GST Act contains provisions that determine how GST applies when a change of law results in a change of GST treatment for supplies of goods and services. These rules are in section 78. These rules will also apply from 1 July 2026 to determine the GST treatment of existing legislative charges that are not amended before that date and therefore will not have "come into force" on or after 1 July 2023.

From 1 July 2026, legislative charges that meet the criteria set out in the general rules and that do not fall within one of the exclusions will increase by the rate of GST. This means that GST is added to the charge.

Example 69: Legislative charge not renewed – GST treatment from 1 July 2026

A legislative charge came into force in 2019. At the time the charge was introduced, the GST treatment was not considered and the body responsible for collecting the charge has not been collecting GST. The amount of the charge is $100 excluding GST. No legislation is introduced (or secondary legislation made) to change the amount of the charge before 1 July 2026.

From 1 July 2026, the body responsible for collecting the charge will need to consider the new rules for legislative charges. If the charge is treated as consideration for a supply of goods and services that is not exempt, the amount of the charge will be increased by the rate of GST.

The body collecting the charge would need to ensure it was collecting GST on the charge. It would also need to ensure it was compliant with other GST obligations, such as providing GST returns to Inland Revenue and taxable supply information to the persons paying the charge.

Repeal of special rules for specific legislative charges

Special rules in the GST Act that apply to specific legislative charges have been superseded and replaced by the new general rules. These special rules will be repealed from 30 June 2026. The GST treatment of these charges does not change because of the repeal of these special rules as the new general rules will apply.

Table 3: Special rules that will be repealed

Section reference	Description
Section 5(6AA)	Levies payable to the New Zealand Transport Agency and the Environmental Protection Authority under the Climate Change Response Act 2002
Section 5(6AAB)	Fees and charges payable pursuant to regulations made under the Land Transport Act 1998
Section 5(6A)	Registration and licence fees payable under the Land Transport Act 1998
Section 5(6AB)	Levies payable to Fire and Emergency New Zealand under the Fire and Emergency New Zealand Act 2017
Section 5(6AC)	Various charges payable under the Waste Minimisation Act 2008
Section 5(6B)	Charges payable under the Road User Charges Act 2012
Section 5(6BB)(a)	Regional Fuel Tax payable under the Land Transport Management Act 2003
Section 5(7F)	The levy payable under the Infrastructure Funding and Financing Act 2020

Build-to-rent exclusion from interest limitation rules

Section YA 1 and schedule 15 of the Income Tax Act 2007

Amendments enacted in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 provide for an in-perpetuity exclusion from the interest limitation rules for build-to-rent land that meets the asset class definition.

Background

The interest limitation rules in subpart DH of the Income Tax Act 2007 (ITA) took effect on 1 October 2021 and are aimed at tilting the playing field for existing residential property away from investors and towards first home buyers and owner-occupiers. The rules deny an interest deduction for interest incurred for disallowed residential property on or after 1 October 2021. However, the rules do not apply to interest incurred for "excepted residential land" as listed in schedule 15 of the ITA.

Exemptions, such as the new build exemption, were included to ensure the interest limitation rules do not have a negative impact on new housing supply. Build-to-rent assets have now been added to the list of excepted residential land to ensure the rules do not negatively impact the supply of this type of large-scale rental property specifically.

Key features

"Build-to-rent land" has been added to the list of excepted residential land in schedule 15. This means the interest limitation rules do not apply to deny deductions for interest incurred for property that the Commissioner of Inland Revenue has received notice has met the asset class definition and been approved as build-to-rent land by Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development. However, if the land at any later point fails to meet the asset class definition, taxpayers will no longer be able to rely on the build-to-rent exclusion to prevent the interest limitation rules from applying to deny interest deductions for that residential rental property.

"Build-to-rent land" definition

The new definition of "build-to-rent land" in section YA 1 of the ITA provides that build-to-rent land is, for a person, land that they own and that is described in section CB 12(1)(a) to (e) or section CB 13 (1)(a) and (b) to the extent to which:

- it is or was part of one project of 20 or more dwellings, and
- it is currently one of 20 or more dwellings used, available for use, or being prepared or restored for use, as a rental property to which the Residential Tenancies Act 1986 (RTA) applies,

if—

- every residential tenancy has the option of a fixed term of at least 10 years, with the ability for the tenant to give 56 days' notice of termination, and
- every tenancy agreement includes a personalisation policy in line with sections 42, 42A and 42B of the RTA.

It does not include land that, at any time after it first meets the above requirements, fails to meet those requirements.

Existing dwellings must meet definition by 1 July 2023

Existing build-to-rent assets have until 1 July 2023 to comply with the tenure and personalisation policy requirements included in the definition of "build-to-rent land". The policy is intended to apply to new and existing build-to-rent developments, however, it is highly unlikely any existing developments will have offered 10-year tenancies to all tenants.

Effective date

The amendments take effect on 1 October 2021 to align with the introduction of the interest limitation rules.

Detailed Analysis

Land is excluded from the interest limitation rules in perpetuity for as long as it meets the definition of "build-to-rent land". The definition contains several elements, which are discussed below.

Land described in sections CB 12(1)(a) to (e) or CB 13(1)(a) and (b)

Land described in sections CB 12 and CB 13 is land where an undertaking or scheme involves the development or division of the land. Indications that land is part of a particular development could include records of title, consent applications, development/subdivision plans or other materials, such as a prospectus for investors.

Land described in sections CB 12 and CB 13 can include land that is in separate adjacent blocks or held on different records of title. This allows for flexibility in the configuration of build-to-rent land if it includes commercial premises or dwellings that do not meet the build-to-rent requirements. In these instances, apportionment will be required (see discussion under the "'To the extent' test" heading below). It also does not preclude land that is not contiguous, for example, if there is a road between pieces of land.

This requirement ensures (in conjunction with the single owner requirement) that the build-to-rent land is part of one cohesive project, even where it spans multiple blocks of land. While flexibility is allowed for in the configuration, it must still be part of the same project. For example, it would not be possible to claim that ten dwellings on a block of land in Thorndon, Wellington and ten dwellings on a block of land in Newtown, Wellington could comprise a single build-to-rent development.

Configuration of development

A build-to-rent development must always have no less than 20 dwellings that satisfy the requirements to qualify as "build-to-rent land".

The dwellings can be held in one or more titles and can be on adjoining parcels of land. The development can include commercial premises or other dwellings (that do not meet build-to-rent requirements) that do not form part of the build-to-rent development. For example, there may be owner-occupied dwellings or rental dwellings that do not offer 10-year tenancies or personalisation policies. In these instances, apportionment will be required.

Including commercial premises within build-to-rent developments enables community amenities to be provided and allows for alternative revenue streams for the development. Including other dwellings supports developments that want to mix tenure types, which may be needed to make developments viable, particularly in regional centres.

'To the extent' test

A dwelling will qualify for the exclusion "to the extent" to which it meets the definition requirements. This means each individual dwelling must meet the definition, as well as the overall development, for interest not to be subject to the interest limitation rules. Only interest relating to the portion of the development that meets the definition of "build-to-rent land" will not be

denied the deductions under the rules. This includes the portion of shared amenities made available to build-to-rent tenants.

Example 70: 'To the extent' to which it meets the definition

Te Awhi Co. completed a 35-apartment development in 2024 that also has a block of commercial shops on the ground floor. Of the 35 apartments, 10 are sold to owner-occupiers and 25 are retained by Te Awhi Co. to rent out under the build-to-rent model.

Assuming the 25 apartments meet the other requirements of build-to-rent land (that is, they are rented out under the RTA, tenants have been offered a 10-year tenancy agreement and personalisation policies have been included), these 25 apartments will qualify as build-to-rent land. Any interest relating to these 25 apartments will therefore not be denied a deduction under the interest limitation rules. Assuming existing tax rules are satisfied, interest incurred for these 25 apartments will be deductible.

Having commercial premises and dwellings that do not meet the "build-to-rent land" definition in the same development does not stop those units that do meet the definition from qualifying for the exclusion.

If, instead of being owner-occupied, the remaining 10 apartments were rented out (as a residential rental property that did not qualify as build-to-rent land), they may still be eligible for the new build exemption for a period of 20 years from the date the code compliance certificate was issued.

Same person

Build-to-rent land must be owned by the same person to qualify for the exclusion. "Same person" can include any natural person or legal entity (for example, a company, limited partnership or joint venture).

Continuous use requirement

A unit must continually meet the requirements of the "build-to-rent land" definition to qualify for the exclusion.

If, after first meeting the requirements, a unit fails at any point to meet the definition, even if the unit again meets the requirements in the future, it can never again qualify as "build-to-rent land".

Existing build-to-rent developments must meet all requirements by 1 July 2023 and continue to do so at all times after that date. All new developments completed after 1 July 2023 must always comply.

Used, available for use, or being prepared or restored for use

A dwelling must be used, available for use or being prepared or restored for use as a build-to-rent dwelling to qualify for the exclusion. The wording "available for use" is intended to cover situations where dwellings are not currently occupied but are being advertised on the market as available for rent. "Being prepared or restored for use" covers scenarios where a dwelling is not currently available for use but is undergoing work to be suitable for use as a rental property. For example, between tenancies a unit may be renovated to replace an outdated kitchen. The dwelling would still qualify during this period even though it is not occupied.

Tenure length requirement

Tenants of a build-to-rent dwelling must be offered a fixed term tenancy of at least 10 years, which is terminable by 56 days' notice under section 58A of the RTA, including at times of tenancy renewal and renegotiation.

This does not mean the tenant has to accept this offer. They may agree to, or request, a different tenancy offer.

Existing build-to-rent developments will have until 1 July 2023 to offer all existing tenants a 10-year contract and must offer all new tenants a 10-year contract from that date. Any build-to-rent development completed after 1 July 2023 will have to meet this requirement immediately.

Personalisation policies

The definition of "build-to-rent land" requires that explicit personalisation policies are offered by build-to-rent providers to their tenants that are in line with sections 42, 42A and 42B of the RTA. Under the RTA, a tenant can ask a landlord if they can make a change (for example, attach a fixture or make an alteration) to the property. The landlord must not unreasonably withhold consent to the change and may impose reasonable conditions. At the end of the tenancy, tenants will be required to 'make good' on any personalisations made during the tenancy, as set out by the RTA.

Personalisation policies are not intended to pre-authorise the personalisations featured in the policies, rather they are intended to make clear to tenants upfront what personalisations the build-to-rent provider is happy for the tenant to make.

This requirement may take the form of a build-to-rent provider including a clause in associated tenancy agreements or producing a document, offered to all tenants within the build-to-rent development, that explicitly outlines how tenants can personalise their dwellings. Providers must include their position on the keeping of pets.

The intention of this requirement is to make lifestyle issues, like pets and home-making, more transparent to prospective tenants.

Existing build-to-rent developments have until 1 July 2023 to provide personalisation policies to all current tenants. Any build-to-rent developments completed after 1 July 2023 will have to comply with this requirement immediately.

When the exclusion applies

To qualify for the exclusion, the Chief Executive of the department responsible for the administration of the Residential Tenancies Act 1986 must be satisfied that the development meets the definition of build-to-rent land. Currently, this approval would be granted by the Chief Executive of Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD). The asset will then be recorded on a register of assets that is then shared with Inland Revenue. The exclusion will continue for as long as the development meets the definition requirements.

Taxpayers with existing build-to-rent developments will be eligible for the exclusion from 1 October 2021 if they meet the definition requirements before 1 July 2023 and are approved by HUD. The exclusion for existing developments applies from 1 October 2021 to align with the introduction of the interest limitation rules. New build-to-rent developments can apply the exclusion from the date of application if they meet the definition requirements and are approved by HUD.

Existing build-to-rent developments completed before 1 July 2023 will have until that date to meet the definition requirements and apply for registration. If a development does not do so by 1 July 2023, it will never be able to qualify for the exclusion. New build-to-rent developments will need to comply with the requirements immediately and will be eligible for the exclusion from the date they apply for the exclusion, provided they meet the requirements and are approved by HUD.

Effect of exclusion

The effect of the build-to-rent exclusion is that the interest limitation rules in subpart DH of the ITA would not apply to deny interest deductions. However, interest would still have to be deductible under existing tax rules.

Provided a deduction is allowed under existing tax rules, the interest that may be deducted if the exclusion applies would include interest on loans to:

- acquire the land a build-to-rent development is on,
- construct or install a build-to-rent development on the land,
- pay for things like insurance and rates, and
- renovate, maintain, or repair a build-to-rent dwelling.

When the exclusion ceases

A dwelling will cease to qualify immediately if it fails to meet the definition of "build-to-rent land". If a dwelling in a development no longer meets the requirements, for example, if it is not rented out under the RTA, interest relating to that dwelling will no longer be excluded from the interest limitation rules. If, when that dwelling ceases to qualify, this results in the development having less than 20 qualifying dwellings, the exclusion will cease to apply to the entire development.

Example 71: When a unit ceases to qualify

Assuming the same facts as in example 1, Te Awhi Co. is currently deducting interest relating to the 25 qualifying units in their development. In February 2025, four of these units are sold, so interest is only deductible for the remaining 21 units.

In May 2025, two units are rented out to new tenants who are only offered three-year contracts. This does not meet the requirement of offering a fixed-term tenancy of at least 10 years. As such, the two units no longer qualify for the build-to-rent exclusion. As only 19 units now meet the requirements in the build-to-rent land definition, the build-to-rent exclusion from the interest limitation rules will cease to apply for the entire development. The new build exemption may apply to the property for a period of 20 years from the date the property received its code compliance certificate.

In situations where an inadvertent breach of the "build-to-rent land" definition occurs, for example, a genuine administrative error sees a tenant in one of 20 dwellings not provided an explicit personalisation policy, Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development will work with taxpayers to assist them in meeting compliance.

Interaction with the new build exemption

The new build exemption currently applies to exempt new builds from the interest limitation rules for a period of 20 years. A new build is a self-contained dwelling that has received its code compliance certificate on or after 27 March 2020.

A build-to-rent development is not barred from accessing the new build exemption. However, a development would still have to meet the build-to-rent land requirements—either from 1 July 2023 if it is an existing build, or immediately for new build-to-rent developments—to be able to access the exclusion at any time in the future (for example, once the 20-year new build exemption ceases).

North Island flood events tax relief – Tax relief for employers' welfare contributions to employees

Changes included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 provide an exemption for certain welfare contributions made by an employer to employees because of the North Island flooding events. The exemption may be applied to:

- accommodation
- "sundry" fringe benefits when the employer cannot reasonably estimate which employees received which benefits, and
- the first $5,000 of monetary remuneration and fringe benefits of the kind where the employer can reasonably be expected to know which employees received which benefits.

A further change extends the definition of "project of limited duration" for projects that are recovering and rebuilding the affected areas.

Effective date

The exemption for certain welfare contributions applies to payments made within an eight-week period from the beginning of the relevant North Island flooding event.

The extended definition of "project of limited duration" applies where the employee starts work at the distant workplace within six months of the first date of the relevant North Island flooding event.[14]

Background

Under existing tax law (with a few limited exclusions), payments and benefits provided by an employer to an employee are taxable, either as monetary remuneration or by way of fringe benefit tax (FBT).

Following the North Island flooding events, employers may make ex-gratia welfare contributions of cash or benefits to their flood-affected employees. As was done for the Canterbury earthquakes, the current changes provide for certain amounts and benefits not to be subject to income tax or FBT.

The changes comprise inter-linked tax exemptions for employers and their employees for North Island flood-related employer welfare contributions.

14 Subsequent to the enactment the Government has extended this timeframe by order in council which is detailed elsewhere in this Tax Information Bulletin. The Government has also proposed a permanent extension in the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill.

Detailed analysis

What is a North Island flooding event?

A new definition of "North Island flooding events" has been added to section YA 1 of the Income Tax Act 2007 (ITA) and means:

(a) Cyclone Hale, which crossed the North Island of New Zealand during the period starting on 8 January 2023 and ending on 12 January 2023, in 1 or more of the following districts:

  (i) Coromandel:

  (ii) Gisborne:

  (iii) Northland:

  (iv) Wairarapa:

  (v) Wairoa.

(b) heavy rainfall starting on 26 January 2023 and ending on 3 February 2023, in 1 or more of the following regions:

  (i) Auckland:

  (ii) Bay of Plenty:

  (iii) Northland:

  (iv) Waikato:

(c) Cyclone Gabrielle, which crossed the North Island of New Zealand during the period starting on 12 February 2023 and ending on 16 February 2023, in 1 or more of the following regions or districts:

  (i) Auckland:

  (ii) Bay of Plenty:

  (iii) Gisborne:

  (iv) Hawke's Bay:

  (v) Northland:

  (vi) Tararua:

  (vii) Waikato.

Income tax exemption

New section CZ 23B of the ITA provides that income (which can include accommodation benefits) derived by an employee from an employer is exempt income if:

- it is provided by the employer for the purpose of relief of employees from the adverse effects of a North Island flooding event
- it would otherwise be assessable income
- it is derived in the eight-week period beginning on the first day of the relevant North Island flooding event
- it does not replace a PAYE income payment, that is, it is not paid in substitution for wages or salary
- it does not depend on the seniority of the employee
- if the employee is associated with the employer, it is also available to an unrelated full-time employee, and
- the employer treats the income as being exempt income of the employee.

Extent of the exemption

Income that satisfies the above criteria is exempt income to the extent it is:

- an accommodation benefit as defined in section CE 1(2), and/or
- less than or equal to $5,000 in total, if the income is in a form other than accommodation (including fringe benefits under new section CZ 24B).

Frequently Asked Questions

This section deals with several questions we have been asked about the application of new section CZ 23B.

The new provision mirrors the provisions that were enacted following the Canterbury Earthquakes, with modifications for the different event and the quantum of the amount paid.

How was the $5,000 determined?

This figure was based on the amount used for the Canterbury Earthquakes, increased by wage inflation over the period since the earthquakes and rounded to $5,000.

How was the eight-week period determined?

This is the same period as that used for the Canterbury Earthquake provisions.

What does the criterion "does not depend on the seniority of the employee" mean?

This restriction is aimed at ensuring that relief payments are not targeted at more senior employees. This could occur in two ways:

- when payments are only made to senior employees, or
- when senior employees are paid higher payments than lower-level employees.

We expect an employer is likely to make identical payments to employees who have been affected by the flooding events, although they may scale payments depending on the scale of the damage suffered by different employees. In either case, it is unlikely that the payment is in substitution for salary and wages. The more linked the payment is to the employee's salary or status, the more likely the payment is in substitution for other PAYE payments.

What if an "accommodation" benefit is provided in cash?

The exemption covers accommodation provided to an employee with no monetary limit, whereas there is a maximum amount payable for monetary benefits that are not accommodation. However, some accommodation benefits are paid in cash (that is, as an allowance or reimbursement) rather than as the provision of accommodation directly to an employee.

Under the ITA there is no difference between the taxation treatments of the provision of accommodation and the provision of a reimbursement for accommodation costs in the form of allowances. The same applies to this relief, and therefore "accommodation" includes both the provision of accommodation and the provision of an accommodation allowance.

Example 72: Payment of accommodation allowance

Grovers Grapes Limited (GGL) has been adversely affected by the flooding in the Hawkes Bay area. Its grape vines have been badly damaged. It is a family-owned business that has several long-serving staff (including some family members) who live in dwellings near the property. Those dwellings have been substantially damaged by the flooding and are not currently liveable.

Gene Grover, the owner of GGL, tells her staff to find alternative accommodation and advises that the company will provide the staff with an accommodation allowance until the staff can get back to some sense of normality after the impact of the flooding. GGL pays an accommodation allowance to its staff for 8 weeks. All employees have the same entitlement, and therefore it is not relevant that some payments were made to associated family members of Gene.

The staff (including the family members) can treat the accommodation allowance paid as exempt income as it meets the requirements of new section CZ 23B(2)(a). No limit will apply to the amount as it is the provision of accommodation and thus the $5,000 limit will not apply.

What if an employer made payments before the Supplementary Order Paper (SOP) being released?

New section CZ 23B was originally introduced into the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 by way of SOP No 319 on 14 March 2023.

One of the requirements of the new section is that the payment has been treated by the employer as being exempt income of the employee. Given the timing of the floods and the release of the SOP, some employers may have provided amounts to their employees before the SOP was released and conservatively treated those payments as taxable to the employee and accounted for PAYE on those amounts.

The section does not prevent those taxpayers from reversing that treatment to treat those previous payments as exempt, as there is no requirement that the payment is treated as exempt at the time the payment was made. If an employer has treated eligible payments made before the release of the SOP as taxable, they should reverse that treatment for the employee as an error correction to a previous employer information return provided. For payments made before 31 March 2023, employers should ensure that an employer information return filed before 31 March 2023 is corrected to ensure that the right amount of income is treated as tax exempt in the correct tax year.

The requirement is designed to prevent asymmetry of the payments where the employer deducts PAYE from a non-flood-related payment and the recipient claims back the PAYE paid as an additional benefit. It is not designed to prevent employers from being able to treat the payment as exempt due to timing.

Example 73: Payment before release of the SOP

B&E Wines Limited (B&E) has a large operation in one of the areas affected by the North Island flooding events. The company has several staff who have been working for it for a long period. When the floods hit, Bert and Ernie, the owners of B&E, want to provide immediate help to their employees, so they pay them all an ex-gratia payment of $4,000 per employee. They pay PAYE on 20 February 2023 as they are unsure if the government will be enacting a tax exemption for those payments.

B&E makes this payment to around 100 employees. Once the SOP is released, the company decides to amend the treatment of the payments in the employer information return for the period including 20 February 2023 to treat them as exempt payments.

As the employer has treated those payments as exempt, and all the other requirements of section CZ 23B have been met, the payments can be treated as exempt income.

Example 74: Asymmetry of payments

In July 2023, Devon decides to file a personal tax return for the year ended 31 March 2023. Devon lives in Esk Valley and, while at the pub one night, heard from a mate that $5,000 is available tax free if he lives in an affected area. He just needs to file his tax return on that basis by reducing the employment income figure Inland Revenue holds for him by $5,000. Devon's employer, Monty Enterprises Limited, didn't provide any specific support payments for its staff.

Inland Revenue will not accept the reduction in employment income as Monty Enterprises Limited has not made a payment eligible for the exemption. For an amount to be tax exempt, all the criteria in section CZ 23B must be satisfied, including the employer treating a payment as exempt.

Fringe benefit tax exemption

New section CZ 24B of the ITA provides that a benefit received by an employee from an employer is exempt from FBT if:

- it is for the purpose of relief of employees from the adverse effects of the effects of a North Island flooding event
- it would otherwise be a fringe benefit
- it is received in the eight-week period beginning on the first day of the relevant North Island flooding event
- it does not replace a PAYE income payment, that is, it is not paid in substitution for wages or salary
- it does not depend on the seniority of the employee
- if the employee is associated with the employer, it is also available to an unrelated full-time employee, and
- the employer treats the benefit as not being a fringe benefit.

Extent of the exemption

All "sundry benefits" are exempt – for example, benefits that were provided at a drop-in centre. Almost always in that case, an employer would have no idea which employee had received what benefits. Accordingly, if the employer cannot estimate the value of the benefits provided to each employee, they are treated as exempt.

If the employer can estimate the value of a benefit that an employee has received for a North Island flooding event, the benefit will be exempt from FBT to the extent that the $5,000 employee income exemption for the North Island flooding event under new section CZ 23B has not been used to exempt employee income.

Example 75: Sundry benefits

Big T's Tech Limited (BTT) is a retail chain that has branches all around the Northland area. BTT's stores have largely been unaffected by the flooding, but many of its staff have been affected. BTT decides to distribute their remaining stock of satellite internet dishes to drop-in centres around the Northland area.

As BTT's staff live in the Northland area and many have lost all forms of communication, some end up going to the drop-in centres to access the internet and call family and friends. The provision of the internet dishes may constitute a fringe benefit to those staff. However, as BTT has no ability to track which employees are using the benefit, or to determine the value of that benefit, it will be exempt from fringe benefit tax as a sundry benefit under new section CZ 24B(3).

Example 76: Specific benefit

Liz is an employee of Fowlers Fencing Limited (FFL), which is a fencing company based in Gisborne. Liz is a keen cyclist and travels to work and most other places on her e-bike. She has access to a work ute during the day to allow her to travel to worksites and carry fencing materials. No private use of the vehicle is permitted, and the vehicle is locked in a garage at FFL's premises during the evenings and at weekends.

Liz lives in a rural area that was hit hard by the North Island flooding events. Due to the damage to roading and the loss of her e-bike to the floods, she is unable to get around. Josh, the owner of FFL, allows Liz to use the work ute to travel to and from home as well as to assist her neighbours in the clean-up of their properties. This private use of the vehicle would usually incur fringe benefit tax.

FFL also provided a cash payment of $500 to each of its staff that has been paid as exempt income under section CZ 23B.

FFL can treat the provision of the vehicle as exempt from FBT up to the value of $4,500 (as the maximum collective amount of exempt cash and fringe benefits permitted is $5,000).

Projects of limited duration

New section CZ 29B of the ITA provides for a modified definition of "projects of limited duration" for projects related to the North Island flooding events to recognise the extended timeframes which those rebuilding projects could take. The value provided or expenditure incurred by an employer on accommodation for employees working on those projects is exempt income of the employees.

The provision applies for the purposes of section CW 16B (Accommodation expenditure: out-of-town secondments and projects) when:

- the employment duties of an employee require them to work on a project of limited duration for rebuilding or recovery in areas affected by the North Island flooding events, and
- the distant workplace is a workplace in the areas affected by the North Island flooding events.

The usual 3-year time limit in the definition of "project of limited duration" is extended to 5 years if the employee starts work within 6 months of the first date of the relevant flooding event.[15]

The section also includes an ability for the time limits to be modified by Order in Council made on the recommendation of the Minister of Revenue. As it is not known how long the recovery and rebuild process will take, this allows for the time limit to be extended if necessary.

15 Subsequent to the enactment the Government has extended this timeframe by order in council which is detailed elsewhere in this Tax Information Bulletin. The Government has also proposed a permanent extension in the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill.

Example 77: Extended time limit

Kaitlyn's Kontractors Limited (KKL) provides contracting services, primarily road building. They have a large plant based in Northland that services the area. They also have a plant based in Palmerston North that services the lower North Island.

In May 2023, with the need to assist in rebuilding the roading infrastructure in the Northland area, Kaitlyn asks 20 of the Palmerston North crew to relocate to Northland to assist with the work for the foreseeable future.

Kaitlyn provides those employees with accommodation in Northland for the duration of the project, which is expected to be 4 to 5 years. The exemption in section CZ 29B will apply to treat the provision of that accommodation as exempt income (subject to the other criteria in section CW 16B being satisfied[16]).

16 See https://www.taxtechnical.ird.govt.nz/operational-statements/2021/os-21-01 for an outline of the requirements of section CW 16B.

Housing remedial

Clarification of the bright-line test exclusion for inherited property

Sections CB 6A(2B), CZ 39(7), and FC 9(2) of the Income Tax Act 2007

The amendments clarify how multiple sections of the Income Tax Act 2007 (ITA) interact to provide relief under the bright-line test when residential land is transferred upon the death of the owner to the executor, administrator or relevant beneficiaries of the estate and subsequently disposed of.

Background

Inherited residential land is effectively exempt from the bright-line test. This outcome is achieved through three different sections in the ITA – sections CB 6A(2B), CZ 39(7), and FC 9 – but it is not always clear that they operate together.

Subpart FC deals with the distribution, transmission, and gifts of property, mainly in relation to the transfer of property on the death of a person. Section FC 9 deals with the transfer of residential land on the death of a person to either the executor or administrator of the estate or a beneficiary beneficially entitled to the residential land under the terms of the deceased's will or the rules governing intestacy. Under section FC 9(2), the bright-line test does not apply to the transfer of the land, including any intervening transfer to an executor or administrator.

Sections CB 6A(2B) and CZ 39(7) state that sections CB 6A and CZ 39 do not apply to an amount derived "by an executor or administrator described in section FC 1(1)(a) (Disposals to which this subpart applies), or a beneficiary described in section FC 1(1)(b)" in disposing of that land. Effectively, this means the bright-line test does not apply if the executor or administrator of the estate or the ultimate beneficiary sells the residential land.

Confusion can arise due to the wording of section FC 9(3). Section FC 9(3) provides that if the recipient disposes of the land and derives income, they take on the deceased person's acquisition date and acquisition cost. Without knowledge of sections CB 6A(2B) and CZ 39(7), it could be incorrectly assumed that this cost base deeming rule in section FC 9(3) means a subsequent disposal of the residential land would be subject to tax under the bright-line test.

CB 6A(2B), CZ 39(7), and FC 9(2) have been amended to clarify this.

Effective date

The amendments took effect on 1 April 2023, the day after the date the Act received the Royal assent.

Rollover relief – bright-line test and interest limitation

Sections CB 6A(1AB)(b), CB 6AB, CB 6AC, CZ 39(1B) and FC 9(4) of the Income Tax Act 2007

Various remedial amendments have been made to the new rules providing rollover relief for the bright-line test and the interest limitation rules to ensure that the relief works as intended.

This article is organised into two parts. Part One (pages 97 to 105) is best suited for readers already familiar with the rollover relief rules. It provides a brief overview and detailed analysis of the most recent amendments to help readers identify what has changed.

Part Two (pages 106 to 117) provides in-depth guidance on the consolidated amendments from the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 that first introduced the new rollover relief rules, and the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023, specifically in the context of rollover relief for the bright-line test. This provides a comprehensive view of the new rollover relief provisions as they apply for the purposes of the bright-line test at the date of this publication.

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

PART ONE – Changes enacted in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023

Background

Rollover relief under the bright-line test ensures certain transfers of residential land are not taxed at the time of the transfer. Instead, the recipient takes on the original owner's acquisition cost and date. When the recipient disposes of the residential land, this cost and acquisition date determines whether the disposal is taxed under the bright-line test and the amount of the gain that is taxable.

In the context of interest limitation, interest deductions for residential property are being gradually phased out between 1 October 2021 and 31 March 2025 for loans drawn down for residential property before 27 March 2021. For residential property loans drawn down on or after 27 March 2021, interest deductions have generally been denied since 1 October 2021 except in simple refinancing scenarios. Rollover relief ensures certain restructures of the property's legal ownership and the accompanying loan do not exclude someone from this phasing-out period and instead place them into full interest denial before 31 March 2025 for loan amounts first drawn down before 27 March 2021.

Bright-line test

The bright-line test, as introduced in 2015, included limited relief for certain transfers: relationship property, inherited land, and company amalgamations. The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 introduced additional rollover relief rules for certain legal transfers of residential land when there is no underlying change in economic ownership. The changes extended coverage of rollover relief to the following legal structures from 1 April 2022, provided certain conditions are met:

- family trusts: standard trusts and Māori authority trusts
- look-through companies
- partnerships
- te Tiriti o Waitangi – the Treaty of Waitangi settlements
- transfers within wholly-owned groups of companies.

The extent of relief under the bright-line test for these new categories generally depends on the amount of consideration paid for the transfer:

- If the transfer occurs at or below the original owner's acquisition cost (that is, the person has not realised a gain), no tax consequences arise for the original owner if the transfer is made within the relevant bright-line period. The recipient then takes on the original owner's bright-line start date and cost base.
- If the transfer occurs for more than the original owner's cost (that is, they have realised a profit), then that gain is taxed if the transfer is made within the relevant bright-line period. A rule that deems bright-line disposals to be made at market value is switched off to ensure any "paper profit" is not taxed. The recipient then takes on the original owner's bright-line start date, but with an updated cost base of the amount for the transfer.

Interest limitation

Rollover relief for interest limitation purposes is provided in the same situations as the bright-line test but with no requirement regarding consideration.

The new interest limitation rules in subpart DH of the Income Tax Act 2007 deny deductions for interest incurred on loans on or after 1 October 2021 where those loans are drawn down on or after 27 March 2021 for "disallowed residential property" (DRP).

Loans drawn down before 27 March 2021 are "grandparented transitional loans", meaning interest deductions are progressively denied over the period from 1 October 2021 to 31 March 2025 as "grandparented residential interest".

In limited circumstances, rollover relief is provided so loans drawn down on or after 27 March 2021 also qualify as grandparented transitional loans.

If certain conditions are met, section DH 5(5)(d) provides that New Zealand dollar denominated loan amounts (ignoring re-drawings or additional borrowings on or after 27 March 2021) are grandparented transitional loans to the extent the loans are for DRP for which a previous owner (the original owner) also had a loan. The loan amounts must be equal to or less than the amount of the original owner's loan at the time the original owner transferred the property.

Key features

Redrafting of rollover trust provisions

Several of the rollover relief provisions applying to transfers to or from family trusts have been substantially redrafted to clarify their application. As part of this redrafting, the following remedial changes have been made:

- Amendments to sections CB 6AB(2) and (3), and CB 6AC(2) and (3) ensure rollover relief applies to a transfer of residential land or DRP out of a family trust, either back to the principal settlor or the group of settlors that originally transferred the land to the trust (provided that, for a group, at least one of the settlors is a principal settlor), even if the settlor (or settlors) is not an "original settlor" (as was required by the originally enacted provisions).
- Rollover relief now applies to a transfer of residential land or DRP out of a family trust to a principal settlor, even if the settlor did not originally transfer the residential property in question to the trust.
- Amendments to sections CB 6AB(2), (3) and (4), and CB 6AC(2), (3) and (4) clarify the wording and intention of the rollover relief provisions for transfers involving multiple legal structures or between different legal capacities.
- New sections CB 6AB(1)(b) and CB 6AC(1)(b) provide that rollover relief applies when residential land or DRP held in a qualifying family trust is resettled onto another family trust, provided certain conditions are met.
- The definition of "close family beneficiary" in section CB 6AB(6) has been amended to include:
  - a trustee of another trust if at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust
  - wider class of charitable or non-profit beneficiaries beyond registered charities, so that discretionary trusts that have in their trust deeds the standard clause defining a broad class of charitable/non-profit beneficiaries may qualify as "rollover" trusts
  - a company in which a 50 percent or more voting interest (or a 50 percent or more market value interest if a market value circumstance exists) is owned by a beneficiary that is a principal settlor of the trust, and the trustee of another trust if at least one beneficiary of the other trust is a close family associate of a beneficiary of the first trust.
- An amendment to section CB 6AC(5) ensures rollover relief is available for certain transfers to or from qualifying family trusts that are Māori authorities, or eligible to be Māori authorities, regardless of how they are eligible to be Māori authorities.

Other remedial changes

Amendments also clarify that when any of the rollover relief provisions applies to a transfer of residential land, the recipient of the land is subject to the same bright-line test settings as the transferor was. This includes having the same bright-line test length as the transferor had, being five or ten years, or not being subject to the bright-line test at all if the transferor first acquired the land before 29 March 2018 (see new sections CB 6A(1AB)(b) and CZ 39(1B)). Along similar lines, new section FC 9(4) provides that when inherited land is transferred to a "rollover person", the transferor's exemption for inherited land is rolled over to the person so that a subsequent disposal by them is also exempt from the bright-line test.

Effective date

The amendments came into force on 27 March 2021, except for the new section CB 6AB(2)(c) and (6)(c) which came into force on 1 April 2023.

Detailed analysis

Transfers to settlors (sections CB 6AB(2) and CB 6AC(2))

Rollover relief is available under either section CB 6AB(2) or CB 6AC(2) for a transfer of residential land or DRP from a qualifying family trust to the settlors of the trust, provided certain conditions are met. Rollover relief may apply if the property was originally transferred to the trust by those settlors or if the settlors had not transferred the property to the trust. Different conditions apply in these two cases to determine whether rollover relief applies.

Previously, a settlor receiving residential land or DRP from their family trust had to be an "original settlor", meaning they made the original settlement of *property* on the trust (being any property, not necessarily land or even the specific land now being transferred from the trust to the settlor). Consequently, rollover relief was arguably not available if the land was transferred to a person who became a settlor of the trust after the trust was originally settled. This was the case even if the settlor was in fact the original owner of the land and had become a principal settlor at, or by, the time they transferred the land to the trustee.

Sections CB 6AB(2) and (3) and CB 6AC(2) and (3) have been redrafted to clarify that rollover relief does apply in these situations.

Note former sections CB 6AB(1) and CB 6AC(1) have also been redrafted as new sections CB 6AB(1)(a) and CB 6AC(1)(a), respectively. This is not intended as a policy change, but rather a streamlining of the provisions in the style of new sections CB 6AB(2) and CB 6AC(2) which has also removed a number of minor inconsistencies that were in the provisions as originally enacted.[17]

Removal of "original settlor" requirement

New section CB 6AB(2)(a) and (b) provides that the bright-line start date for land (referred to as the "bright-line acquisition date" in the legislation) when a person (the transferee) disposes of the land is the bright-line start date of the trustee (being the previous owner), provided the following conditions are met:

- the trustee transfers the land to the transferee(s) on or after 1 April 2022
- the transferee (along with all other transferees if there is more than one) is a settlor of the trust and had originally transferred the land to the trustee
- if there is more than one transferee, the transferees acquire proportionally the same amount of land they originally transferred to the trustee, and
- at the time the trustee transfers the land to the transferee(s):
  - all transferees are beneficiaries of the trust
  - at least one transferee is a principal settlor, and
  - the trust is a "rollover trust".

The definition of "rollover trust" in section CB 6AB(5) has been amended so it no longer refers to the former "original settlor" requirement. The amended definition provides that "rollover trust" means, at the time of a relevant transfer to or from the trust:

- all principal settlors are beneficiaries of the trust
- all principal settlors are close family associates,[18] and
- all beneficiaries are close family beneficiaries.[19]

The amendments ensure rollover relief applies under section CB 6AB in the situation where a settlor receives land back from a qualifying family trust that the settlor previously sold the land to or settled the land on – including circumstances where the transferee is not the "original settlor" of the trust.

17 The only substantive change to sections CB 6AB(1) and CB 6AC(1) is the addition of a new paragraph (b) to each of these sections, which provides rollover relief for resettlements of family trusts in certain circumstances. Previously, rollover relief for trust resettlements was not explicitly provided for in the legislation, although the intention was always that rollover relief should apply in such situations provided the usual conditions relating to the principal settlors and beneficiaries were met for both trusts. This is discussed in more detail below at 'Resettlements of family trusts'.

18 Two people are "close family associates" under section CB 6AB(7) if they are within four degrees of blood relationship, or are married, in a civil union or de facto relationship, or one person is within four degrees of blood relationship to the other person's spouse, civil union partner or de facto partner.

19 "Close family beneficiary" is defined in section CB 6AB(6) to mean, for the relevant trust, a beneficiary that is one or more of the following: a principal settlor; a trustee of another trust and at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust; a close family associate of another beneficiary who is also a principal settlor; a company in which a 50 percent or more voting interest, or a 50 percent or more market value interest if a market value circumstance exists, is owned by a beneficiary who is a principal settlor or a close family associate of another beneficiary who is a principal settlor; a charity registered under the Charities Act 2005; or any association, club, institution, society, organisation or trust not carried on for the private profit of any person whose funds are applied wholly or principally to any civic, community, charitable , philanthropic, religious, benevolent or cultural purpose, whether in New Zealand or elsewhere – provided that if the family trust only has one principal settlor, there is at least one other natural person beneficiary who is a close family associate of the principal settlor.

Example 78: Sale to family trust by non-original settlor

In 2005, Martha settles a new family trust, with herself, her husband Bill and their children, Jack and Sean, as the beneficiaries of the trust.

In 2007, Jack makes substantial settlements on the trust such that he becomes the principal settlor.

In 2009, Jack acquires an investment property for $250,000.

In May 2019, Jack sells the investment property to the trust for $600,000.

In November 2022, the trust sells the property back to Jack for $600,000, even though the market value of the property is now over $1 million. At the time of the sale, Jack is still the principal settlor of the trust.

As the amount paid by Jack for the property is equal to the amount the trustee originally paid for the property, full rollover relief would apply to the transfer under the proposed amendments. This means the trust would not be subject to tax under the bright-line test on the transfer of the property to Jack in November 2022. This is because the trustee would be treated as disposing of the land at cost, meaning their net income arising under the bright-line test is zero.

Jack would be deemed to have a bright-line start date of May 2019 for the land (being the trustee's bright-line start date for the land) and a cost base of $600,000.

New section CB 6AC(2) similarly provides that the bright-line start date for land when a person (the transferee) disposes of it is the bright-line start date of the Māori trustee (being the previous owner), provided certain conditions are met. Like the amendments to section CB 6AB, references to "original settlor" have been removed from section CB 6AC(2) and its surrounding subsections, including the definition of "Māori rollover trust" in subsection (4).

Rollover relief applies under section CB 6AC(2) if:

- the Māori trustee transfers the land to the transferee(s) on or after 1 April 2022
- the transferee (along with all other transferees if there is more than one) is a settlor of the trust and had originally transferred the land to the Māori trustee
- if there is more than one transferee, the transferees are all settlors of the trust and acquire proportionally the same amount of land they originally transferred to the Māori trustee, and
- at the time that the trustee transfers the land to the transferee(s):
  - all transferees are beneficiaries of the trust
  - the trust is a "Māori rollover trust".

As mentioned above, the definition of "Māori rollover trust" in section CB 6AC(4) has been amended. "Māori rollover trust" now means, at the time of a relevant transfer:

- all beneficiaries of the trust are either members of the same iwi or hapū, or descendants of the same tīpuna (living or dead), and
- the land being transferred is subject to Te Ture Whenua Māori Act 1993.

Provided the above conditions are met, rollover relief applies if the trustee is a Māori authority or eligible to be one (see the definition of "Māori trustee" in section CB 6AC(5)).

Principal settlor not original owner of land

New section CB 6AB(2)(c) provides another route for rollover relief to apply when residential land or DRP is transferred from a rollover trust to a settlor. Rollover relief applies under the section when the land is transferred to a settlor or group of settlors, provided all settlors receiving the land are principal settlors at both the time the land is acquired by the trustee and the time the trustee transfers the land to the settlor(s).

Rollover relief does not apply to transfers to settlors who are not principal settlors of the trust either at the time the land was acquired by the trustee or the time the trustee transfers the land. This timing requirement ensures a beneficiary of the trust cannot become a principal settlor immediately before the transfer to them just so they receive the land without bright-line test tax implications. It also ensures that rollover relief does not apply to a transfer to someone who is no longer a principal settlor of the trust.

Rollover relief also does not apply under this provision if the transferees had previously transferred the land to the trustee. This is because section CB 6AB(2)(a) and (b) already provides for transferees who had previously owned the land before transferring it to the trustee. Paragraph (c) is relatively limited provision, as it only applies in the specific scenario where the transferee had not originally owned the land.

It should be noted the new section CB 6AB(2)(c) was inserted with effect on 1 April 2023, the day after the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 received the Royal assent. This means that, unlike the other amendments to sections CB 6AB and CB 6AC, it does not apply retrospectively to transfers occurring on or after 1 April 2022. Instead, section CB 6AB(2)(c) only has effect for transfers occurring on or after 1 April 2023.

Example 79 Transfer from family trust to principal settlor who made cash settlement on trust

In August 2019, Melville decides to settle a family trust with himself, his father, Dean, and his sister, Rosie, as the beneficiaries of the trust. The only property settled on the trust at that time is $900,000 in cash contributed by Melville, making Melville the principal settlor of the trust (being the settlor whose settlements for the trust are greatest or greatest equal). Shortly afterward, in September 2019, the trustee purchases a residential property for $850,000.

Rosie makes a cash settlement on the trust of $700,000 in December 2019.

In May 2023, the trustee transfers the property to Melville for its cost of $850,000, even though at that time it is worth $1.2 million. At the time of the transfer, Melville is still a principal settlor of the trust.

As the amount paid by Melville for the property is equal to the amount the trustee originally paid for the property, full rollover relief would apply to the transfer under the proposed amendments. This means the trust would not be subject to tax under the bright-line test on the transfer of the property to Melville in May 2023. This is because the trustee would be treated as disposing of the land at cost, meaning their net income arising under the bright-line test is zero.

Melville would be deemed to have a bright-line start date of September 2019 for the land (being the trustee's bright-line start date for the land) and a cost base of $850,000.

If the property had instead been transferred by the trustee to Rosie, that transfer would not have qualified for rollover relief. This is because Rosie is not a principal settlor. Even if Rosie had become a principal settlor in December 2019 by making a larger settlement on the trust (equal or greater in value to Melville's), a transfer of the property to her would still not qualify for rollover relief as she was not a principal settlor at the time the land was acquired by the trustee.

Transfers to self but in a different capacity and transfers involving multiple legal structures (sections CB 6AB(3) and (4), CB 6AC(3) and (4))

Section CB 6AB provides rollover relief for transfers of residential land or DRP to trusts, partnerships and look-through companies (LTCs), as well as transfers out of these structures to the land's original owner. For example, rollover relief is provided for the transfer of land held on a rollover trust to a person who is both a principal settlor and beneficiary of the trust. Rollover relief is also provided under section CB 6AB(4) if that person then decides to transfer the land to an LTC of which they are the sole shareholder. For efficiency, it makes sense to provide rollover relief where the same result is achieved in one transaction, rather than two (for example, where land is transferred directly from a rollover trust to an LTC owned by the principal settlor of the trust).

The former version of section CB 6AB(3) provided rollover relief for such composite transfers, as did former section CB 6AC(3) for composite transfers involving family trusts that were Māori authorities or were eligible to be Māori authorities. Rollover relief applied where the original owner received the land from the legal structure but in a different capacity to the one in which they became "original settlor". The sections also contained the proportionality requirement[20] that applies when land is transferred from a rollover trust back to a settlor who had originally transferred the land to the trust (now contained in new sections CB 6AB(2)(b) and CB 6AC(2)(b)).

20 Basically, the rule is that when land is transferred from a family trust back to a group of settlors who originally transferred the land to the trust, the settlors should acquire proportionally the same amount of land they each held before it was transferred to the trust.

Former section CB 6AB(4) provided rollover relief if a person transferred residential land or DRP to themselves in a different capacity (such as from their "personal" capacity to their capacity as a shareholder in an LTC or a partner in a partnership, or vice versa) and there was "no intervening transfer to a third party".

The following amendments have been made to clarify the effect and intention of these provisions:

- Sections CB 6AB(2) and (3) and CB 6AC(2) and (3) have been redrafted so the proportionality and capacity rules are now in separate subsections, rather than being combined into a single subsection as they were previously. As mentioned above, the proportionality rule is now in sections CB 6AB(2)(b) and CB 6AC(2)(b), while the capacity rule remains in sections CB 6AB(3) and CB 6AC(3), albeit in a revised form. The references to a person having a capacity "other than settlor or original settlor" have been removed with an added clarification that, for the purposes of applying subsections (1)(a) and (2), the transferors or transferees (as applicable) may have different capacities in relation to the different criteria in those subsections. For example, a transferee may be a settlor of the trust in their personal capacity and be a beneficiary as an LTC owner, or they may have transferred the land to the trust in their personal capacity and acquire it back from the trust as a partner in a partnership. The changes to subsection (3) mean that, in such situations, the relevant criteria in subsection (1)(a) or (2) (whichever applies) are satisfied – therefore, rollover relief applies if all other relevant conditions set out in section CB 6AB or CB 6AC are also met.
- The requirement in section CB 6AB(4) that the transfer "must not be to or from a person in their capacity of settlor, beneficiary or trustee" has been removed. This wording was originally inserted with the aim of making it clear that either section CB 6AB(3) or CB 6AC(3) is the relevant provision that applies when land is transferred from a trustee of a family trust to the principal settlor's (or principal settlors') LTC or partnership (or to the LTC owners or partners in the instance when it was the LTC or the partnership that originally transferred the land to the family trust), but the chosen wording could have been clearer. The reference to there being "no intervening transfer to a third party" has also been removed as it appears it was redundant.

Resettlements of family trusts (sections CB 6AB(1)(b) and CB 6AC(1)(b))

New sections CB 6AB(1)(b) and CB 6AC(1)(b) provide rollover relief when residential land or DRP held on a rollover trust is resettled onto another, related, rollover trust.

If certain conditions are met, new section CB 6AB(1)(b) provides that a person holding land as trustee of the resettled trust (trust A), where the land was transferred to them from another related rollover trust (trust B), has the same bright-line start date for the land that the trustee of trust B had. This treatment applies if:

- trust A and trust B are both rollover trusts, and
- for trust A:
  - all the beneficiaries are the same as for trust B, or
  - all the natural person beneficiaries are either the same as, or close family associates of a principal settlor of, trust B.

In other words, rollover relief is only available if both trusts meet all the usual requirements for rollover relief in section CB 6AB(5).

To qualify for rollover relief, each natural person beneficiary of trust A must be a close family beneficiary. In the case of multiple principal settlors, each principal settlor must be a close family associate of the other principal settlors. At a minimum, each natural person beneficiary of trust A must be either a principal settlor, or a close family associate of a principal settlor, of trust B.

Trust A may not necessarily have the same beneficiaries as trust B. However, provided the above conditions are met, this would not preclude the resettlement from qualifying for rollover relief. For example, if an additional generation were added to trust A's beneficiaries, rollover relief would still be available if the close family beneficiary requirements were satisfied.

Rollover relief also applies even if the principal settlor of trust B is deceased.

Example 80: Resettlement of family trust

Wayne is the principal settlor and a beneficiary of his family trust, which meets the definition of a "rollover trust" in proposed new section CB 6AB(5).

In April 2021, the trustee of the trust resettles the trust property, which includes residential land on a new family trust.

The beneficiaries of the new family trust include Wayne's relatives within four degrees of blood relationship and their spouses, as well as a couple of registered charities. Aside from Wayne, the new trust has one other principal settlor, Wayne's wife, Karen, who is also a beneficiary of the trust.

All principal settlors of the new trust (including Wayne) are close family associates, and all beneficiaries are close family beneficiaries, meaning the new trust is a rollover trust. As the transfer to the new trust at nil consideration is for less than the cost of the land to the trustee of the first trust, rollover relief applies to the transfer of the residential land from the first trust to the new trust. This means the trustee of the first trust is treated as disposing of the land at cost so their net income arising under the bright-line test is zero. The trustees of the new trust are deemed to have the same bright-line start date and cost base for the land as the trustee of the first trust.

New section CB 6AC(1)(b) similarly provides rollover relief for resettlements of Māori rollover trusts.

The definition of "Māori rollover trust" in section CB 6AC(4) has been amended so that it means, at the time of a relevant transfer:

- all beneficiaries of the trust are either members of the same iwi or hapū, or descendants of the same tīpuna (living or dead), and
- the land is subject to Te Ture Whenua Māori Act 1993.

Provided the first trust (trust B) and resettled trust (trust A) have the same beneficiaries and are both Māori rollover trusts, rollover relief applies under section CB 6AC(1)(b) if, for each of the trusts, the trustee is a Māori authority or is eligible to be one (see the definition of "Māori trustee" in section CB 6AC(5)). As with the rule for general family trusts above, this includes the situation where one of the settlors of the first trust is deceased.

Definition of "close family beneficiary" (section CB 6AB(6))

Amendments have been made to the definition of "close family beneficiary" in section CB 6AB(6) as follows:

- **A new paragraph (ab) has been added to include a trustee of another trust if at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust.** The words "or trustees of another trust and at least one beneficiary of the other trust is a close family beneficiary of the relevant trust" that were in paragraph (d) of the definition of "close family associate" in section CB 6AB(5) have been deleted.
- **A new paragraph (ac) has also been added so the definition of "close family beneficiary" includes any association, club, institution, society, organisation or trust not carried on for the private profit of any person whose funds are applied wholly or principally to any civic, community, charitable, philanthropic, religious, benevolent, or cultural purpose, whether in New Zealand or elsewhere.** This expands the scope of permissible beneficiaries to include charities beyond those registered under the Charities Act 2005, so that discretionary trusts that have in their trust deeds the standard clause defining a broad class of charitable/non-profit beneficiaries may qualify as rollover trusts. Equally, it also permits non-discretionary family trusts to include non-registered charities as beneficiaries and qualify as rollover trusts. However, there is an additional condition that applies if the trust (discretionary or otherwise) has just one principal settlor. In this case, a charitable or non-profit beneficiary of the type described in paragraph (ac) qualifies as a close family beneficiary only if the trust has at least one natural person beneficiary who is a close family associate of the principal settlor. This is intended to ensure the trust is a genuine family trust.
- **The scope of paragraph (c) has been expanded to include a company in which a 50 percent or more voting interest – or a 50 percent or more market value interest, if a market value circumstance exists – is owned by a beneficiary that is a principal settlor (see new subparagraph (i)).** Previously, only a company in which a 50 percent or more voting interest (or market value interest) was owned by a beneficiary that was a close family associate of a principal settlor (now contained in subparagraph (ii)) was included in the definition. It should be noted the amendment to paragraph (c) came into force on 1 April 2023 (this contrasts with the other two amendments to the "close family beneficiary definition" described above, which both took effect on 27 March 2021).

Māori family trusts rollover relief (section CB 6AC(5))

Rollover relief is provided for transfers of residential land or DRP subject to Te Ture Whenua Māori Act 1993 in certain situations. Rollover relief applies under section CB 6AC when land is transferred to or from a trust that is either a Māori authority or eligible to be a Māori authority, and where all beneficiaries are members of the same iwi or hapū or are descendants of the same tīpuna (living or dead). This is intended to mirror the rollover relief rules for general family trusts while recognising that Māori family trusts may be structured differently.

The policy intent is that rollover relief should be available regardless of the reason why the trustee is a Māori authority or eligible to be one. However, the provision was previously restricted to just those situations where the trustee was (or was eligible to be) a Māori authority because it received and managed assets on behalf of claimants where those assets were transferred by the Crown as part of the settlement of a claim under te Tiriti o Waitangi – the Treaty of Waitangi. This was because the definition of "Māori trustee" in section CB 6AC(5) formerly referred to a trustee of a trust that is either a Māori authority, or eligible to elect to be a Māori authority, under section HF 2(3)(e)(i).[21] However, this restriction was not necessary because another section already provided rollover relief for Treaty of Waitangi settlements. The erroneous cross-reference to section HF 2(3)(e)(i) in section CB 6AC(5) has been deleted so the Māori trustee definition includes any trust that is eligible to elect to be a Māori authority.

Other bright-line remedial amendments

Relevant bright-line period (sections CB 6A(1AB)(b) and CZ 39(1B))

When a transfer of residential land is eligible for rollover relief, the intent is the bright-line period does not reset. This includes both the start date of the bright-line period (that is, when the "clock" runs from) and which bright-line test applies (for example, the five-year or ten-year test). The start date of the bright-line period is generally determined by the date the legal title was transferred (referred to as the "bright-line acquisition date" in the legislation), whereas which bright-line test applies is determined by the date of acquisition (generally when a person enters into the agreement to purchase a property).

Previously, the legislation produced the unintended effect that, when rollover relief applied, the recipient only took on the original owner's bright-line start date and not the underlying acquisition date.[22] This meant that, while the start date did not reset, the recipient became subject to a ten-year bright-line period if the transfer was made on or after 27 March 2021. For example, a property acquired in 2016 would have been subject to the two-year test and could have been disposed of without tax under the bright-line test from 2018 onwards. However, if a transfer eligible for rollover relief occurred in 2022, in the absence of a remedial amendment the recipient would have become subject to the ten-year bright-line test (with a 2016 start date) and would need to retain the property until 2026 to be able to dispose of the property without it being taxed under the bright-line test.

This is not the policy intention, and so new sections CB 6A(1AB)(b) and CZ 39(1B) have been inserted to ensure a transferee in this situation also takes on the appropriate bright-line test length and other settings – including where no bright-line test applies because the land was originally acquired before 1 October 2015.

New section CB 6A(1AB)(b) provides that the ten-year bright-line test (section CB 6A) does not apply to a person's disposal of residential land if the land meets the requirements of one of sections CB 6AB, CB 6AC, CB 6AE or FB 3A and the transferor first acquired an estate or interest in the land before 27 March 2021. New section CZ 39(1B) similarly provides that the five-year bright-line test (preserved in section CZ 39 for land first acquired on or after 29 March 2018 and before 27 March 2021) does not apply to a person's disposal of residential land if the land meets the requirements of sections CB 6AB, CB 6AC, CB 6AE or FB 3A and the transferor first acquired an estate or interest in the land before 29 March 2018.

21 Section HF 2(3) sets out the circumstances in which the trustees of a trust are eligible to make an election to become a Māori authority. Paragraph (e)(i) of that section applies to the trustees of a trust who, on behalf of Māori claimants, receive and manage assets that are transferred by the Crown as part of the settlement of a claim under te Tiriti o Waitangi.

22 See sections CB 6AB(1), (2), (4), CB 6AC(1), (2), CB 6AE(1) and FB 3A(3).

Example 81: Land purchased before 27 March 2021 and sold to owners' LTC after 27 March 2021

Sanjay and his wife, Marie, purchase residential land in their own names for $670,000 on 6 May 2018, each of them holding a 50 percent share of the land. On 17 July 2023, they sell the land to a look-through company, A Co, that they jointly own 50:50, for $950,000. The market value of the land at that time is $1.12 million.

Sanjay and Marie are subject to the five-year bright-line test for the land, but because they held the land for five years before selling it to A Co, there is no tax liability under the bright-line test.

Partial relief applies to the sale to A Co, meaning A Co takes on Sanjay and Marie's bright-line start date of 6 May 2018 but not their acquisition cost of $670,000. A Co's cost base would instead be the amount of consideration it provided, being $950,000. A Co would also be subject to the five-year bright-line test for the land, being the bright-line test period Sanjay and Marie were subject to.

Inherited property transferred to rollover person (section FC 9(4))

The rollover relief provisions previously did not work as intended when inherited residential land was transferred by the beneficiary of a deceased person's estate to a person qualifying for rollover relief (referred to here as a "rollover person"). Examples of such transfers include when a beneficiary of an estate transfers inherited land to a rollover trust they are a principal settlor and beneficiary of, or to an LTC they own.

An amendment has been made to ensure the exemption from the bright-line test that applies when a person disposes of land they inherited also applies to a receiving rollover person when they dispose of the land.

Pre-existing sections CB 6A(2B) and CZ 39(7) provide that a disposal of inherited land by the beneficiary of a deceased person's estate is not taxable under the bright-line test. Where the recipient of the disposal is a rollover person, rollover relief ensures that when the rollover person disposes of the land it has the same bright-line start date and cost base for the land as the beneficiary had (as given by section CB 6AB or CB 6AC, and section FC 9(3), respectively). The problem with how the law previously worked was that only the beneficiary's bright-line start date and cost base were "rolled over" – the actual exemption from the bright-line test in CB 6A(2B) (or in CZ 39(7) for the five-year test) was not rolled over to the recipient. This result was at odds with the intention of rollover relief, which is to ensure a rollover person holds residential land subject to all the same bright-line tax settings as the previous owner of the land – including that a disposal by the rollover person should not be subject to the bright-line test in cases where the previous owner inherited the land.

New section FC 9(4) provides that if residential land is transferred by a beneficiary of the deceased person on or after 1 April 2022 to a person who is a recipient as described in section FC 9B(a) to (e), and the person disposes of it, sections CB 6A and CZ 39 do not apply to the disposal. This ensures that when a beneficiary of an estate transfers inherited residential land to a rollover person, the beneficiary's exemption from the bright-line test for the inherited land is rolled over.

Example 82: Transfer of inherited property to rollover trust

Jerry inherits a house from his father, Tom, after Tom dies in July 2021.

In June 2023, Jerry transfers the property to his family trust, the Smith Family Trust, for nil consideration. The Smith Family Trust is a rollover trust and Jerry is both a beneficiary and principal settlor of the trust at the time of the transfer. As he inherited the property, Jerry will not pay tax under the bright-line test, as disposals of inherited property are exempt.

Because the transfer was made after 1 April 2022, rollover relief applies to the transfer from Jerry to the Smith Family Trust, meaning Jerry's exemption from the bright-line test is rolled over the to the trustees of the Smith Family Trust. This means if the trustees dispose of the property, they will have the same bright-line tax treatment that Jerry had on disposal – that is, the disposal is exempt from the bright-line test.

PART TWO – Bright-line rollover relief – Consolidated amendments since 2022

Sections CB 6A(1AB)(b), (7), (7B), (7C), (15), CB 6AB, CB 6AC, CB 6AE, CZ 39(1B), (6B), (6C), (6D), FC 9(4), FC 9B, FC 9C, FC 9D and FM 15(2B) of the Income Tax Act 2007

Guidance in this Part replaces the coverage of bright-line test rollover relief in *Tax Information Bulletin* Vol 34 No 5 (June 2022) and in the Special report on interest limitation and additional bright-line changes (published 31 March 2022).

For a complete overview of rollover relief for interest limitation, Part One of this article (where it describes the latest changes to sections CB 6AB and CB 6AC) should be read in conjunction with the guidance on transitional residential interest and rollover relief for interest limitation contained in *Tax Information Bulletin* Vol 34 No 5 (June 2022).

This Part provides in depth guidance on the bright-line test rollover relief first introduced in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 and recently amended by the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023. The following guidance chiefly concerns rollover relief as it applies to transfers to or from family trusts and certain Māori trusts, as well as transfers to or from look-through companies and partnerships. This guidance incorporates all amendments made to these provisions as at the date of publication.

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

Note about interest limitation

Section DH 5(5)(d) provides rollover relief for the purposes of subpart DH of the Act (the interest limitation rules), including for transfers to or from family trusts or transfers between different capacities.

Section DH 5(5)(d) applies to every transfer of disallowed residential property (DRP) since the original owner acquired it that meets the requirements of any of paragraphs (a) to (e) in section FC 9B. Paragraphs (a) to (e) link to sections CB 6AB(1), (2) and (3), and CB 6AC(1) and (2), respectively, treating the relevant requirements of those sections as applying to a transfer of DRP on after 27 March 2021 (rather than a transfer of residential land on or after 1 April 2022). Because of the link to sections CB 6AB and CB 6AC, the changes to these sections introduced in the latest Act also have relevance for interest limitation rollover relief.

Note about bright-line start date versus acquisition date

When a transfer of residential land is eligible for rollover relief, the intent is that the bright-line period does not reset. This includes both the start date of the bright-line period (that is, when the "clock" runs from) and which bright-line test applies (for example, the five-year or ten-year test). The start date of the bright-line period is generally determined by the date on which legal title was transferred (referred to as the "bright-line acquisition date" in the legislation), whereas which bright-line test applies is determined by the date of acquisition (generally when a person enters into the agreement to purchase a property).

From this point onwards, the term "bright-line start date" is used in this document when referring to the date the bright-line "clock" runs from for clarity purposes, in place of the term "bright-line acquisition date" used in the legislation.

Family trusts

Prior to the introduction of rollover relief for certain residential land transactions involving family trusts, the bright-line test generally taxed these transfers when the transfer occurred within the applicable bright-line period.

Under the bright-line test, a transfer of residential land to a trust (whether by settlement or sale) constitutes a disposal by the transferor (the person transferring the land) and an acquisition by the transferee (the trustee(s) of the trust). Depending on the circumstances, this can create an income tax liability under the bright-line test or restart the bright-line clock even if the transferor originally acquired the land before 1 October 2015.[23] Section CB 6AB provides rollover relief when residential land is transferred to or from a family trust on or after 1 April 2022, provided certain conditions are met.

23 The original two-year bright-line test applied to residential land acquired on or after 1 October 2015.

Transfers to family trusts

Section CB 6AB(1)(a) provides that if a trustee holds residential land on a "rollover trust", the bright-line start date for the land, when the trustee disposes of it, is the bright-line start date the transferor (or transferors) had for the land. This applies if:

- the transfer to the trustee (whether by settlement or sale) occurs on or after 1 April 2022, and
- at the time the transferors transfer the land to the trustee:
  - each transferor is both a settlor and a beneficiary of the trust, and
  - at least one transferor is a principal settlor of the trust.

"Rollover trust" is defined in section CB 6AB(5) to mean, at the time of a relevant transfer:

- all principal settlors are beneficiaries of the trust
- all principal settlors are close family associates, and
- all beneficiaries are close family beneficiaries.

"Close family beneficiary" is defined in section CB 6AB(6) to mean, for the relevant trust, a beneficiary that is at least one of the following:

- A principal settlor.
- A close family associate of another beneficiary who is also a principal settlor.
- A trustee of another trust, if at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust.
- A company in which a 50 percent or more voting interest (or a market value interest of at least 50 percent, if a market value circumstance exists) is owned by a beneficiary that is a principal settlor or a close family associate of another beneficiary that is a principal settlor.
- A charity registered under the Charities Act 2005.
- Any association, club, institution, society, organisation, or trust not carried on for the private profit of any person whose funds are applied wholly or principally to any civic, community, charitable , philanthropic, religious, benevolent, or cultural purpose, whether in New Zealand or elsewhere, and, in the case of it having one principal settlor only, the trust has one or more beneficiaries who are close family associates of the principal settlor.

Under section CB 6AB(7), two persons are "close family associates" if one or more of the following applies:

- they are within four degrees of blood relationship (paragraph (a))
- they are married, in a civil union, or in a de facto relationship (paragraph (b)), or
- one person is within four degrees of blood relationship to the other person's spouse, civil union partner, or de facto partner (paragraph (c)).

This definition includes relatives by adoption, as section 16(2) of the Adoption Act 1955 deems adopted children to be the natural children of their adoptive parent.

Section CB 6A(7)(c) (the third bullet point above) also extends coverage of the association test to include stepchildren and in-laws.

The rules mirror the existing associated person rules in section YB 4 but with an expansion from two degrees to four degrees of association. This is to account for the fact that many family trusts include a wider range of family members than simply those only two degrees removed.

A non-exhaustive list of some common examples of familial relations that meet the "close family associates" test is as follows (references are to paragraphs in the section CB 6A(7) definition):

- The principal settlor's parents and children (one degree of blood relationship – paragraph (a)).
- The principal settlor's grandchildren, grandparents and siblings (two degrees of blood relationship – paragraph (a)).
- The principal settlor's aunts, uncles, nieces, nephews, great-grandchildren, and great-grandparents (three degrees of blood relationship – paragraph (a)).
- The principal settlor's cousins, great-nieces, great-nephews, and great-great-grandchildren (four degrees of blood relationship – paragraph (a)).

- The principal settlor's spouse or de facto partner (paragraph (b)).
- The principal settlor's stepparents, stepchildren, step-siblings, parents-in-law, brothers-in-law, sisters-in-law, daughters-in-law or sons-in-law (within four degrees of blood relationship to the spouse or de facto partner – paragraph (c)).

Further information on how degrees of association are determined in family situations can be found in IR620.[24]

Example 83: Characteristics of a family trust qualifying as a rollover trust

Joan has no children of her own, but she wants to set up a family trust for the benefit of her nephew, George, and his family. The trust's assets include Joan's house in Auckland, a holiday home in Waihi and some other financial assets. The beneficiaries of the trust are Joan, George, George's de facto partner, Charlotte, their two children, Jack and May, along with George's son, Eli, from a previous relationship. Joan loves animals and has been a long-time volunteer for the SPCA, so she also lists the SPCA as a beneficiary of the trust.

The relationships of the beneficiaries are as follows:

George: three degrees of blood relationship from Joan.

George's partner, Charlotte.

George's children, Jack, May and Eli: four degrees of blood relationship from Joan.

SPCA: registered charity under the Charities Act 2005.

All the beneficiaries are close family beneficiaries and Joan's trust qualifies as a rollover trust.

Transfers from family trusts

Section CB 6AB(2) provides for rollover relief in certain circumstances when residential land is transferred by the trustee of a rollover trust to a settlor or a group of settlors (referred to as "the transferees") on or after 1 April 2022. If rollover relief applies, the transferees' bright-line start date for the land when they dispose of it is the bright-line start date the trustee had.

Two separate tests determine whether rollover relief applies. The first test, contained in paragraphs (a) and (b), applies if the transferees had originally transferred the land to the trustee. Rollover relief applies under this test if the transferees acquire proportionally the same amount of land they had originally transferred to the trustee and, at the time the trustee transfers the land to the transferees:

- all transferees are beneficiaries of the trust
- at least one transferee is a principal settlor, and
- the trust is a rollover trust.

Where land is transferred to a rollover trust on or after 1 April 2022 and subsequently transferred back to the original transferors, the combination of sections CB 6AB(1) and (2)(a) and (b) mean that a person (being both a settlor and a beneficiary) who receives land back from the trust will have the same bright-line start date they had for the land before it was transferred to the trust. This is because the trustee of the rollover trust will have the bright-line start date the person had before the land was transferred to the trust.

The second test, contained in paragraph (c), applies in the opposite situation where the transferees had **not previously transferred the land to the trustee. In this instance, rollover relief applies if:**

- all transferees are principal settlors at the time the trustee transfers the land to the transferees and also at the time the trustee acquired the land, and
- the trust is a rollover trust.

The timing requirement above is to ensure a beneficiary of the trust cannot become a principal settlor immediately before the transfer to them just so they receive the land without bright-line test tax implications. It also ensures rollover relief does not apply to a transfer to someone who is no longer a principal settlor of the trust.

24 IR620 *A guide to associated persons definitions for income tax purposes, available at* www.ird.govt.nz

It should be noted paragraph (c) was inserted with effect on 1 April 2023. This means that, unlike the other provisions of section CB 6AB, it does not apply to all relevant transfers occurring on or after 1 April 2022. Instead, the second test (in paragraph (c)) only has effect for relevant transfers occurring on or after 1 April 2023.

Rollover relief is not available under either test where residential land held on a family trust is subsequently transferred or distributed to a different beneficiary (for example, a child who is not a settlor and/or did not previously transfer the land to the trust, or in the case of the second test, is not a principal settlor). Such transfers or distributions of trust property remain subject to the bright-line test, as would be the case if a person transferred residential land directly to their child.

Resettlements of family trusts

Section CB 6AB(1)(b) provides rollover relief for trust resettlements. Under the section, the bright-line start date of a trustee of a resettled trust is the bright-line start date the trustee of the first trust had, if the trustee of the first trust transfers residential land to the resettled trust on or after 1 April 2022. This applies if both trusts are rollover trusts and either:

- all the beneficiaries of the resettled trust are the same as for the first trust, or
- all the natural person beneficiaries of the resettled trust are either the same as for the first trust or are close family associates of a principal settlor of the first trust.

In other words, rollover relief is only available if both trusts meet all the usual requirements of a "rollover trust" in section CB 6AB(5) and are sufficiently closely related.

To qualify for rollover relief, each natural person beneficiary of the resettled trust must be a close family beneficiary. In the case of multiple principal settlors, each principal settlor must be a close family associate of the other principal settlors. At a minimum, each natural person beneficiary of the resettled trust must be either a principal settlor, or a close family associate of a principal settlor, of the first trust.

The resettled trust may not necessarily have the same beneficiaries as the first trust. However, provided the above conditions are met, this would not preclude the resettlement from qualifying for rollover relief. For example, if an additional generation were added to the resettled trust's beneficiaries, rollover relief would still be available if the close family beneficiary requirements were satisfied.

Rollover relief also applies even if the principal settlor of the first trust is deceased.

Transfers to or from different capacity (look-through companies, partnerships)

Relief may also apply in certain cases under section CB 6AB when:

- residential land is transferred from a look-through company (LTC) or partnership to a family trust, or vice versa (where a person may be a settlor of the trust in a different capacity to the capacity in which they are a beneficiary), or
- a person receives land back from a trust they originally transferred it to, but in a different capacity to the capacity in which they previously held it.

Section CB 6AB(3) provides that, for the purposes of applying subsection (1)(a) (where a person transfers residential land to a trust) or subsection (2) (where a person receives residential land back from a trust), the transferors and transferees may have different capacities in relation to the different criteria in those provisions. For example, a transferee may be a settlor of the trust in their personal capacity and be a beneficiary as an LTC owner, or they may have transferred the land to the trust in their personal capacity and acquire it back from the trust as a partner in a partnership.

Transfers of shares in LTCs

Section CB 6AB(8) provides that relief does not apply when shares in an LTC are transferred to a rollover trust, nor when these shares are transferred from a rollover trust to a settlor or group of settlors.

Determining which bright-line test applies

Section CB 6A(1AB)(b) provides that the ten-year bright-line test (and the five-year bright-line test for new build land) in section CB 6A does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, and the transferor first acquired an estate or interest in the land before 27 March 2021. Section CZ 39(1B) similarly provides that the five-year bright-line test (preserved in section CZ 39 for land first acquired on or after 29 March 2018 and before 27 March 2021) does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, and the transferor first acquired an estate or interest in the land before 29 March 2018.

These provisions ensure that if rollover relief applies to a transfer under section CB 6AB, the receiving trustee (if the transfer is from a settlor to a rollover trust, or a rollover trust resettlement) or receiving settlor (if the transfer is from a rollover trust to a settlor) has the same bright-line test length as the transferor.[25] The relevant start date the bright-line "clock" runs from is the bright-line start date the transferor had, as per section CB 6AB(1) or (2) (whichever applies).

In other words, if the transferor first acquired the land:

- on or after 27 March 2021 – a disposal of the land by the transferee within **ten years** of their bright-line start date is taxable under section CB 6A, or within **five years** if it satisfies the definition of "new build land"
- on or after 29 March 2018 but before 27 March 2021 – a disposal of the land by the transferee within **five years** of their bright-line start date is taxable under section CZ 39
- before 29 March 2018 – a disposal of the land by the transferee is **not subject to any bright-line test**. This includes if the transferor first acquired the land on or after 1 October 2015, meaning the transferor's bright-line period was the original two-year bright-line test.

Determination of transferor's net income and transferee's cost base

If the above requirements are met for either a transfer to or from a rollover trust, new sections FC 9B and FC 9C provide that the transfer is treated as being for the greater of:

- the total cost of the residential land to the transferor, or
- the amount of any consideration provided by the transferee.

This applies for calculating both the transferor's net income arising from the disposal under the bright-line test (see section FC 9B(a) and (b)) and the transferee's cost base and thus their net income arising under the bright-line test from a future disposal of the land (see section FC 9C).

This means if the amount of consideration for the transfer is less than or equal to the cost of the land to the transferor (in other words, the original owner has not realised a gain), the transfer is deemed to be for the transferor's cost – thus, full rollover relief applies.

If the amount of consideration exceeds the cost of the land to the transferor (in other words, the original owner has realised a gain even if it is not a full market value profit), then only partial relief applies. In this case, the transfer is treated as being for the amount of consideration provided. This overrides existing section GC 1 so that the transfer is not deemed to be for the market value of the land at the time of the transfer. In other words, the transferor is only taxed on the actual profit realised on the sale of the land, and the transferee's cost base is what they paid for the land.

25 Unless the original two-year bright-line period applied to the transferor because they first acquired the land on or after 1 October 2015 but before 29 March 2018, in which case the transferee will not be subject to any bright-line test at all.

Example 84: Settlement on family trust – full rollover relief applies

Married couple Sunita and Ronald purchase residential land in their own names for $1 million on 9 November 2021. On 20 July 2023 Sunita and Ronald decide to settle the land on a trust with Sunita's sister and her sister's spouse as the trustees. Sunita, Ronald and their children are beneficiaries of the trust. The only property settled on the trust is the residential land and the trustees provide consideration of $1 million (even though, in that intervening period, the market value of the property has increased to $1.2 million). The trustees then sell the residential land for $1.7 million on 31 January 2027.

Sunita and Ronald are both beneficiaries of the trust. Sunita and Ronald are also both principal settlors, given the trust has no other property and Sunita and Ronald have each made the greatest equal settlements. Sunita and Ronald are associated through marriage, and both non-settlor beneficiaries (their two children) are associated with a principal settlor (in this case, both Sunita and Ronald) within the required four degrees of blood relationship (being within one degree of blood relationship). This means they satisfy the requirements of new section CB 6AB.

Full rollover relief applies, as the consideration paid by the trustees to Ronald and Sunita is equal to the price they originally paid for the property. Sunita and Ronald are not subject to tax under the bright-line test on the disposal of their residential land to the trustees of their family trust on 20 July 2023. This is because they are treated as disposing of the land at cost, which means their net income arising under the bright-line test is zero.

The trustees are deemed to have a bright-line start date of 9 November 2021 for the residential land (being Sunita and Ronald's bright-line start date for the land) and a cost base of $1 million. The trustees' bright-line period ends on 31 January 2027 when the land is sold for $1.7 million. As this is within the 10-year period for the bright-line test (9 November 2021 to 8 November 2031), the sale is subject to income tax under the bright-line test. Ignoring other income tax deductions, the trustees have net bright-line income of $700,000.

Example 85: Sale from settlor to trust – partial relief applies

Neo acquired residential land on 3 March 2017 for $500,000. On 29 October 2022, Neo sells the residential land to his family trust. Neo is the principal settlor of the trust, and he and his son, Archie, are the beneficiaries. Neo's outstanding mortgage is $400,000. The trustee provides consideration of $600,000 which is less than the market value of the land, being around $800,000 at that time.

Neo is subject to the two-year bright-line test for the land.[26] The sale to the trust is a disposal under the bright-line test, but there is no tax liability under the bright-line test because Neo held the land for more than two years.

Partial relief applies to ensure the bright-line clock is not restarted, meaning the trustee takes on Neo's bright-line start date of 3 March 2017 but not Neo's acquisition cost of $500,000. The trustee's cost base is instead the amount of consideration it provided, being $600,000.

Example 86: Transfer from family trust to LTC – partial relief applies

Melissa owns 100 percent of the shares in Mel Co, a look-through company. Melissa is also the principal settlor and a beneficiary of the Melissa Family Trust. All the other beneficiaries of the Melissa Family Trust, aside from her husband, Dan, are associated with Melissa within four degrees of blood relationship, being her parents and her and Dan's children.

Melissa purchased an investment property in 2012 for $250,000 and sold it to Mel Co the following year on 6 April 2013 for $275,000.

In October 2022, Mel Co sells the property to the Melissa Family Trust for $700,000. Melissa does not pay tax under the bright-line test in her capacity as shareholder of Mel Co, as the land was acquired by the company before the introduction of the original two-year bright-line test.

Partial relief applies to the transfer of the property from Mel Co to the Melissa Family Trust. This means the transfer does not reset the start of the bright-line period for the Melissa Family Trust.

26 The two-year bright-line test applied to residential land acquired between 1 October 2015 and 28 March 2018.

Application of land-rich trust anti-avoidance rule

After a transfer of residential land that qualifies for relief is made to a trust, if new beneficiaries are added with the purpose of defeating the bright-line test, the land-rich trust anti-avoidance rule in existing section GB 53 applies to reverse the relief by deeming the transferee to have disposed of the land at market value.

Disposals from trusts to beneficiaries

The relief provided by new section CB 6AB does not cover disposals from trustees to beneficiaries that are not also settlors. Disposals of residential land from the trustee to a beneficiary within the relevant bright-line period for the trustee may still be subject to the bright-line test and may produce income for the trustee.

Māori family trust rule

Rollover relief is provided for transfers of residential land on or after 1 April 2022 that is subject to Te Ture Whenua Māori Act 1993 in certain situations. This recognises that land subject to Te Ture Whenua Māori Act 1993 has alienation restrictions that lead to interests in land being passed from generation to generation. These interests are often fragmented and can result in a large number of owners all belonging to the same iwi or hapū or who are all descendants of the same tīpuna.

Transfers to Māori family trusts

Section CB 6AC(1)(a) provides that if a Māori trustee holds residential land subject to Te Ture Whenua Māori Act 1993 on a Māori rollover trust, the bright-line start date for the land, when the trustee disposes of it, is the bright-line start date the transferor (or transferors) had for the land. This applies if:

- the transferors are settlors of the trust, and
- at the time they transfer the land to the trustee, they are also beneficiaries of the trust.

"Māori rollover trust" is defined in section CB 6AC(4) to mean, at the time of a relevant transfer to or from a relevant trust:

- all beneficiaries of the trust are either members of the same iwi or hapū or descendants of the same tīpuna (living or dead), and
- the land being transferred is subject to Te Ture Whenua Māori Act 1993.

Section CB 6AC(5) defines "Māori trustee" as a trustee of a trust that is either a Māori authority or eligible to elect to be a Māori authority.

Transfers from Māori family trusts

Section CB 6AB(2) provides for rollover relief in certain circumstances when residential land is transferred by the Māori trustee of a Māori rollover trust back to the settlors who originally transferred the land to the trust (referred to as "the transferees"). If rollover relief applies, the transferees' bright-line start date for the land when they dispose of it is the bright-line start date the Māori trustee had. Rollover relief applies if the Māori trustee transfers the land to the transferees on or after 1 April 2022 and:

- the transferees are settlors of the trust, and
- the transferees acquire proportionally the same amount of land they had transferred to the Māori trustee and, at the time the Māori trustee transfers the land to the transferees:
  - the transferees are beneficiaries of the trust
  - the trust is a Māori rollover trust, and
  - the transferees are settlors of the trust.

Example 87: Transfer from trustee of Māori family trust back to the settlors of the trust

Before August 2010, John and several members of his extended whānau, who are all members of the same iwi, held interests in a parcel of residential land subject to Te Ture Whenua Māori Act 1993. In August 2010, John and members of his whānau sold their interests in the land to a trust that was settled by John and his sister, Mere, for $5 million. John, Mere and the rest of the whānau that held interests in the land were at this time beneficiaries of the trust (and still are).

On 28 May 2022, the trustees of the trust sell the interests in the land back to members of the whānau for the $5 million the trustees originally paid for the land. The market value of the land at this time is $10 million.

In the absence of relief, John, Mere and the rest of the whānau who purchased their interests in the land back from the trust would have a bright-line start date of 28 May 2022. However, because the transfer was made at cost, rollover relief applies. This means the whānau who purchased their interests back have a deemed bright-line start date of August 2010, being the transferors' bright-line start date (that is, when the land was transferred to the trustees of the trust), with a total cost base in the land of $5 million (being the total cost of the interests in the land to the trustees). In other words, the bright-line clock is not reset for John and Mere and their fellow interest holders who repurchased their interests in May 2022. As their bright-line start date is August 2010, a future disposal by the interest holders will not be subject to the bright-line test.

Transfers to or from different capacity (LTCs, partnerships)

Relief may also apply in certain cases under section CB 6AC when:

- residential land is transferred from an LTC or partnership to a Māori rollover trust or vice versa, where a person may be a settlor of the trust in a different capacity to the capacity in which they are a beneficiary, or
- a person receives land back from a Māori rollover trust they originally transferred the land to, but in a different capacity to the capacity in which they previously held it.

Section CB 6AC(3) provides that, for the purposes of applying subsection (1)(a) (where a person transfers residential land to a Māori rollover trust) or subsection (2) (where a person receives residential land back from a Māori rollover trust), the transferors and transferees may have different capacities in relation to the different criteria in those provisions. For example, a transferee may be a settlor of the trust in their personal capacity and be a beneficiary as an LTC owner, or they may have transferred the land to the trust in their personal capacity and acquire it back from the trust as a partner in a partnership.

Resettlements of Māori family trusts

Section CB 6AC(1)(b) provides rollover relief when residential land that is subject to Te Ture Whenua Māori Act 1993 and which is held on a Māori rollover trust is resettled on another Māori rollover trust.

Under this section, the bright-line start date of the Māori trustee of the resettled trust is the bright-line start date the Māori trustee of the first trust had, if the Māori trustee of the first trust transfers residential land to the resettled trust on or after 1 April 2022. This applies if all the beneficiaries of the resettled trust are the same as for the first trust. As with the rule for general family trusts, this includes the situation where one of the settlors of the first trust is deceased.

Disposals from trusts to beneficiaries

Similar to section CB 6AB for general family trusts, the relief provided by new section CB 6AC for transfers to or from certain Māori trusts does not cover disposals from trustees to beneficiaries that are not also settlors. Disposals of residential land from the trustee to a beneficiary within the relevant bright-line period for the trustee may still be subject to the bright-line test and may produce income to the trustee.

Determining which bright-line test applies

Section CB 6A(1AB)(b) provides that the ten-year bright-line test (and the five-year bright-line test for new build land) in section CB 6A does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AC, and the transferor first acquired an estate or interest in the land before 27 March 2021. Section CZ 39(1B) similarly provides that the five-year bright-line test in section CZ 39 does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AC, and the transferor first acquired an estate or interest in the land before 29 March 2018.

These provisions ensure that if rollover relief applies to a transfer under section CB 6AC, the receiving Māori trustee (if the transfer is from a settlor to a Māori rollover trust, or a resettlement of a Māori rollover trust) or receiving settlor (if the transfer is from a Māori rollover trust to a settlor) has the same bright-line test length as the transferor.[27] The start date the bright-line "clock" runs from is the bright-line start date the transferor had, as per section CB 6AC(1) or (2) (whichever applies).

In other words, if the transferor first acquired the land:

- on or after 27 March 2021 – a disposal of the land by the transferee within **ten years** of their bright-line start date is taxable under section CB 6A, or within **five years** if it satisfies the definition of "new build land"
- on or after 29 March 2018 but before 27 March 2021 – a disposal of the land by the transferee within **five years** of their bright-line start date is taxable under section CZ 39
- before 29 March 2018 – a disposal of the land by the transferee is **not subject to any bright-line test**. This includes if the transferor first acquired the land on or after 1 October 2015, meaning the transferor's bright-line period was the original two-year bright-line test.

Determination of transferor's net income and transferee's cost base

If the above requirements are met for either a transfer to or from a Māori rollover trust, new sections FC 9B and FC 9C provide that the transfer is treated as being for the greater of:

- the total cost of the residential land to the transferor, and
- the amount of any consideration provided by the transferee.

This applies for calculating both the transferor's net income arising from the disposal under the bright-line test (see section FC 9B(d) and (e)) and the transferee's cost base and thus their net income arising under the bright-line test from a future disposal of the land (see section FC 9C).

This means if the amount of consideration is less than or equal to what the transferor originally paid (in other words, the original owner has not realised a gain), the transfer is deemed to be for the transferor's cost – thus, full rollover relief applies.

If the amount of consideration exceeds the cost of the land to the transferor (that is, the transferor has realised a gain, even if it is not a full market value profit), then only partial relief applies. In this case, the transfer is treated as being for the amount of consideration provided. In other words, the transferor is only taxed on the actual profit realised on the sale of the land to the transferee, and the transferee's cost base is what they paid for the land.

Transfers of residential land as part of a settlement under te Tiriti o Waitangi

Settlements of claims under te Tiriti o Waitangi – The Treaty of Waitangi (te Tiriti) can be a multi-stage process. The Crown will transfer Tiriti settlement property to a single governance entity (post-settlement governance entity or PSGE) that may act on behalf of several groups, for example, different hapū, or as a collective for a number of iwi groups. The PSGE will then transfer settlement assets to different members of the claimant group as required under the deed of settlement or settlement legislation.

This transfer from the PSGE to a member of the claimant group could be subject to income tax under the bright-line test for the PSGE. It could also start the bright-line clock for the member to whom the residential land has been transferred. The transfer of residential land from the PSGE to a claimant group member was less likely to trigger the bright-line test under the previous two-year and five-year tests. However, with the extension of the test to ten years, this could become an impediment for iwi to transact efficiently with settlement assets involving residential land.

Section CB 6AE applies when residential land that is subject to Te Ture Whenua Māori Act 1993 and is part of the settlement of a claim under te Tiriti is transferred to a trustee of a trust who:

- is a Māori authority, or is eligible to be a Māori authority, and
- on behalf of Māori claimants, receives and manages assets that are transferred by the Crown as part of the settlement of a claim under te Tiriti, in accordance with the requirements of existing section HF 2(3)(e)(i).

This is to provide rollover relief for the transfer of Tiriti settlement residential land from the PSGE to a member of the claimant group, for example, hapū.

New section CB 6AE(2) provides that the recipient trustee has the transferor's bright-line start date.

27 Unless the original two-year bright-line period applied to the transferor because they first acquired the land on or after 1 October 2015 but before 29 March 2018, in which case the transferee will not be subject to any bright-line test at all.

Determining which bright-line test applies

Section CB 6A(1AB)(b) provides that the ten-year bright-line test in section CB 6A (and the five-year bright-line test for new build land) does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AE, and the transferor first acquired an estate or interest in the land before 27 March 2021. Section CZ 39(1B) similarly provides that the five-year bright-line test in section CZ 39 does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AE, and the transferor first acquired an estate or interest in the land before 29 March 2018.

These provisions ensure that if rollover relief applies to a transfer under section CB 6AE, the recipient trustee has the same bright-line test length as the PSGE.[28] As outlined above, the relevant start date the bright-line "clock" runs from is the bright-line start date the PSGE had, as per section CB 6AE(2).

In other words, if the PSGE first acquired the land:

- on or after 27 March 2021 – a disposal of the land by the trustee within **ten years** of their bright-line start date is taxable under section CB 6A, or within **five years** if it satisfies the definition of "new build land"
- on or after 29 March 2018 but before 27 March 2021 – a disposal of the land by the trustee within **five years** of their bright-line start date is taxable under section CZ 39
- before 29 March 2018 – a disposal of the land by the trustee is **not subject to any bright-line test**. This includes if the PSGE first acquired the land on or after 1 October 2015, meaning the PSGE's bright-line period was the original two-year bright-line test.

Determination of transferor's net income and transferee's cost base

If the above requirements are met for the transfer of Tiriti settlement residential land, new section FC 9D sets out that the recipient trustee is deemed for the purposes of the bright-line test to have acquired the land for its market value at the time the land was transferred by the Crown. It may not be feasible to determine the market value at the exact time of the settlement – a reasonable estimate shortly thereafter (for example, determined for insurance purposes) would be acceptable.

Section FC 9B(f) provides that the transferor (the PSGE) is treated as disposing of the land for the greater of its cost to the PSGE or the amount of consideration received (if any) from the member of the claimant group to whom they transfer the land.

Transfers by or to persons in their capacity as LTC owners or partners in a partnership

Shareholders in LTCs are treated as directly holding the LTCs' assets, deriving income, and incurring expenses in accordance with their shareholding percentage. In effect, LTCs are transparent for tax purposes, which means the income tax consequences for someone who holds residential land through an LTC are generally the same as for someone who holds residential land directly. Nonetheless, the process of transferring residential land from an individual shareholder into the LTC (or vice versa) currently constitutes a bright-line disposal and acquisition.

Partnerships are also transparent for tax purposes. Equally, the process of transferring residential land from an individual partner to the partnership (or vice versa) constitutes a bright-line disposal and acquisition.

Relief applies under new section CB 6AB(4) if a person, in one capacity (such as their personal individual capacity), transfers residential land to themselves in a different capacity (such as a shareholder in an LTC or a partner in a partnership). The section provides that the person's bright-line start date for the land when they ultimately dispose of it to a third party is the bright-line start date they first had for the land.

This applies to the extent a person transferring the land to themselves in another capacity has the same ownership interest in the land before and after the transfer. It is also intended to apply when residential land is transferred from an LTC to another LTC with identical shareholding (meaning the two LTCs have the exact same owners who each hold the exact same proportion of shares in the second LTC as they hold in the first LTC).

Determining which bright-line test applies

Section CB 6A(1AB)(b) provides that the ten-year bright-line test in section CB 6A (and the five-year bright-line test for new build land) does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, and the transferor first acquired an estate or interest in the land before 27 March 2021. Section CZ 39(1B) similarly provides that

28 Unless the original two-year bright-line period applied to the transferor because they first acquired the land on or after 1 October 2015 but before 29 March 2018, in which case the transferee will not be subject to any bright-line test at all.

the five-year bright-line test in section CZ 39 does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, and the transferor first acquired an estate or interest in the land before 29 March 2018.

These provisions ensure that if rollover relief applies to a transfer under section CB 6AB(4), the transferee (having a person receiving a land transfer in one capacity that they made, in a different capacity, to themselves) has the same bright-line text length as the transferor.[29] The relevant start date the bright-line "clock" runs from is the bright-line start date the person first had for the land (in the capacity in which they originally held it) as per section CB 6AB(4).

In other words, if the person first acquired the land:

- on or after 27 March 2021 – a subsequent disposal of the land (that is, **after** the transfer of the land to themselves in a different capacity) within **ten years** of their bright-line start date is taxable under section CB 6A, or within **five years** if it satisfies the definition of "new build land"
- on or after 29 March 2018 but before 27 March 2021 – a subsequent disposal of the land (after the transfer of the land to themselves in a different capacity) within **five years** of their bright-line start date is taxable under section CZ 39
- before 29 March 2018 – a subsequent disposal of the land (after the transfer of the land to themselves in a different capacity) is **not subject to any bright-line test**. This includes if the person first acquired the land on or after 1 October 2015, meaning their original bright-line period (before transferring the land to themselves in a different capacity) was the original two-year bright-line test.

Determination of transferor's net income and transferee's cost base

If the above requirements are met for a person's transfer of residential land to themselves in a different capacity, new sections FC 9B and FC 9C provide that the transfer is treated as being for the greater of:

- the total cost of the residential land to the transferor, and
- the amount of any consideration provided by the transferee.

This applies for calculating both the transferor's net income arising from the disposal under the bright-line test (see section FC 9B(c)) and the transferee's cost base and thus their net income arising under the bright-line test from a future disposal of the land (see section FC 9C).

This means if the amount of consideration is less than or equal to the cost of the land to the transferor (or in other words, the original owner has not realised a gain), the transfer is deemed to be for the transferor's cost – thus, full rollover relief applies.

If the amount of consideration exceeds the cost of the land to the transferor (that is, a partial gain has been realised, even if it is not a full market value profit), then only partial relief applies. In this case, the transfer is treated as being for the amount of consideration provided. In other words, the transferor is only taxed on the actual profit realised on the sale of the land, and the transferee's cost base is what they paid for the land.

Inherited property transferred to rollover person

A beneficiary of a deceased person's estate may transfer inherited residential land to a person qualifying for rollover relief (referred to here as a "rollover person"), such as an LTC owned by the beneficiary or a rollover trust. A special rule in section FC 9(4) applies in this circumstance to ensure the exemption from the bright-line test for inherited property applies to the rollover person if it disposes of the land.

Pre-existing rules (which in their earliest form date back to when the original two-year bright-line test was introduced in October 2015) provide that the disposal of inherited residential land is not taxable under the bright-line test. Under section FC 9, the transfer of such land on the death of a person to an executor or administrator of the deceased's estate, as well as the transfer of the land to a beneficiary of the estate, is exempt from the bright-line test. Sections CB 6A(2B) and CZ 39(7) provide that a subsequent disposal of the property by the beneficiary is also not taxable under either the ten-year or five-year bright-line test.

Section FC 9(4) provides that if residential land is transferred by a beneficiary of the deceased person on or after 1 April 2022 to a person who is a recipient as described in section FC 9B(a) to (e), and the person disposes of it, sections CB 6A and CZ 39 do not apply to the disposal. This ensures when a beneficiary of an estate transfers inherited residential land to a rollover person (such as a rollover trust the estate beneficiary is a settlor and beneficiary of), the beneficiary's exemption from the bright-line test for the inherited land is "rolled over".

29 Unless the original two-year bright-line period applied to the transferor because they first acquired the land on or after 1 October 2015 but before 29 March 2018, in which case the transferee will not be subject to any bright-line test at all.

Transfers between companies within a wholly-owned tax consolidated group

Rollover relief also applies to transfers of residential land within a wholly-owned group of companies that is a consolidated group under subpart FM. Section FM 15(2B) provides that the recipient company (company B) is treated as having the same bright-line start date for that transferred land as the transferor company (company A). This ensures the transfer to company B does not reset the bright-line clock.

The restriction of relief to tax-consolidated groups effectively limits the rollover relief to New Zealand resident companies, as non-residents cannot be part of a consolidated group. Similar to the pre-existing rollover rule for company amalgamations in section FO 17(3), this ensures relief is only available on the condition the property remains within the New Zealand tax base.

Example 88: Transfer within consolidated group

First Co and Second Co are companies that are both members of the same wholly-owned group of companies, of which all the members are New Zealand resident companies. The group is a consolidated group under subpart FM of the Income Tax Act 2007.

First Co acquired residential rental property in the form of an apartment complex in central Hamilton on 12 January 2019 for $15 million. On 23 May 2022, First Co transfers the property to Second Co for $20 million.

Under the consolidation rules, income does not arise to First Co under the bright-line test. However, in the absence of relief, the bright-line clock would reset on the transfer of the property to Second Co.

Relief applies to the transfer, meaning Second Co. is treated as having a bright-line start date for the property of 12 January 2019.

Changes in co-ownership of residential land

Sections CB 6A(1AB)(a), (5B), (5C) and (5D), and CZ 39(5B), (5C) and (5D)

Recent amendments to the Income Tax Act 2007 (ITA) clarify the bright-line test tax implications of changes in co-ownership of residential land. A further amendment clarifies which bright-line test applies to shares in residential land that a person acquires at different times.

Background

The bright-line test provides that income from the disposal of residential land is taxable when the disposal is within five or 10 years of the instrument of title being registered under the Land Transfer Act 2017,[30] depending on when the land was first acquired.

The bright-line test was originally introduced as a two-year test. The two-year bright-line period applied for residential land acquired on or after 1 October 2015 and up to 28 March 2018. A five-year test applies for residential land acquired on or after 29 March 2018 and up to 26 March 2021. The 10-year bright-line test generally applies to residential land acquired on or after 27 March 2021, although a shorter test of five years applies if the residential land qualifies as "new build land".

When there is a change to the shares that co-owners have in residential land, or where a co-owner is added or removed, the disposal of the share that changes hands may be subject to tax under the bright-line test. The start of the bright-line period should reset only for the ownership share that has changed hands. Similarly, when a joint tenancy is converted to a tenancy in common or vice versa, the start of the bright-line period should only reset to the extent that the co-owners' proportional ownership shares (or nominal shares) in the land have changed. Provisions to clarify this were enacted in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, but they contained a number of wording inaccuracies and ambiguities.

There was also a transitional issue relating to which bright-line test applied and whether different tests applied to shares a person acquired at different times. The application provisions for the earlier two-year and five-year tests provide that they apply when someone first acquires an interest in residential land on or after 1 October 2015 and 29 March 2018 respectively. However, the application provision for the 10-year test omitted the word "first".

30 In some cases, a different start date may apply.

Key features

The following remedial amendments have been made to the bright-line rules in sections CB 6A and CZ 39:

- In the provisions concerning changes to the form of co-ownership of residential land, the former references to a joint tenancy or tenancy in common being "acquired" have been amended to refer to the form of tenancy being "converted". This better reflects that the provisions are concerned with changes to the form of co-ownership rather than the acquisition of land.
- Clarifications have been made to the provisions concerning changes in co-ownership proportions of residential land, including amendments to:
  - clarify that a person's bright-line start date does not change for any ownership interest or "share" that has not changed hands, and
  - improve the wording of the provisions so that it is clearer what land is specifically being referred to and what the purpose of the provisions is.
- Amendments also clarify that, when a person disposes of land, the bright-line test length and associated settings that apply depend on when the person first acquired an interest in the land. If they acquired an interest in residential land before 27 March 2021 and then acquired an additional interest or share in the land after that date, when the land is sold it all falls into the bright-line test length (and associated settings) that applied at the time they acquired their first interest in the land being sold.

Effective date

The amendments to section CB 6A for the 10-year bright-line test take effect on and after 27 March 2021. The amendments to section CZ 39 for the five-year bright-line test take effect on and after 29 March 2018.

Detailed analysis

Changes in the form of co-ownership (sections CB 6A(5B), (5C), CZ 39(5B) and (5C))

Under a joint tenancy, co-owners do not have defined shares in the property. However, when considering how the bright-line test applies to conversions between joint tenancy and tenancy in common, joint tenants are seen as equal co-owners. For example, for two co-owners of a property held under a joint tenancy, each co-owner is considered to hold a notional 50 percent, and for four co-owners, each is considered to hold a notional 25 percent.

While the registration of a transfer instrument to effect a change in the **form** of co-ownership of land should not be considered a disposal for the bright-line test, registration of a transfer instrument under the Land Transfer Act 2017 sets the start date of the bright-line period.[31] As such, a question arose as to whether the registration of a transfer instrument to change the form of co-ownership of a parcel of land would reset the bright-line "clock", meaning the bright-line period would start again from that point.

Sections CB 6A(5B) and (5C), and CZ 39(5B) and (5C) of the ITA were introduced by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022. These provisions are intended to clarify that the bright-line clock is not reset when a transfer instrument is registered to effect a change in the form of co-ownership of land to the extent the economic ownership of the land has not changed.

Sections CB 6A(5B) and CZ 39(5B) apply when a joint tenancy is converted to a tenancy in common, while sections CB 6A(5C) and CZ 39(5C) apply in the reverse situation when a tenancy in common is converted to a joint tenancy. The intent of these provisions is to clarify that the bright-line start date of residential land held under a tenancy in common or joint tenancy is not impacted by a change to a different form of co-ownership. However, the provisions previously stated that the bright-line start date was the date the joint tenancy[32] or the tenancy in common in equal shares[33] was "acquired", which was not technically correct. Consistent with IS 22/03, those forms of co-ownership are not things that can be owned (and, therefore, acquired), so it is more accurate to refer to the date the form of co-ownership is changed. Amendments have been made to the provisions to replace the references to the date the tenancy was "acquired" with references to the date the tenancy was "converted".

31 For further information, see IS 22/03 "Income Tax – Application of the land sale rules to co-ownership changes and changes of trustees" available at https://www.taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-03.

32 In the case of a conversion from a joint tenancy to a tenancy in common – see section CB 6A(5B).

33 In the case of a conversion from a tenancy in common to a joint tenancy – see section CB 6A(5C).

The provisions also previously referred to the bright-line start date ("bright line acquisition date" in the legislation, which is when the bright-line "clock" starts running) being the date the tenancy in common or joint tenancy (as appropriate) was acquired. However, the date the bright-line clock should run from is whatever date it ran from before the change to the form of co-ownership. This will typically be the date the land was originally transferred to the co-owners, not the date the land was originally "acquired" (which is typically when a sale and purchase agreement was entered into).

Conversion from joint tenancy to tenancy in common

New section CB 6A(5B) provides that, when a joint tenancy is converted to a tenancy in common, the bright-line start date for the definitions of "10-year test land" and "5-year test land" is the same as it was before the conversion.

Section CZ 39(5B) applies for the purposes of the five-year bright-line test (which applies to disposals of residential land first acquired on or after 29 March 2018) when a joint tenancy is converted to a tenancy in common. Amended section CZ 39(5B) provides that an amount that a person derives from disposing of the land after the conversion is income of the person if the disposal date is within five years of the date that was the person's bright-line start date for the land before the conversion. In other words, the conversion does not reset the person's bright-line start date.

Example 89: Change from a joint tenancy to a tenancy in common

Tony and Greta started a relationship in 2015. Both have children from previous relationships. In 2019, Tony and Greta purchased a rental property together as joint tenants. Two years later, they decide that, in the event of one of them dying, they want the share of the partner who dies to go to that partner's children. In June 2021, LINZ registered their land transfer to change their ownership of the property from a joint tenancy to a tenancy in common (50:50).

For the bright-line test to apply, there must have been a disposal of residential land by Tony and/or Greta. In this case, there has not been a disposal of land by either of them.

Tony and Greta own the same land (the estate in fee simple) before and after the transfer. Before the transfer, they each had an interest in the whole of the property and a notional equal separate share (that is, 50 percent) they had the right to sever during their lifetime. After the transfer, they each still have an interest in the whole of the property, and they each now have a present entitlement to a 50 percent share. No land has passed from one party to another.

The bright-line start date is **not** reset in June 2021 when LINZ registered the transfer to change the form of co-ownership of the property. Tony and Greta's bright-line period starts on the date in 2019 when the property was originally transferred to Tony and Greta.

Conversion from tenancy in common to joint tenancy

New section CB 6A(5C) provides that, when a tenancy in common is converted to a joint tenancy, the bright-line start date for the definitions of "10-year test land" and "5-year test land" is the same as it was before the conversion.

Section CZ 39(5C) applies for the purposes of the five-year bright-line test when a tenancy in common is converted to a joint tenancy. Amended section CZ 39(5C) provides that an amount that a person derives from disposing of the land after the conversion is income of the person if the disposal date is within five years of the date that was the person's bright-line start date for the land before the conversion. As in the case of the other amendments, this ensures the conversion does not effectively reset the person's bright-line start date.

Changes in co-ownership proportions (sections CB 6A(5D) and CZ 39(5D))

When a share in residential land is disposed of, the disposal of that share may be subject to tax under the bright-line test. The bright-line clock should reset only for the ownership share that has changed hands (despite the fact the registration of the transfer instrument may effect a transfer of the whole of the land from the parties to themselves in different proportions). For example, if co-ownership shares held by two people change from 50:50 to 25:75, the bright-line clock should reset only for the 25 percent share transferred.

Sections CB 6A(5D) and CZ 39(5D) were enacted in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to clarify that the bright-line clock is reset only for the newly acquired share when there is a change in ownership proportions. Remedial amendments have been made to clarify the wording of the provisions and ensure they operate as intended.

The amended provisions apply when a person who owns land (referred to as "pre-existing land") has more land transferred to them (the "transfer land") or transfers part of their pre-existing land (also the "transfer land"). For the purposes of the definition of "bright-line acquisition date" (being the person's bright-line start date), the instrument of transfer for the transfer land is for the transfer land only and is treated as not being for the pre-existing land. In other words, when there is a change in co-ownership proportions, the bright-line clock resets only for the ownership share that changes hands, in line with the original policy intention.

Example 90: Change in the proportional share of co-owners who are tenants in common

In July 2018, Sarah and Hans bought a rental property as 50:50 owners. Sarah's financial position changes in 2021, and so she asks Hans if he is interested in buying out her share of the property. He is keen to do this, so he buys Sarah's 50 percent share at market value. LINZ registers the transfer in December 2021, and the register shows that the land is now held solely by Hans. This means that, for the bright-line test, Sarah has disposed of a 50 percent share in the land. The amount that Sarah sold the 50 percent share to Hans for is income to Sarah under the bright-line test, as the disposal was within the relevant bright-line period (five years). Sarah can deduct the amount she paid for her original 50 percent share of the property.

The bright-line start date for the 50 percent share Hans has purchased from Sarah is the date in December 2021 that the 50 percent share was transferred to him. However, Hans' bright-line start date is **not** reset to December 2021 in relation to his original 50 percent share – it remains as July 2018.

Relevant bright-line period (section CB 6A(1AB)(a))

New section CB 6A(1AB)(a) provides that the 10-year bright-line test (section CB 6A) does not apply to land if the person first acquired an estate or interest in the land before 27 March 2021. This ensures that, if a person acquires a part share in residential land before 27 March 2021 and subsequently acquires an additional share in the same land on or after 27 March 2021, when the land is sold it all falls into the bright-line test length and associated settings that applied at the time they acquired their first interest in the land.

Example 91: Part share acquired in 2018 and additional share acquired in December 2021

Consider Hans in example X. Hans started with a 50 percent share in a rental property in 2018 and subsequently acquired the other 50 percent share in the property in December 2021.

When Hans eventually sells the rental property, the disposal is subject to the five-year bright line test – being the relevant bright-line test that applies if the owner first acquired an estate or interest in the residential land between (and including) 29 March 2018 and 26 March 2021. Note, however, that Hans has a July 2018 bright-line start date for 50 percent of the land but a December 2021 bright-line start date for the 50 percent share acquired that month. Therefore, if Hans sells the rental property before the relevant date in December 2026, 50 percent of the amount from the sale would be income under the bright-line test.

Updates to definitions used for interest limitation rules and the bright-line test

Sections CB 16A, DD 11, and YA 1 of the Income Tax Act 2007

The amendments update the definitions of "business premises", "principal settlor" and "settlement", which are used for the bright-line test and the interest limitation rules.

Background

The Taxation (Annual Rates for 2020—21, Feasibility Expenditure, and Remedial Matters) Act 2021 and the Taxation (Annual Rates for 2021—22, GST, and Remedial Matters) Act 2022 introduced several changes to the way residential property is taxed in New Zealand. This included changes to the bright-line test and the introduction of the interest limitation rules.

Many existing defined terms were used, but in some situations the corresponding definitions were not updated. In addition, when a term is used for more than one regime, it is considered appropriate to define the term in section YA 1 of the Income Tax Act 2007 (ITA) rather than within the regime for which it was first used.

Key features

The amendments update the following defined terms to better reflect their relevance for the interest limitation rules and bright-line test:

- business premises,
- principal settlor, and
- settlement.

Effective date

The amendments took effect on 27 March 2021.

Detailed analysis

Business premises

The interest limitation rules in subpart DH of the ITA do not apply to the extent disallowed residential property is used as business premises. However, the section YA 1 definition of "business premises" states it "is defined in section DD 11 (Some definitions) for the purposes of subpart DD (Entertainment expenditure) and the land sales provisions". "Land sales provisions" is defined in section EL 3 only for the purposes of subpart EL and comprises sections CB 6A to CB 15 and CZ 39.

The definition of "business premises" in section DD 11 has been repealed and relocated to section YA 1. The updated definition in section YA 1 applies for the purposes of subpart DD and DH, as well as sections CB 6A to CB 15 and CZ 39.

Principal settlor

The term "principal settlor" is relevant when determining whether rollover relief is available for the interest limitation rules and the bright-line test in certain family trust situations. It is also used to determine whether the main home exception applies for the bright-line test and interest limitation rules.

Before the enactment of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, "principal settlor" was defined in section CB 16A(7) and applied for the purposes of section CB 16A, section CZ 40, and subpart EL. The section YA 1 definition of "principal settlor" previously simply referred back to section CB 16A(7).

To account for the broader application of the term, the Taxation (Annual Rates for 2021—22, GST, and Remedial Matters) Act 2022 replicated the section CB 16A(7) definition in section YA 1. However, the definition in section CB 16A(7) was not repealed at the time.

The redundant definition of "principal settlor" in section CB 16A(7) has now been repealed.

Settlement

"Settlement" is defined in section YA 1. Paragraph (c) of that definition provides a specific definition of "settlement" for the definition of "principal settlor" in section CB 16A(7).

In line with the repeal of the definition of "principal settlor" in section CB 16A(7), this reference to section CB 16A(7) in the definition of "settlement" has been removed. Paragraph (c) of the definition of "settlement" continues to apply for the definition of "principal settlor" as defined in section YA 1.

Interposed entities – property excluded from calculation of interposed residential property percentage

Section DH 6 of the Income Tax Act 2007

The amendment ensures that all disallowed residential property (DRP) that is excluded from the interest limitation rules is also excluded from the calculation of the interposed residential property (IRP) percentage of an interposed residential property holder (IRPH).

NEW LEGISLATION

Background

The interposed entity rules support the integrity of the interest limitation rules in subpart DH of the Income Tax Act 2007. The rules deny interest deductions for taxpayers who indirectly hold DRP through an IRPH and borrow money to acquire ownership interests in, or become a beneficiary of, the IRPH. An IRPH is a company or trust that has DRP as a percentage of its total assets that exceeds a specified percentage. The rules deny interest deductions for a person based on the IRP percentage of the IRPH.

Section DH 6 contains the rules for calculating the IRP percentage of an IRPH. Section DH 6(1) sets out the following formula to calculate the IRP percentage:

disqualified assets ÷ total assets.

Section DH 6(2) defines the items used in the formula. Section DH 6(2)(a) provides that "disqualified assets" is the value of the IRPH's DRP. Section DH 6(2)(a)(i) excludes from "disqualified assets" property described in sections DH 4(1) to (3).

Sections DH 4(1) to (5) provide subpart DH does not apply to interest incurred in relation to the land described in those sections, and section DH 4(6) provides that subpart DH does not apply to Kāinga Ora–Homes and Communities and its wholly-owned subsidiaries.

However, while property described in sections DH 4(1) to (3) is expressly excluded from "disqualified assets" in section DH 6, property described in sections DH 4(4) to (6) was not. As a result, prior to the enactment of the Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Act 2023 taxpayers who borrowed money to acquire such property through an IRPH would have been denied deductions for interest on the borrowed money. This result was unintended, and the amendment rectifies this.

Key features

The amendment excludes all DRP described in section DH 4 from the definition of "disqualified assets" in section DH 6.

This ensures that DRP that is subject to an exemption is not treated as a "disqualified asset".

Effective date

The amendment took effect on 27 March 2021.

Interposed entities – when DRP is a mixed-use asset

Section DH 6 of the Income Tax Act 2007

The amendment ensures the interposed entity rules apply where disallowed residential property (DRP) is held through a close company by providing that property that is DRP and a mixed-use asset (MuA) is not excluded from the definition of "disqualified assets".

Background

The interposed entity rules support the integrity of the interest limitation rules in subpart DH of the Income Tax Act 2007. They deny interest deductions for taxpayers who indirectly hold DRP through interposed residential property holders (IRPHs) and borrow money to acquire ownership interests in such entities. They work by denying interest deductions based on an IRPH's interposed residential property (IRP) percentage.

The MuA rules in subpart DG deal with the deductibility and apportionment of expenditure incurred in relation to specified types of assets that are used partly for income-earning purposes, partly for private purposes, and not at all for at least 62 days in an income year. This means that DRP, such as a holiday home, can be a MuA.

Section DH 6 contains the rules for calculating the IRP percentage of an IRPH. Section DH 6(1) sets out the following formula to calculate the IRP percentage:

disqualified assets ÷ total assets.

Section DH 6(2) defines the items used in the formula. Section DH 6(2)(a) provides that "disqualified assets" is the value of the IRPH's DRP. Section DH 6(2)(a)(ii) excludes property that is subject to subpart DG from "disqualified assets".

The effect of the exclusion in section DH 6(2)(a)(ii) is that a close company that holds DRP that is a MuA may not be an IRPH. This would occur if, for example, a person borrows to acquire shares in a close company that only holds a holiday home that is DRP, and that holiday home is used for private purposes and to earn income (and is not used for at least 62 days in an income year). In such a case, the MuA rules would allow an apportioned interest deduction based on the time that the holiday home is used to earn income. This result was unintended. The policy intent is that the interest deduction should be fully denied under the interest limitation rules.

The amendment rectifies this.

Denial of deductions on foreign currency loans

Section DH 9 of the Income Tax Act 2007

Section DH 9 of the Income Tax Act 2007 has been repealed as it was redundant.

Background

Section DH 9 previously overrode sections DH 8(2) and (3) to deny all interest deductions on foreign currency loans in two situations.

Phasing out of deductions

Interest on a loan to fund disallowed residential property is denied a deduction under section DH 8(1). However, if the interest is grandparented residential interest, the interest deductions are phased out under section DH 8(2). Section DH 9 provided that, despite section DH 8(2), deductions were denied for all interest on foreign currency loans. This was to ensure that phased-out deductions were not available for foreign currency loans due to the impact of fluctuations in foreign currency rates during the phasing-out period. However, foreign currency loans were already excluded from the application of section DH 8(2) because they cannot generate grandparented residential interest.

Under section DH 5(5) a "grandparented transitional loan means loan amounts denominated in New Zealand dollars…". As a foreign currency loan cannot be denominated in New Zealand dollars, it cannot be a grandparented transitional loan and cannot generate grandparented residential interest. Therefore, the phasing out of deductions in section DH 8(2) cannot apply to a foreign currency loan. It was therefore unnecessary for section DH 9 to override section DH 8(2).

Interposed close companies

Deductions are also denied for interest incurred to acquire an interest in a close company that is an interposed residential property holder. The formula in section DH 8(3) denies a portion of interest incurred by the shareholder in proportion to the amount of disallowed residential property held by the interposed residential property holder. There was no reason for section DH 9 to override this apportionment for a foreign currency loan.

Section DH 9 was therefore redundant so has been repealed.

Effective date

The repeal came into effect on 27 March 2021, the date the provision originally applied from.

Mixed-use asset rules – apportionment of interest for DRP

Sections DG 5 and DG 11 of the Income Tax Act 2007

The amendments correct a minor drafting error to ensure that interest incurred by a person, including a close company, on disallowed residential property (DRP) that is a mixed-use asset (MuA) is apportioned, separately from any other expenditure, under the formula in section DG 9(2) of the Income Tax Act 2007 (ITA).

Background

The MuA rules are in subpart DG of the ITA and apply to natural persons and to close companies. Under the rules, interest incurred by natural persons for a MuA is apportioned between income-earning use, private use, and no use, using the formula in section DG 9(2). Interest incurred by close companies is apportioned under the applicable formula in section DG 11. The rules allow a deduction for the interest apportioned to income-earning use.

The policy intent is that interest incurred by a close company for DRP that is a MuA is to be apportioned using the formula in section DG 9(2) and subject to the interest limitation rules in subpart DH.

The legislation previously did not achieve this intent because interest incurred by a close company for DRP that is a MuA was not subject to the MuA rules. This is because, when the interest limitation rules were enacted, interest incurred by a close company for DRP that is a MuA was removed from apportionment under the applicable formula in section DG 11 and no provision was included for such interest to be apportioned using the formula in section DG 9(2).

Prior to the enactment of the Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Act 2023, the legislation was also not clear that interest incurred for DRP that is a MuA was to be apportioned separately from other expenditure under the formula in section DG 9(2). This is because the definition of the item "expenditure" in section DG 9(3)(a) aggregates all expenditure. Separate apportionment is required because if the apportioned interest is denied under section DH 8, it would have been allowed under section DH 11 on the disposal of the DRP that is a MuA if the amount derived was taxable income.

Key features

The amendments insert new section DG 5(2)(d) and amend existing section DG 11(1)(b) to ensure that a person (being a natural person or a close company) must apportion interest for DRP that is a MuA using the formula in section DG 9(2) and must treat that interest as the item "expenditure" in section DG 9(3)(a).

Effective date

The amendments took effect on 27 March 2021.

Partitioning of land among co-owners

Section CW 3C of the Income Tax Act 2007

The amendment ensures that the allocation of subdivided land among the co-owners of the original undivided land in accordance with their original ownership percentages is exempt income.

Background

Taxpayers sometimes purchase land together as co-owners to pool resources. It is not uncommon in this situation for the co-owners to then subdivide the land and allocate the subdivided parcels to each of the co-owners based on their ownership interests in the original parcel. This is known as partitioning.

Inland Revenue's Tax Counsel Office (TCO) consulted on a draft Interpretation Statement in 2021 that stated that the partitioning of land among co-owners constitutes a disposal under the bright-line test and other land sales provisions.[34]

Section GC 1 of the Income Tax Act 2007 (ITA) deems the partitioning to occur at market value.

Prior to the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 and the introduction of new section CW 3C, an income tax liability could have arisen on partitioning even where there was no effective change in economic ownership or where the person would not have been taxed on the eventual sale of the property (for example, because it was their main home, or they held the property for longer than the bright-line period).

34 PUB00411, "Income tax – Application of the land sale rules to changes to co-ownership, subdivisions, and changes of trustees". The draft has now been finalised as IS 22/03, "Income Tax – Application of the land sale rules to co-ownership changes and changes of trustees".

Example 92: Subdivided land allocated among co-owners – outcome under previous law

Gordon and Elena buy a parcel of residential land as 50:50 co-owners to subdivide into two equal parcels.

The bright-line acquisition date of this parcel of land is 23 July 2022.

The subdivision occurs on 30 November 2022, with Gordon and Elena showing as 50:50 co-owners on each title. When the land is subdivided, Gordon and Elena each legally own 50% of the two parcels.

Together they build two houses, one on each parcel, and split the costs accordingly. On 5 July 2023, one parcel is transferred to Gordon and the other to Elena. Gordon uses the property as his main home, while Elena rents her property out.

On 5 July 2023 when one parcel is allocated to Gordon, Elena has legally disposed of her 50% interest in that parcel to Gordon. When the other parcel is allocated to Elena, Gordon has legally disposed of his 50% interest in that parcel to Elena.

There is no payment between Elena and Gordon for this allocation because the values of the allocated properties align with their ownership of the original parcel of land and the construction costs were split accordingly.

The properties are valued at $1 million each at the time the partition occurs.

The disposals on 5 July 2023 are taxed under the bright-line test at market value. Before costs are deducted, Gordon's bright-line income is $500,000 (arising from his disposal of his 50% share in Elena's allocated property, i.e. 50% of $1 million). Elena's bright-line income is $500,000 (arising from her disposal of her 50% share in Gordon's allocated property, i.e. 50% of $1 million). The main home exclusion does not apply because Gordon did not use Elena's allocated property as his main home and Elena did not use Gordon's allocated property as her main home.

For taxpayers on revenue account who are also taxed on the eventual disposal of the land, this meant two taxing events – the partition or allocation, and the final sale. While section GC 1 of the ITA provides an uplift in the cost base to ensure there is no double taxation of the same income, taxpayers may face additional compliance costs and timing issues if the partition and eventual sale occur in different income years.

Key features

New section CW 3C(1) provides that an amount derived from the partitioning of land among co-owners is exempt income. If the allocated shares after the subdivision do not align with the co-ownership interests in the original parcel, the intention is that only the difference should not be exempt under CW 3C and be taxed where the bright-line test or other land sales rules apply. This is not currently provided for in the new legislation, but it is intended an amendment should be recommended for inclusion in the next available tax bill.

Example 93: Subdivided land allocated among co-owners – outcome under section CW 3C

Taking the same facts from the Gordon and Elena example above, section CW 3C provides that the allocation of the parcels on 5 July 2023 does not result in bright-line income for either Gordon or Elena because section CW 3C exempts the income that would otherwise be calculated under section GC 1 and taxable under section CB 6A.

Section CW 3C(2) intends to provide a small safe harbour where the post-allocation ownership proportions do not exactly line up with the co-ownership proportions of the undivided land. This could arise because of the topography of the land or the design of the units, for example. The intent is that if the difference in allocations is minor – no more than 5% of the smallest co-owner's original share – that difference should be ignored in determining whether section CW 3C(1) applies. If the difference exceeds 5% of the smallest co-owner's original share, the full difference should be taxed. This is not currently provided for in the new legislation, but it is intended an amendment should be recommended for inclusion in the next available tax bill.

Example 94: Allocated shares not proportional to original shares

Shahlaa and Jordan are co-owners of a piece of residential land. Shahlaa holds a 75% share and Jordan holds a 25% share. They subdivide the land into two and allocate the parcels among themselves. However, due to the nature of the land, Shahlaa's parcel equates to 74% and Jordan's 26%. This allocation should be covered by the safe harbour and therefore within scope of the exemption under CW 3(1). Under the intended 5% buffer rule, the permitted proportions would be between 73.75:26.25 and 76.25:23.75 (as 5% of 25% is 1.25%).

The type of subdivision is irrelevant. For example, the proposed amendment applies to fee simple subdivisions as well as unit titles issued under the Unit Titles Act 2010.

Sections CB 6A(4) and CZ 39(3) continue to apply so that, where the bright-line test applies, the relevant bright-line test acquisition date(s) for the allocated subdivided parcels should be the bright-line acquisition date for the original undivided parcel of land.

The new provision applies for those who hold their land on capital account (and would therefore only pay income tax under the bright-line test if they sell within the relevant bright-line period) as well as those who hold their land on revenue account (for example, because they acquired the land with a purpose or intent of disposal or have a business of developing land).

Effective date

The amendment has effect for partitions occurring on or after 27 March 2021.

For partitions occurring before 27 March 2021, Inland Revenue will not apply resources to identify non-compliance based on the current law interpretation.

Ring-fenced residential rental losses when a tax debt is written off

Sections 89C and 177C of the Tax Administration Act 1994

The amendments enable the Commissioner of Inland Revenue to extinguish excess deductions ring-fenced under subpart EL of the Income Tax Act 2007 (ITA) when a taxpayer's tax debt is written off.

Background

Section 177C(5) of the Tax Administration Act 1994 (TAA) requires the Commissioner to extinguish a taxpayer's tax loss if a tax debt is written off. This ensures that taxpayers are not able to "double dip" and benefit from having a tax debt written off while still being able to use any accrued losses in the future.

The residential rental loss ring-fencing rules have been in effect since the 2019–20 income year. Under section EL 4 of the ITA, deductions relating to residential rental property cannot exceed a person's residential rental income for the year. Any excess amount is effectively ring-fenced and cannot be offset against other non-residential property income that year (for example, salary and wages). The excess amount is carried forward to a later year when the person derives residential income.

"Tax loss" is undefined in the TAA, but it is defined in the ITA with reference to section IA 2(1) of the ITA. There was uncertainty around whether section EL 4 excess deductions form part of a taxpayer's tax loss and could therefore be extinguished when they have a tax debt written off.

Key features

New section 177C(5BA) of the TAA clarifies that the Commissioner must extinguish a taxpayer's ring-fenced residential rental losses (excess deductions under section EL 4 of the ITA) when he writes off a taxpayer's tax debt. The amount extinguished is limited to the amount of the tax debt written off, taking into account the tax value of the ring-fenced residential rental losses using a 33% rate for non-companies and 28% for companies.

If, in addition to ring-fenced residential rental losses, a taxpayer also has a tax loss and/or a tax credit carried forward under section LE 3 of the ITA, the amendment to section 177C(5C) provides that the tax loss must be extinguished first, followed by ring-fenced residential rental losses or bright-line losses, and then finally, the tax credit.

Section 89C of the TAA requires the Commissioner to issue a notice of proposed adjustment (NOPA) when making an assessment unless a specific exception applies. In line with existing section 89C(lb), which provides that a NOPA is not required when a tax loss is extinguished under section 177C(5), new section 89C(lbb) provides a similar exception for ring-fenced residential rental losses.

Effective date

The amendments have effect for tax debts written off on or after 1 April 2023. This applies even if the ring-fenced residential rental loss relates to a previous income year.

Bright-line losses when a tax debt is written off

Sections 89C and 177C of the Tax Administration Act 1994

These amendments enable the Commissioner of Inland Revenue to extinguish a taxpayer's bright-line losses when that taxpayer has a tax debt written off.

Background

Section 177C(5) of the Tax Administration Act 1994 (TAA) requires the Commissioner to extinguish a taxpayer's tax loss if a tax debt is written off. This ensures that taxpayers are not able to "double dip" and benefit from having a tax debt written off while still being able to use any accrued losses in the future.

The rules for bright-line losses (excess deductions under section EL 20 of the Income Tax Act 2007 (ITA)) have been in effect since the 2019–20 income year. Under section EL 20 of the ITA, bright-line losses can be used against bright-line income and other income from land that year, with any excess loss amount being carried forward to a later year when the taxpayer derives further income from land.

"Tax loss" is undefined in the TAA, but it is defined in the ITA with reference to section IA 2(1) of the ITA. There was uncertainty around whether bright-line losses form part of a taxpayer's tax loss and could therefore be extinguished when they have a tax debt written off.

Key features

New section 177C(5BA) of the TAA clarifies that the Commissioner must extinguish a taxpayer's bright-line losses when he writes off that taxpayer's tax debt. The amount extinguished is limited to the amount of the tax debt written off, taking into account the tax value of the bright-line losses using a 33% rate for non-companies and 28% for companies.

If, in addition to bright-line losses, a taxpayer has a tax loss and/or a tax credit carried forward under section LE 3 of the ITA, the amendment to section 177C(5C) provides that the tax loss must be extinguished first, followed by ring-fenced residential rental losses or bright-line losses, and then finally, the tax credit.

Section 89C of the TAA requires the Commissioner to issue a notice of proposed adjustment (NOPA) when making an assessment unless a specific exception applies. In line with existing section 89C(lb), which provides that a NOPA is not required when a tax loss is extinguished under section 177C(5), new section 89C(lbb) provides a similar exception for bright-line losses.

Effective date

The amendments have effect for tax debts written off on or after 1 April 2024. This applies even if the bright-line losses relate to a previous income year.

Affected loan balance formula

Section DH 10 of the Income Tax Act 2007

Section DH 10 of the Income Tax Act 2007 has been amended so that it correctly treats the sale of property funded by a loan that could not be traced when the interest limitation rules came into effect.

Background

Under the interest limitation rules, interest deductions for residential property loans drawn down before 27 March 2021 are gradually phased out between 1 October 2021 and 31 March 2025.

When a loan drawn down before 27 March 2021 relates to both disallowed residential property (DRP) and allowed property, and the borrower cannot reasonably trace the funds borrowed between these two purposes, the formula in section DH 7(2) of the Income Tax Act 2007 effectively apportions the loan between the two property types.

Section DH 7(4) then specifies how to treat any repayment of the notional loan principal for the DRP. As originally drafted, amounts applied to repayment of this notional loan principal became the amount of the "unrelated repayments" item in the "affected loan balance" formula in section DH 10(5). This formula is used to calculate what portion of interest can be grandparented and can continue to be deducted during the phase-out period, rather than being fully disallowed.

However, this original definition of the "unrelated repayments" item led to an error. If a repayment is sourced from the sale proceeds of allowed property, there should be no change to the affected loan balance that is grandparented. Instead, however, the previous law achieved no change in the affected loan balance when the sale proceeds are from DRP.

Key features

The definition of the "unrelated repayments" item has been amended to refer to repayments under section DH 7(4) other than against the notional loan principal.

Effective date

The amendment came into effect on 27 March 2021, the date the provision originally applied from.

Foreign trust remedials

Aligning the foreign-sourced income exemption with the foreign trust disclosure rules

Section HC 26 of the Income Tax Act 2007, Sections 3, 59BA, 59B, 59C, 59D, 59E of the Tax Administration Act 1994

The amendments introduce a new definition of a "foreign exemption trust". A foreign exemption trust now includes any trust that was a foreign trust before the amendments, but also includes trusts where a trustee has used the foreign-sourced income exemption under section HC 26 of the Income Tax Act 2007 (ITA), unless there is an election under section HC 33 in effect.

The "foreign exemption trust" definition replaces the "foreign trust" definition for the purposes of applying the foreign trust disclosure obligations. This aligns the foreign-sourced income exemption in the ITA with the foreign trust disclosure rules in the Tax Administration Act 1994 (TAA), consistent with the policy intent of the disclosure rules.

Background

Since 1987, New Zealand has taxed trusts based on the settlor's tax residence. A trust with a New Zealand resident settlor is taxed on its worldwide income. This is the case even if its trustees are non-residents. Conversely, a trust that does not have a New Zealand resident settlor is only taxed on its New Zealand-sourced income, even if its trustees are residents. This is achieved through the foreign-sourced income exemption in section HC 26 of the ITA.

In 2017, the disclosure requirements for foreign trusts were substantially strengthened in response to concerns that they were being used to avoid foreign income tax. For a "foreign trust" to use the foreign-sourced income exemption, it had to comply with the foreign trust disclosure rules in sections 59B to 59D of the TAA. However, this requirement only applied to a "foreign trust". Some trusts could use the foreign-sourced income exemption without technically being a "foreign trust" and therefore without complying with the foreign trust disclosure rules. This misalignment was contrary to the original policy intent.

Key features

The amendments correct this misalignment as follows:

- A new definition of "foreign exemption trust" has been added to denote which trustees must register and comply with the foreign trust disclosure rules. The new definition includes any trust that previously had to comply with the foreign trust disclosure rules as a "foreign trust". However, the new definition also includes a trust for which the trustee uses, or has previously used, the foreign-sourced income exemption in section HC 26 of the ITA. An exception applies if an election under section HC 33 is effective for the trust.
- A trustee of a foreign exemption trust is not required to apply the domestic trust disclosure rules.

Effective date

The amendments came into effective on 1 April 2023.

Detailed analysis

Before the amendments, there was a misalignment between the foreign trust disclosure rules and the foreign-sourced income exemption. This is because the exemption applied to trusts that do not have a New Zealand resident settlor in a given income year. The exemption has always worked in this way as the ITA considers income on a yearly basis. It envisages that settlors may migrate to and from New Zealand and taxes accordingly. In contrast, the definition of "foreign trust" did not envisage settlors' circumstances changing. A trust could only be a foreign trust if it had not had a New Zealand resident settlor since 1987, when the current tax regime for trusts was introduced.

As a result of this misalignment, some trusts could use the foreign-sourced income exemption without technically being a "foreign trust". For example, a trust that had a New Zealand resident settlor in a previous income year, but not in its current income year, could previously qualify for the foreign-sourced income exemption. This was the case even though such a trust would not technically be a "foreign trust", because it previously had a New Zealand resident settlor. Such a trust would not have to, and indeed could not, comply with the foreign trust disclosure rules, which only applied to "foreign trusts". Often these trusts

would not have to comply with the domestic trust disclosure rules in sections 59BA and 59BAB either, as they did not have any New Zealand-sourced income. Such trusts could therefore use New Zealand's settlor-based trust regime to escape taxation in their home countries, without being required to disclose any information about their income to Inland Revenue. This was exactly the mischief the 2017 disclosure requirements were intended to address.

The amendment resolves this issue by creating a new definition of "foreign exemption trust" to denote which trusts should comply with the foreign trust registration and disclosure obligations. In addition to those trusts that must already comply with the disclosure rules, a "foreign exemption trust" explicitly includes any trust, whether currently a foreign trust or not, that has derived income that is, or has been, exempt under the foreign-sourced income exemption. The definition excludes trusts for which an election under section HC 33 is in effect, as such trusts are broadly treated as complying trusts after the election.

Use of the foreign-sourced income exemption

A trust that has had a New Zealand settlor at some point after 1987 is not a "foreign trust" under the law existing before the amendment. Such a trust only becomes a "foreign exemption trust" if its trustee uses, or has previously used, the foreign-sourced income exemption. Some trustees may derive income that qualifies for the exemption, but not use it, instead making an election under section HC 33. Other trustees will not use the exemption because they derive no foreign-sourced income, even though they would qualify for the exemption if they did. Such trusts do not have to comply with the foreign trust disclosure rules. This will reduce unnecessary compliance and administration costs.

Example 95: Trust with only a New Zealand rental portfolio

In 2022, Meritiana, a New Zealand resident, sets up a trust with New Zealand trustees to hold her New Zealand rental portfolio. The trustees derive assessable income and will have to comply with the domestic trust disclosure rules.

In 2026, Meritiana moves to Australia. The trustees continue to derive only New Zealand-sourced rental income so do not use the foreign-sourced income exemption. The trust therefore does not have to comply with the foreign trust disclosure rules and continues to comply with the domestic trust disclosure rules. The New Zealand tax consequences and disclosure requirements for the trust are identical to those for a purely domestic trust.

In 2030, Meritiana moves back to New Zealand. Despite Meritiana's movements, the trust never has to comply with the foreign trust disclosure rules because it never uses the foreign-sourced income exemption (even though it had a New Zealand resident settlor after a settlement was first made on the trust).

A New Zealand resident trustee of a trust becomes required to register that trust if it falls within the "foreign exemption trust" definition. For some trustees this would occur once they use the foreign-sourced income exemption.

- For trustees that have already used the exemption before 31 March 2023, the requirement to register would be triggered on 31 March 2023. The trustee would then have until 30 April 2023 to apply for registration.
- In any other case, the requirement to register commences on the due date for an income tax return in which the trustee first takes a tax position that foreign income of the trust is exempt under section HC 26 of the ITA. The trustee would then have to apply for registration within 30 days.

In either of the two cases above, the trustee may be entitled to the longer grace period of 4 years 30 days if the requirements of section 59C(3) are met.

The amendment also requires the trustee to provide an annual return that includes the period in which the exemption is first claimed (even if that period occurred before the requirement to register is triggered). The annual return has to meet the requirements of section 59D of the TAA.

Example 96: Trust using the foreign-sourced income exemption

In 2022, Rory, a New Zealand resident, sets up a trust with a New Zealand corporate trustee. The trust's assets consist solely of foreign shares, which return foreign investment fund (FIF) income. The trust complies with the domestic trust disclosure rules and has a standard balance date of 31 March.

In June 2026, Rory moves to Luxembourg. For the income year ending 31 March 2027, the trust cannot use the foreign-sourced income exemption as it had a New Zealand resident settlor during the income year. Nor is it a foreign exemption trust as it has had a New Zealand resident settlor after 1987. Therefore, it must still comply with the domestic trust disclosure rules.

For the income year ending 31 March 2028, the trust has no New Zealand resident settlor. It therefore uses the foreign-sourced income exemption for the 2027–28 income year. The trust has a tax agent, so the due date for its 2027–28 income tax return is 31 March 2029.

Under the amendments to section 59C, the trustee has to apply for the trust to be registered as a foreign exemption trust within 30 days of 31 March 2029.

Under the amendments to section 59D, the trustee has to provide an annual return for the period 1 April 2027 to 31 March 2028, being the first year in which the exemption is claimed. This return has to be provided at the same time that the trustee applied for registration.

The new "foreign exemption trust" definition replaces the previous "foreign trust" definition only for the purposes of applying the foreign trust disclosure rules. A trust that is registered as a "foreign trust" under previous law is to be treated as already being registered as a "foreign exemption trust" and does not have to re-apply for registration. Consequently, such a trust continues to be subject to the foreign trust disclosure rules under the new "foreign exemption trust" definition, regardless of whether it has used the foreign-sourced income exemption.

Exception for trusts with a section HC 33 election

If a person makes an election under section HC 33 to satisfy the income tax liability of the trustee, the trust stops being a foreign exemption trust from the date the election applies. This ensures that trusts taxed on their worldwide income are subject to the domestic trust disclosure rules rather than the foreign trust disclosure rules.

Example 97: Trust with section HC 33 election

In 2019, Emilia, a Swiss resident, sets up a trust with a New Zealand trustee to hold her share portfolio and Swiss rental properties. Assume the trust has a standard balance date of 31 March. The trust is a foreign trust. It registers with Inland Revenue and complies with the foreign trust disclosure rules from its inception. The trustee also uses the foreign-sourced income exemption in section HC 26.

Emilia subsequently moves to New Zealand and stops being a transitional resident on 15 May 2026. On 1 April 2027, she makes an election under section HC 33 to satisfy the income tax liability of the trustee.

Once Emilia becomes New Zealand resident, the trust would not fall under limb (a) of the "foreign exemption trust" definition (as it has had a New Zealand settlor after 1987) but would still fall under limb (b) of that definition as its trustee has previously used the section HC 26 exemption. It must continue to comply with the foreign trust disclosure rules.

However, from the date of the election the trust would not fall under either limb of the "foreign exemption trust" definition. It would no longer have to comply with the foreign trust disclosure rules and would instead comply with the domestic trust disclosure rules. The trustee would therefore file a final foreign exemption trust return for the 2026–27 year. From the 2027–28 year onwards, the trust would have to comply with the domestic trust disclosure rules.

Interaction with "foreign trust" definition

The "foreign exemption trust" definition applies for the disclosure rules in the TAA. The "foreign trust" definition applies for working out how its distributions are taxed under the ITA. The two definitions apply for different purposes and can therefore operate independently. A trust will often be both a "foreign trust" and a "foreign exemption trust" at the same time. However, it could also be a "foreign exemption trust" but not a "foreign trust".

Example 98: Foreign exemption trust but not a foreign trust

On 1 May 2020 Jacques, a non-resident, sets up a trust with a New Zealand trustee to hold his European rental properties. Assume the trust has a standard balance date of 31 March.

Jacques becomes a New Zealand resident but remains a transitional resident until 6 October 2025. No election under section HC 33 is made for the trust.

The trust uses the foreign-sourced income exemption for its European rental income in each income year from 1 May 2020 until 31 March 2025 (inclusive). It cannot use the exemption in the 2025–26 income year as Jacques stopped being a transitional resident in that year.

From 1 May 2020, the trust would be a foreign exemption trust under the amendments. The trust would have to register with Inland Revenue and comply with the foreign trust disclosure rules.

Once Jacques becomes a New Zealand resident (even while he is a transitional resident), the trust would no longer be a foreign trust. However, it would remain a foreign exemption trust because it has used the section HC 26 exemption and has not made an election under section HC 33.

Power to deregister a trust

Section 59DB of the Tax Administration Act 1994

The amendment creates an explicit power for the Commissioner of Inland Revenue to deregister a trust if the trust does not meet the requirements for registration under section 59B of the Tax Administration Act 1994. This power can be exercised on the Commissioner's own initiative or on application by the trust.

Effective date

The amendments came into effect on 1 April 2023.

Detailed analysis

Previously, the legislation did not provide a power to deregister trusts, despite the Income Tax Act referring to deregistered trusts in section HC 26(1)(c)(iii). A trust may need to be deregistered if it no longer meets the requirements for registration or was mistakenly registered because it did not meet those requirements in the first place. For example, this may occur if the trust is not a foreign trust or foreign exemption trust, or it does not have a New Zealand resident trustee.

The amendment addresses this by explicitly granting the Commissioner the power to deregister a foreign trust either by his own initiative or on application by a trust.

The deregistration can be backdated to the date when the trust stopped meeting the statutory requirements for registration. For example, if a trust stopped being a foreign trust on 1 January 2024 (and is not a foreign exemption trust), but the Commissioner did not become aware of this until 15 March 2024, the Commissioner is able to backdate the deregistration to 1 January 2024.

When the Commissioner exercises the power to deregister on his own initiative, he must give the contact trustee at least 30 days' notice before the deregistration takes effect. The contact trustee then has an opportunity to respond if they consider the trust should remain registered, providing supporting information to the Commissioner as appropriate.

A contact trustee of a trust must also apply for the trust to be deregistered if they become aware that the trust does not meet the requirements for registration. The trustee has to provide the Commissioner with certain information, such as:

- the reasons for deregistration
- final annual returns that include the date before it is deregistered, and
- any further information required by the Commissioner, such as supporting evidence where appropriate.

Final annual returns could be part-year accounts (for example, if the trust winds up) or full-year accounts that include the date before deregistration (for example, if a trust continues to exist but has stopped being a foreign trust because its trustees have moved offshore).

Require signed declaration from post-registration settlors

59D of the Tax Administration Act 1994

There is an existing requirement for contact trustees to provide a signed declaration for each settlor of a trust on registration. The amendment extends this to also require a signed declaration for persons who become settlors after registration.

Background

When applying for registration of a foreign trust, sections 59B(3)(c)(i) and (4) of the Tax Administration Act 1994 (TAA) require trustees to provide certain information, including a signed declaration, for any settlor of the trust. The signed declaration must state that each settlor has been informed of, and agreed to, certain TAA and anti-money laundering requirements, or that the settlor is deceased or cannot be located.

However, some settlors may not make their first settlement on the trust until after the trust has been registered, and it was debatable under previous law whether the requirement to provide a signed declaration still applied.

While section 59D(2)(c) did require the trustee to provide the same information about such new post-registration settlors in the annual return, before the amendment this requirement did not extend to the signed declaration.

The amendment extends this requirement to provide information in the annual return to include a signed declaration for post-registration settlors. The signed declaration is required for all annual returns filed after the date the Act comes into force.

Effective date

The amendments came into effect on 1 April 2023.

Treatment of residual beneficiaries

Section 59B of the Tax Administration Act 1994

The amendment clarifies that residual beneficiaries are subject to the same disclosure requirements as discretionary beneficiaries.

Background

Residual beneficiaries, also known as final beneficiaries, are beneficiaries that have a right to any undistributed trust property when the trust is wound up. Before the amendment, the disclosure rules did not mention residual beneficiaries and only referred to beneficiaries of fixed and discretionary trusts (for example, sections 59B(3)(c), (d) and (e) of the Tax Administration Act 1994). It was therefore unclear what disclosure requirements residual beneficiaries should comply with.

The disclosure requirements for beneficiaries of fixed trusts on registration are more stringent than those for beneficiaries of discretionary trusts (before a distribution is made to that beneficiary). The reason is because a beneficiary of a fixed trust has a fixed and certain interest in the trust property. In contrast, a beneficiary of a discretionary trust does not have a certain interest in the trust property and only has a right to be considered for a distribution. Sometimes discretionary beneficiaries are only stated as a class in the trust deed (for example, all descendants of the settlor) such that it cannot be known at the time of registration who all the discretionary beneficiaries of the trust are. Accordingly, when applying for registration of a discretionary trust, the contact trustee only has to provide enough details for the Commissioner of Inland Revenue to determine, when a distribution is made under the trust, whether a person is a beneficiary (section 59B(3)(e)). Further details, such as the name, address and tax residence of a discretionary beneficiary, are only required when a distribution is made to that beneficiary (section 59D(2)(e)).

Residual beneficiaries are similar to discretionary beneficiaries in that they do not have a certain interest in the trust property and may be stated in the trust deed as a class. The amendment therefore clarifies that residual beneficiaries are subject to the same disclosure requirements as those that apply to discretionary beneficiaries.

Effective date

The amendments came into effect on 1 April 2023.

Updating trust information when it changes

Sections 59B, 59C, 59D of the Tax Administration Act 1994

The amendments require contact trustees to update information provided in an annual return if it changes. Changes to trustees or contact details have to be updated within 30 days of the contact trustee becoming aware of it. Changes to other information have to be updated in the next annual return at the latest.

Background

Section 59B(5) of the Tax Administration Act 1994 (TAA) requires contact trustees to update information provided on registration, including the signed declarations for trustees, when that information changes. They are required to do this within 30 days after becoming aware of the addition or alteration (section 59C(2)).

In addition, section 59B(6) provides that a contact trustee who anticipates ceasing to be contact trustee must also provide the Commissioner with certain details when the contact trustee or their details change. Changes in trustees and trustee details generally are subject to the 30 day time limit (see sections 59B(3)(c)(v), 59B(5) and 59C(2)).

However, before the amendment, there was no corresponding requirement to update information that changes when it was provided in an annual return (for example, details of new settlors or beneficiaries). This was not intended. The need for information to be up-to-date applies regardless of whether it was first provided in an annual return or on registration.

In addition, the 30-day time limit for updating information provided on registration could be inconvenient for trustees and could result in inadvertent non-compliance. For most types of information, it is sufficient if the information is updated in the next annual return. However, an exception is for changes to contact trustees or their contact details. It is important for the Commissioner of Inland Revenue to have reliable contact information for contact trustees, and therefore this information should continue to be provided within the 30-day time limit.

Key features

The amendments clarify that contact trustees are required to update information provided in an annual return if the information changes.

The amendments also address the timeframes within which updates must be provided:

- Changes to contact trustees (under section 59B(6)) or their contact details (under new section 59B(6B)) have to be provided to the Commissioner within 30 days of the trustee becoming aware of it.
- Changes to other information, regardless of whether it was given on registration or in an annual return, must be provided to the Commissioner in the next annual return at the latest. Contact trustees retain the option to provide information earlier, outside the annual return cycle, if they want.

Effective date

The amendments came into effect on 1 April 2023.

Testamentary trusts

Section HC26 of the Income Tax Act 2007, Section 59B of the Tax Administration Act 1994

The amendments treat a will creating and governing a trust as a trust deed for the purposes of the foreign-sourced income exemption.

Effective date

The amendments came into effect on 21 February 2017.

Detailed analysis

Section HC 26 of the Income Tax Act 2007 provides for foreign-sourced income to be exempt from tax if certain requirements are met. One such requirement was that the trust must have a trust deed (sections HC 26(1)(c)(i) and (1)(d)(i)). Testamentary trusts created by wills do not have trust deeds, as wills are not legally trust deeds. This means that, before the amendment, testamentary trusts could not access the exemption.

It was never intended for foreign trusts created under a will to be treated differently from a foreign trust created by a living settlor under a trust deed. The amendments therefore allow a trust to access the section HC 26 exemption if it was created by a will instead of a trust deed.

Some changes were also made to sections HC 26(1)(c)(i) and (d)(i) of the Income Tax Act 2007 to match the new wording of section 59B(3)(f) of the Tax Administration Act 1994. These changes ensure that foreign trusts created by a document other than a trust deed or will can access the foreign-sourced income exemption. Ensuring consistency between these sections removes ambiguity for taxpayers.

The amendments have retrospective effect from 21 February 2017, the date when foreign trusts were first required to comply with the disclosure rules to use the foreign-sourced income exemption.

Commissioner's discretion to backdate registration

Section 59B of the Tax Administration Act 1994

The amendment gives the Commissioner of Inland Revenue the discretion to backdate a foreign trust's registration where a trustee has made reasonable efforts to be registered on time.

Background

To use the foreign-sourced income exemption in section HC 26 of the Income Tax Act 2007, a foreign trust must meet certain conditions. One condition is that it must be registered both at the beginning of the income year and at the time when the foreign-sourced income is derived.

Section HC 26(1B)(b) gives the Commissioner the discretion to allow the foreign-sourced income exemption to apply despite minor compliance failures with the disclosure rules. However, before the amendment, this discretion could not apply where a foreign trust is not registered in time. This could be excessively harsh in some cases where the trustee made reasonable efforts to be registered on time.

The amendment allows the Commissioner to backdate the trust's registration. This is expected to be simpler, particularly where the trust has derived multiple items of foreign-sourced income in the relevant period.

Effective date

The amendments came into effect on 1 April 2023.

New civil penalty and greater discretion for foreign-sourced income exemption

Section HC 26(1B)(b) of the Income Tax Act 2007, Section 139AC of the Tax Administration Act 1994

The amendments allow for a more flexible and proportionate response to non-compliance with the foreign trust disclosure rules by introducing a new civil penalty for failure to comply with the rules and granting the Commissioner of Inland Revenue greater discretion to allow a trust to use the foreign-sourced income exemption in cases of minor non-compliance.

Background

When the foreign trust disclosure requirements were enacted in 2017, the penalties were not updated. The current penalties that apply are the general criminal penalties in the Tax Administration Act 1994 (TAA). In practice, the main consequence for a foreign trust that does not comply with the disclosure requirements in an income year is that it cannot use the foreign-sourced income exemption that year. This result can be too harsh (if the non-compliance was relatively minor) or too lenient (if the trust has no foreign-sourced income).

Under section HC 26(1B)(b) of the Income Tax Act 2007 (ITA), the Commissioner has a discretion to allow the foreign-sourced income exemption where there has been a failure to comply, but only if a trustee has corrected that failure within a reasonable time. However, some failures may not be able to be corrected – for example, the age of the trust, or prior mismanagement, may result in the loss of historical information on settlors or settlements – but are still so minor that the loss of the foreign-sourced income exemption is disproportionate to the extent of the failure.

Key features

The amendments:

- introduce a new civil penalty of up to $1,000 for failure to comply with the disclosure rules, and
- give the Commissioner a discretion to allow a trust to use the foreign-sourced income exemption.

Effective date

The amendments came into effect on 1 April 2023.

Detailed analysis

New civil penalty

The new civil penalty can be applied for failure to comply with the disclosure rules, such as when a trustee misses a deadline, provides an incomplete annual return, or provides false information. This penalty could apply instead of, or in addition to, the trust being denied the foreign-sourced income exemption. The penalty cannot apply to a failure to meet the disclosure requirements if the Commissioner is satisfied that the trustee made reasonable efforts to comply with the requirements and to remedy the non-compliance with the requirements.

Discretion to allow the foreign-sourced income exemption

The Commissioner's discretion can only be exercised where the trustee has made reasonable efforts to:

- comply with the requirements of sections 22, 59B, 59C and 59D of the TAA (as required in section HC 26(1) of the ITA), and
- remedy any failures to comply, even if the failure could not in fact be corrected.

Clarifications to the trust rules

Sections YA 1 and HC 26 of the Income Tax Act 2007, and sections 3, 22, 59B, 59C, 59D, 59E, 143, 147, 147B of the Tax Administration Act 1994

The Act introduced a number of amendments that clarify the rules by:

- replacing certain references in the Tax Administration Act 1994 (TAA) to beneficiaries of a "fixed trust" or "discretionary trust" with references to beneficiaries with fixed or discretionary interests in a trust

- replacing the confusing, undefined references to trustees "in the business of providing trustee services" in the TAA with the broadly similar, existing defined term of "professional trustee"
- updating the definition of "trust rules" in section YA 1 of the Income Tax Act 2007 (ITA) to refer to the relevant sections of the foreign trust disclosure rules in the TAA
- amending sections 59B(3)(d) and 59D(2)(e) of the TAA to refer to the "date of birth" of the minor beneficiary instead of their "age"
- amending references to a "resident foreign trustee" in the TAA to refer to a "trustee", and
- updating several minor cross-referencing errors in the TAA's penalties provisions.

Background

References to fixed and discretionary trusts

Before the amendments, the TAA referred to beneficiaries of a "fixed trust" or a "discretionary trust" in sections 59B(3)(c)(vi), (vii), (d) and (e).

A trust deed can provide for both fixed and discretionary beneficiaries in the same deed. It is unclear in such a case if the trust is a "fixed trust" or a "discretionary trust". Arguably, the single trust deed can create multiple trusts – some fixed, some discretionary. However, this is not consistent with how the legislation is ordinarily understood and such an interpretation could cause unintended consequences (for example, separate disclosures having to be made or multiple registration and filing fees being paid in respect of the same trust deed). The amendments remove this uncertainty.

Replacing references to trustees "in the business of providing trustee services" with "professional trustee"

Before the amendments, sections 59B(3)(b)(i), 59C(3)(c), and 59E(5)(b) of the TAA referred to a trustee "in the business of providing trustee services". This phrase was not a defined term.

In contrast, the term "professional trustee" was defined, was better understood and captured largely the same idea. It is therefore clearer to use that existing defined term in these sections. Before the amendment, the definition of "professional trustee" in section 3 of the TAA only applied for the purposes of section 43B. The amendment therefore updates the definition of "professional trustee" so that it can apply for the purposes of the foreign trust disclosure rules.

Updating the definition of "trust rules"

The definition of "trust rules" in section YA 1 of the ITA previously did not refer to the relevant sections of the foreign trust disclosure rules. As a result, some provisions and definitions that should have applied to the foreign trust disclosure rules arguably did not. The amendment rectifies this.

Referring to the "date of birth" rather than "age" of minor beneficiaries

Sections 59B(3)(d) and 59D(2)(e) of the TAA previously required a trustee to disclose the "age" of any minor beneficiaries of a fixed trust. Technically this required trustees to notify the Commissioner of Inland Revenue of the minor beneficiary's new age every year as it changes, which is impractical. The amendment therefore requires disclosure of a minor beneficiary's "date of birth" instead.

Changing references from "resident foreign trustee" to "trustee"

The TAA previously used the term "resident foreign trustee" in various places to refer to a New Zealand resident trustee of a foreign trust. This term was confusing as it could imply the trustee was foreign, even though it referred to a New Zealand resident trustee. The amendments remove this confusion.

Updating penalties provisions cross-references

Sections 143(1B) and (1C) of the TAA, which set out how the absolute liability offences in section 143(1) apply to resident foreign trustees, reflected the wording of the pre-2017 disclosure regime.

Section 143(1C) referred only to section 59B (registration and initial disclosure requirement) and not to section 59D (annual return requirement).

Section 143(1C)(b) referred to the appointment of another resident foreign trustee under section 59B(7) even though that subsection no longer provides for the appointment of a trustee.

The amendments to section 143 of the TAA:

- ensure that subsection (1C) refers to section 59D, and
- remove the reference to section 59B(7).

Effective date

The amendments came into effect on 1 April 2023.

GST remedials

GST treatment of government grants and subsidies paid to public authorities

Section 5(6D) of the Goods and Services Tax Act 1985

The amendment removes the exclusion for public authorities from the rules for government grants and subsidies. It ensures public authorities must account for GST on grants and subsidies they receive.

Background

The Goods and Services Tax Act 1985 requires GST-registered recipients of government grants and subsidies[35] to account for GST on the amounts they receive to the extent they relate to their taxable activity.

However, grants and subsidies paid to public authorities were not subject to GST under the GST rules for government grants and subsidies. This is because public authorities were specifically excluded from the rules.

The amendment removes the exclusion for public authorities. A person that is a public authority that receives a government grant or subsidy will now be required to account for GST on the amount received if it relates to its taxable activity. The change ensures that GST-registered recipients, who are generally able to claim input tax deductions for goods and services they purchase with government grants and subsidies, are no better off than recipients that are not registered for GST.

Effective date

The amendment has effect for all government grants and subsidies paid on or after 1 April 2023.

Optional use of proxies for GST place of supply and zero-rating rules

Sections 8(4), 8B, 8BB and 8BC of the Goods and Services Tax Act 1985 (GST Act)

Background

GST is a consumption tax on goods and services supplied to New Zealand consumers. The remote services and distantly taxable (low value imported) goods rules within in the GST Act allow non-resident suppliers to use certain commercial proxies or practices to determine whether their supply is a taxable supply to a New Zealand resident consumer. Using proxies based on commercial information make the GST rules easier for these suppliers to apply.

The ability to use these proxies or practices has been expanded to suppliers of exported remote services and non-resident suppliers of high value imported goods. This allows these suppliers to choose to use these rules to determine the tax residency of their customers or whether their customers are GST-registered businesses.

Key features

GST-registered exporters of remote services and non-resident importers of goods can elect to use certain proxies when applying the GST zero-rating and "place of supply" rules. These proxies may reduce compliance costs by allowing these suppliers to use certain pieces of commercial information to determine if their customers are non-residents or registered persons. The proxies are based on similar rules used by suppliers of imported remote services and distantly taxable goods.

The requirement for a non-resident importer of goods to have agreement with a GST-registered recipient of the goods for the supply to be treated as being made in New Zealand, has been replaced with an ability for the non-resident supplier to unilaterally treat the supply as being made in New Zealand.

35 The term "government grants and subsidies" refers to payments in the nature of a grant or subsidy that are made on or behalf of the Crown or by any public authority.

Effective date

The amendments apply from 1 April 2023.

Detailed analysis

Allowing the residency proxies in section 8B to be used for exported remote services

Section 8B of the Goods and Services Tax Act 1985 provides a list of various items of commercial information relevant for determining a recipient's residency (for example, billing address, internet protocol address, bank details, and phone number). If two of the items support the conclusion that the recipient of the supply is a New Zealand resident, then the remote services rules treat that person as a New Zealand resident.

Section 8B has been mainly used to determine the GST treatment of imported remote services supplied by a non-resident supplier.

Other suppliers, such as New Zealand exporters of remote services, can now elect to apply section 8B to determine if their supplies of remote services are being supplied to a person who is outside New Zealand at the time the services are performed and can therefore qualify as zero-rated supplies under sections 11A(1)(k), (l) or (m).

If a supplier does not wish to apply section 8B which involves using certain pieces of commercial information to determine the residency of the person they are supplying, they can instead elect to apply section 8BC. This allows the supplier to use other items of commercial information which may include information obtained from the supplier's existing systems and processes that are used to collect information about the supplies made and the recipients of those supplies. For example, a supplier may have an existing process whereby they ask or require their customers to declare if they are not a New Zealand tax resident and outside New Zealand and apply the GST rules based on this information.

Example 99: Exporter of remote services

Douglas is a New Zealand resident who has a GST-registered business which provides online tutoring to English language students, some of whom are in New Zealand, and others offshore.

Douglas determines if his online tutoring is a zero-rated supply of exported services by asking his students if they are outside New Zealand and if so, are they not a New Zealand tax resident. He also tells them to notify him if either of these circumstances change. Douglas chooses to apply section 8BC to continue using this existing process for his personalised online tutoring remote services.

Douglas has also developed a package of online services (software programmes, slide packs and videos) which he will sell as a new type of remote service to a wider customer base. Because he plans to sell this new remote service to hundreds of new customers, he elects to use the items of commercial information in section 8B to determine if these new customers are non-residents for the purposes of applying the zero-rating of exported services rules.

Douglas charges 0% GST on the new package of online services if the customer is accessing it from outside New Zealand (based on IP address) and he has at least two items of evidence that support the conclusion that the customer is not resident in New Zealand, such as the IP address, billing address and phone number being all connected to the same foreign country, and less than two conflicting items of evidence that the customer could be resident in New Zealand. In other cases, he charges 15% GST.

Non-resident suppliers of imported goods to GST-registered recipients

Section 8(4) previously allowed the non-resident supplier of goods that are in New Zealand at the time of supply and the GST-registered recipient of those goods to make an agreement that the supply is made in New Zealand. Such agreements allow the non-resident supplier to charge 15% GST on the supply of the goods and to claim input tax deductions for costs incurred to make the supply (such as GST imposed by Customs when the goods enter New Zealand). It can be burdensome to enter into and manage these agreements in circumstances where non-resident importers have a lot of GST-registered customers.

Therefore, the requirement to have an agreement with the recipient of the goods has been replaced with an ability for the non-resident supplier to unilaterally treat the supply as being made in New Zealand. The non-resident supplier would implement this by charging 15% GST on the supply of the goods. This approach is consistent with the rules for remote services and distantly taxable goods in sections 8(4D) and 8(4F), which allow a non-resident supplier to treat the supply of services as being made in New Zealand.

To further assist non-resident supplier to determine the correct tax position themselves, the application of section 8BB has been expanded to allow non-resident importers to choose to use the sources of information outlined in that section to determine whether the recipient is GST registered for the purposes of section 8(4). The use of section 8BB was previously limited to situations where a non-resident is supplying remote services or distantly taxable goods.

Section 8BB allows the non-resident supplier to take a position that they are making a supply to a registered person if the recipient of the supply notifies them that they are a registered person or the recipient provides their GST registration number or New Zealand business number. It also allows the Commissioner to agree with the non-resident supplier on an alternative method for determining if their customers are registered persons.

If a non-resident supplier does not wish to apply section 8BB, they can instead choose to apply section 8BC. This allows the supplier to use other items of commercial information which may include information obtained from the supplier's existing systems and processes that are used to collect information about the supplies made and the recipients of those supplies. For example, a supplier may have an existing process whereby they reach an agreement with their customers to apply section 8(4) to the supply because the recipient is a registered person who will use the imported goods to make taxable supplies.

Example 100: Non-resident supplier of imported goods

Machinery Co is a non-resident supplier registered for GST for its business of selling industrial equipment. At the time Machinery Co issues an invoice, most of this equipment is located outside New Zealand, but Machinery Co makes agreements with their GST-registered customers to treat such supplies as being made in New Zealand under section 8(4).

For supplies made after 1 April 2023, Machinery Co is no longer required to obtain an agreement with their GST-registered customers to treat these supplies as being made in New Zealand. They can, however, continue to use agreements if they consider this is a good commercial practice for determining if they are supplying the goods to a registered person.

Because Machinery Co finds it onerous to obtain agreements in respect of each supply, they instead choose to apply section 8BB which allows them to rely on the GST registration number the customer provides them as part of the billing details to treat the supply as being made to a registered person.

Machinery Co then applies section 8(4) to treat the supply as being made in New Zealand and charges 15% GST. Machinery Co deducts input tax in relation to the GST they pay to Customs when the goods enter New Zealand and the GST they pay on other inputs they purchase to make the supply, such as paying another business to deliver or install the equipment.

Liabilities incurred during a voluntary administration

Section 58 of the Goods and Services Act 1985

The amendments clarify that administrators are personally liable for GST liabilities incurred as an agent of a company in voluntary administration.

Background

When a registered person dies, becomes incapacitated, or goes into bankruptcy, receivership, or liquidation they become an "incapacitated person" for the purposes of the Goods and Services Tax Act 1985 (GST Act). Section 58 of the GST Act deems the person carrying on the taxable activity on behalf of the incapacitated person (the specified agent) to be carrying on that taxable activity, including being GST registered.

This means the incapacitated person is not treated as carrying on the taxable activity during the period, and the specified agent is liable for GST obligations of the incapacitated person during the agency period.

Previously, there was uncertainty as to whether an administrator,[36] carrying on a voluntary administration,[37] was within the scope of section 58.

The amendments provide certainty and consistency to the treatment of GST obligations incurred during a voluntary administration.

Key features

The amendments expand the definition of "incapacitated person" to include voluntary administration and the definition of "specified agent" to include administrator. This means the administrator would be deemed to be a registered person carrying on the taxable activity of the company or limited partnership in voluntary administration.

A consequential amendment to section 58(3) means the notification requirements now apply to voluntary administrations. This means administrators are now subject to the same notification requirements as liquidators, receivers and executors of an estate.

Effective date

The amendments came into effect on 1 April 2023.

Associating members of joint ventures with the joint venture

Section 2A(1)(db)

The amendment associates members of a joint venture with the joint venture for GST purposes.

Background

When a joint venture is used to carry on a taxable activity it will register for GST and become a registered person that is separate from its members under section 57 of the Goods and Services Tax Act 1985 (GST Act). To reflect their aligned economic interests, the amendment associates joint ventures and their members for GST purposes. This treatment is consistent with the rules that apply for other unincorporated bodies, such as partnerships and trusts.

Key features

The effect of parties to a transaction being associated for GST purposes includes the following:

- a supply of goods and services between associated persons is subject to GST at the open market value of the goods or services
- the value of a secondhand goods input tax deduction on a supply of goods acquired from an unregistered associated person is appropriately limited under section 3A(3) of the GST Act, and
- the time of supply for goods and services supplied between associated persons is deemed to take place when the services are performed or when the goods are either removed or made available to the associated person.

The existing rules in section 2A(1)(b) that associate companies and other persons will continue to apply to joint ventures that are companies.

Effective date

The amendment took effect on 30 August 2022.

36 Section 239B of the Companies Act 1993.

37 Part 15A of the Companies Act 1993.

Input tax deductions for goods and services not yet available for use in making taxable supplies

Section 20(3C)(a) and (b), 20(3L), 20(3LB)

The amendments clarify that a GST-registered person can claim an input tax deduction when goods or services are supplied to them to the extent those goods or services are intended to be used by them in making taxable supplies.

A number of minor consequential amendments also clarify the application of sections 20(3L) and (3LB) of the Goods and Services Tax Act 1985 (GST Act).

Background

Under previous section 20(3C), a GST-registered person could claim an input tax deduction for GST paid on goods and services supplied to them to the extent to which the goods or services were used for, or available for use in, making taxable supplies. This was inconsistent with the policy intention, which is to allow input tax deductions to be recognised in the same taxable period in which the GST time of supply occurred.

Key features

The amendments to section 20(3C)(a) and (b) clarify that a GST-registered person is able to claim an input tax deduction to the extent to which goods and services supplied to them are used for, or intended to be used by them, in making taxable supplies. This aligns the timing of the input tax deduction with the GST time of supply, which is determined by section 9 of the GST Act.

For example, where a GST-registered person purchases goods ahead of them being produced, they can claim an input tax deduction at the time of supply to the extent to which they intend to use those goods in making taxable supplies

Under section 21G(2)(a), the adjustment period for input tax deductions claimed by a registered person begins when the goods or services are physically acquired or made available to them. Therefore, a GST-registered person that claims an input tax deduction in line with the amendment (for example, on the basis that they intend to use the goods or services in making taxable supplies) does not need to consider the adjustment rules until those goods or services are physically acquired or made available to them.

To ensure consistency, amendments to sections 20(3L) and (3LB) also allow GST-registered non-residents to claim an input tax deduction for GST paid on goods and services supplied to them to the extent to which those goods or services are used or intended to be used by them in making taxable supplies (treating all their supplies as if they were made and received in New Zealand).

A further consequential amendment to section 20(3C) ensures that section only applies when section 20(3LB) does not apply.

Effective date

The amendments take effect on the following dates:

- 1 April 2011 for the amendments to section 20(3C)(a) and (b)
- 30 March 2022 for the amendment to the words before paragraph (a) in section 20(3C)
- 1 April 2014 and 30 March 2022 for the amendments to section 20(3L), and
- 30 March 2022 for the amendment to section 20(3LB).

Clarifications to the compulsory zero-rating of land rules

Section 11(8D)(a) and (b), 11(9), 5(23) and 5(23B)

Three amendments ensure the GST business-to-business compulsory zero-rating of land rules work as intended:

- An amendment to section 11(8D)(a) allows supplies that wholly or partly consist of the grant of an interest in land (such as the grant of a commercial lease) to be zero-rated, provided they meet the requirements set out in section 11(1)(mb) of the Goods and Services Tax Act 1985 (GST Act).

- An amendment to section 11(8D)(b) standard-rates periodic payments made under an agreement for periodic supplies of an interest in land (such as a commercial lease) following an irregular lump-sum payment of more than 25% of the total consideration under the agreement.
- An amendment to section 5(23) to clarify when a taxable supply is considered to have been incorrectly treated as a zero-rated supply of land and therefore requires the recipient of the goods to return output tax.

Background

The GST business-to-business compulsory zero-rating of land rules are in place to address the risk of phoenix fraud and reduce compliance costs for GST-registered persons. The rules apply to supplies that are wholly or partly of land, provided the requirements in section 11(1)(mb) are met. In some circumstances, the zero-rating rules may apply to certain types of payment made under commercial leases (which are not regular lease payments) as outlined in section 11(8D). The amendments ensure these rules work as intended.

Grant of an interest in land – section 11(8D)(a)

The amendment provides for the zero-rating of a supply that wholly or partly consists of a grant of an interest in land, provided the requirements of section 11(1)(mb) are also met. This is intended to capture the situation where the purchase of business assets by a GST-registered person is made conditional on the grant of a lease over the business premises.

In some situations, this type of transaction could be zero-rated as a going concern under section 11(1)(m). However, the supply will not always fit the GST Act definition of a "going concern" and applying going concern treatment will not always make commercial sense for the given transaction. If a pre-existing lease had instead been assigned to the GST-registered purchaser alongside the asset purchase, this transaction would be zero-rated under section 11(8D)(a).

The amendment is not intended to affect the GST treatment of the subsequent rental payments made under a newly granted lease. This is because section 11(8D)(b) provides that regular periodic payments made under an agreement providing for periodic payments for supplies of an interest in land (a lease) are not zero-rated supplies of land. Instead, these regular rental payments would generally be for standard-rated supplies (such as rents on a commercial property) or exempt supplies of accommodation in a dwelling (such as rents under a residential tenancy).

Irregular lump sum payments made under a lease – section 11(8D)(b)

The amendment requires standard-rating (15% GST) of regular periodic payments made following an irregular lump sum payment of more than 25% of the total consideration specified in the lease agreement. Under the previous law, if a zero-rated irregular lump sum payment of more than 25% of the total consideration outlined in the lease agreement was made, any subsequent payments would also have to be zero-rated, including regular payments such as monthly rent. This treatment was intended to reduce compliance costs for taxpayers, however, taxpayers have informed Inland Revenue it has the opposite effect.

The amendment also clarifies that the value of the lump sum payment is based on the combined value of irregular payments made. This is to ensure that lump sum payments cannot be split up to avoid the application of zero-rating treatment.

Incorrect zero-rating – sections 5(23) and 5(23B)

Previous section 5(23) applies where it is discovered, after the date on which the relevant land transaction was settled, that section 11(1)(mb) was incorrectly applied to zero-rate a taxable supply of goods that did not meet the requirements of that section. The recipient of those goods is deemed to make a supply of the goods themselves and must return output tax (15% GST) on the purchase price. This rule is retained in new section 5(23B).

The amendments clarify when new section 5(23B) applies.

First, it clarifies that it must be the supplier who incorrectly zero-rated the supply of goods in a GST return provided by them.

Second, it requires either the supplier or the Commissioner to find that section 11(1)(mb) was incorrectly applied to the supply of goods.

Third, it specifies that the rule applies to require the recipient to return output tax when the recipient did not provide the supplier with correct or sufficient information under section 78F to enable the supplier to determine whether the supply should be zero-rated. This addresses the concern that malicious suppliers might use section 5(23) to shift the output tax liability onto unwitting recipients.

If the deeming rule in section 5(23B) applies, no changes to the supplier's GST assessment in respect of the incorrectly zero-rated supply are necessary.

If a person who receives a supply that was incorrectly zero-rated is not registered for GST, the person would be required to register for GST so they could account for output tax on the deemed supply under section 5(23B). In this situation, the person's GST registration would relate solely to this supply, and there would be no other GST consequences. The registration could be cancelled once a GST return including the supply had been provided.

Effective date

The amendments take effect on 1 April 2023.

Modernising information requirements for GST

Sections 5, 19E, 19F, 19K, 19G, 19L, 19N, 19Q, 20, 55B and 75 of the Goods and Services Tax Act 1985.

Section 21 of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022

Background

A GST Issues Paper released in February 2020 proposed modernising the invoicing requirements in the GST Act. The main objective identified was to allow a wider range of ordinary business-to-business information to be used to support GST output tax and input tax. The two main purposes underlying this were:

- to reduce compliance costs for businesses, and
- to facilitate the introduction of e-invoicing.

Rules to reform the tax invoicing rules were then enacted in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 (the 2022 Amendment Act). The reforms are permissive in nature, so invoicing practices or systems that complied with the previous rules are also compliant with the new information rules, which are less prescriptive. The amendments achieve this simplification in two main ways, by:

- requiring the supplier and recipient of a taxable supply to retain a minimum set of information relating to that supply, and
- repealing the rules that required formal documents (tax invoice, credit note, and debit note) to support output tax and input tax information included in a GST return for a taxable period.

The amendments included in this Tax Information Bulletin are remedial amendments that have been made to these rules in response to feedback from stakeholders. These amendments ensure that the rules work as intended and in accordance with the policy intent. The amendments are explained below so that they can be understood within the context of the wider rules.

Key features

Taxable supply information

Remedial amendments have been made to clarify or improve how the rules work in relation to taxable supply information. The amendments:

- clarify that a statement that shows the amount of tax charged for a supply that has a value that exceeds $200 but does not exceed $1000 will specify GST inclusive and exclusive amounts.
- clarify that the thresholds for providing differing levels of taxable supply information are expressed as a GST inclusive amount.
- clarify that a registered person must provide taxable supply information within 28 days of a request for the information by the recipient.
- provide the Commissioner of Inland Revenue with greater discretion to allow the omission of certain particulars from taxable supply information.
- provide the Commissioner with discretion to allow taxable supply information to not be issued on an industry basis.

- clarify that buyer-created taxable supply information only needs to be provided for taxable supplies to which the agreement relates.

Supply correction information

Remedial amendments have been made to clarify or improve how the rules work in relation to supply correction information. The amendments:

- provide that supply correction information can be expressed in a less prescriptive manner, including allowing for corrections to be dealt with by cancelling an incorrect invoice and issuing a new one.
- clarify that the timing for providing supply correction information is now less prescriptive, and can be provided at a date agreed to by the parties.
- provide the Commissioner with discretion to allow supply correction information not to be issued or certain particulars to be omitted from the supply correction information.
- clarify that supply correction information must be issued before an input tax deduction can be claimed.

Record-keeping requirements

Remedial amendments have been made to clarify or improve the record-keeping requirements of the new invoicing rules. The amendments have been made to:

- clarify that a registered person is not required to keep a record of the GST registration number of the supplier if the amount of consideration for the supply is less than $200.
- clarify that a registered person is only required to keep records if they are acquiring the supply to make taxable supplies.
- clarify that a registered person who receives a supply of second-hand goods that is not a taxable supply only needs to keep records of those goods if they have claimed an input tax deduction in respect of them.

GST groups and supplier groups

Remedial amendments have been made to improve the GST group and supplier group rules. The amendments have been made to:

- clarify that the requirement to provide a name and registration number only applies to either the supplying member or the representative/issuing member of a GST/supplier group.
- clarify that an issuing member of a supplier group is only responsible for the GST record-keeping obligations of a supplying member, not their GST obligations generally. These obligations only apply to supplies to which the agreement relates.

Effective date

As these amendments are making changes to the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, they apply from the date that Act received royal assent, 30 March 2022. The application date of the substantive provisions is set out in that Act and is generally applicable for taxable periods starting on or after 1 April 2023.

Detailed analysis

Background

As per the 2022 Amendment Act, the requirement to use tax invoices has been replaced from 1 April 2023 by a more general requirement to provide and keep certain records known as 'taxable supply information'.

The changes provide more flexibility. Invoicing practices that were compliant under the old rules will continue to comply with the new rules. The new terms are as follows:

Old term	New term
Tax invoice	Taxable supply information
Debit note/credit note	Supply correction information
Buyer-created tax invoice	Buyer-created taxable supply information

NEW LEGISLATION

Taxable supply information

Background

Under the rules enacted in the 2022 Amendment Act that apply from 1 April 2023, the taxable supply information that needs to be supplied or kept depends on the value and the type of supply.

Taxable supply information is essentially the records required to be kept or provided in relation to the supply to support the position taken in a GST return. It is broken down into 5 categories. These are supplies that are:

- $200 or less[38]
- More than $200 and up to and including $1,000
- More than $1,000
- Imported goods and services
- Second-hand goods

This information does not need to be kept in a single physical document as it was under the previous tax invoice rules.

Example 101: Taxable supply information

PC enterprises Ltd is a GST registered supplier with a taxable activity of supplying computers. PC enterprises Ltd sells a computer to Lucy for $1,500. Lucy is using the computer for her personal use and is not registered for GST.

Section 19E(2)(a) sets out what taxable supply information is required for a supply where the consideration in money or money's worth exceeds $1,000. The information required to be held by PC enterprises Ltd to support its tax position is as follows:

- *the name and registration number of the supplier (PC enterprises Ltd's own name and GST number)*
- *recipient details for the recipient39*
- *The date of the invoice, or where no invoice is issued, the time of supply*
- *A description of the goods and services*
- *A statement that specifies the GST inclusive and exclusive amounts in relation to the supply*

This information does not need to be contained in any one specific document, but must be retained by PC enterprises Ltd to support their tax position.

Remedial amendments

Section 19E(2)(b) of the GST Act – specifying tax charged in taxable supply information

Section 19E(2)(b) sets out what taxable supply information means for a supply that has a value that exceeds $200 but does not exceed $1,000. Under the law as previously written, a statement must be provided as part of this taxable supply information stating that the amount of consideration includes tax charged for the supply, or a statement of the amount of tax charged for the supply. This was problematic as it could result in the recipient mistakenly claiming an input tax credit for a zero-rated supply.

Amended section 19E(2)(b) provides that this statement must specify the GST inclusive and exclusive amounts.

Section 19E(2)(a),(b) and (c) of the GST Act – GST inclusive thresholds for taxable supply information

Section 19E(2)(a),(b) and (c) set out what taxable supply information is required for supplies that exceed $1,000, exceed $200 but do not exceed $1000, and for supplies that do not exceed $200 respectively. These thresholds were originally expressed in the 2022 Amendment Act for supplies having "a value that" exceeds the specified threshold. This would have resulted in an unintended change to some of the thresholds because value is based on the GST exclusive amount for the supply.

38 Under section 19K(7)(a), a supplier is not required to provide taxable supply information if the amount of consideration for the supply does not exceed $200.

39 "recipient details" is defined in section 2 of the GST Act and requires the name of the recipient and one or more of a list of identifying details that are relevant to the recipient. This could include an address of a physical location for the person, which could include a PO BOX number.

Amended sections 19E(2)(a),(b) and (c) have replaced this terminology with "consideration in money for the supply" which is a GST inclusive amount. This brings the law into line with how the previous thresholds were expressed in section 24 of the GST Act which also referred to the consideration in money. These remedial amendments apply for taxable periods starting on or after 1 April 2023, which is the same application date that the unintended change would have otherwise taken effect.

Sections 19K(1) and 19K(5) of the GST Act – providing taxable supply information within 28 days of a request for the information

Amended section 19K(1) provides that a registered person who makes a taxable supply to another registered person must provide taxable supply information to the recipient for the supply within 28 days of a request for the information. This replaces the previous requirement that the taxable supply information must be provided within 28 days.

Amended section 19K(5) provides that, for the purposes of buyer-created taxable supply information, the taxable supply information for the supply must be provided to the supplier by the recipient within 28 days of a request for the information, or by an alternative date agreed to by the supplier and recipient.

Sections 19K(10) – flexibility for the Commissioner to allow the omission of taxable supply information

Section 19K(10) provides that taxable supply information does not need to be issued if the Commissioner is satisfied that there are sufficient records to establish the particulars of the supply or class of supplies, and it would be impractical to require taxable supply information to be provided.

The section has now been amended to provide the Commissioner with further flexibility regarding the provision of taxable supply information. In addition to having a discretion not to provide taxable supply information, amended section 19K(10) provides the Commissioner with discretion to allow any one or more of the particulars specified in section 19E(2) to not be contained in the taxable supply information.

Sections 19K(10) – Commissioner discretion to allow for the omission of taxable supply information on an industry basis

Section 19K(10) has also been amended further to provide the Commissioner with the discretion to determine that taxable supply information or certain particulars specified in section 19E(2) does not need to be issued on an industry basis. This ability to grant industry wide exemptions is achieved by extending the provision further than a supplier to "class of suppliers".

Sections 19K(4) – Buyer-created taxable supply information

Amended section 19K(4) clarifies that the recipient is only required to issue buyer-created taxable supply information for taxable supplies to which the agreement relates. This clarifies the previous drafting which, on the face of it, required the recipient to issue taxable supply information for **each** taxable supply between the supplier and recipient.

Supply correction information

Background

The previous law on credit and debit notes has been replaced by a new concept known as "supply correction information". These changes were made in the 2022 Amendment Act and apply for taxable periods starting on or after 1 April 2023.

Under the new rules, a seller must provide supply correction information to correct an error in the original taxable supply information, or filed return. It does not matter if the buyer has already paid for the goods or services.

Some examples of when supply correction information is required include:

- when a buyer adds more items or cancels an order
- all or some of the goods are returned to the seller
- some of the goods were not delivered to the buyer
- there is an incorrect description of the goods or services
- incorrect seller or buyer details included
- the date is incorrect
- GST is calculated at the wrong rate
- an incorrect GST amount is charged.

In accordance with section 19E(1), supply correction information must include:

- the seller's name (or trade name) and GST number
- the date the correction was provided
- details identifying the taxable supply information (for example, an invoice number)
- the correction to the taxable supply information including, if relevant, a correction to the amount of tax charged for the supply.

Example 102: Supply correction information

Paul's pizzeria ltd runs a Pizza shop from a building owned by Kraymond holdings ltd. Paul's pizzeria pays rent under its commercial lease at $3,000 per month + GST, commencing on 1 January 2023. Ten months into the lease, on 5 October 2023, Kraymond holdings ltd realises there has been an error and Paul's pizzeria has actually been overcharged. The lease payments should have been $2,000 per month + GST.

Kraymond holdings ltd issues Paul's pizzeria ltd with supply correction information for the supply. Per 19E(1) the information provided in the supply correction information is as follows:

- *The name and registration number of the supplier* (Kraymond holdings ld)
- *Information identifying the taxable supply information* (in this circumstance this requirement is met by simply referring to lease payments made between 1 January 2023 and 1 October 2023 and individual invoice numbers do not need to be provided as this will be sufficient for Paul's pizzeria to determine the taxable supply information to which the correction relates)
- *The date of the supply correction information* (5 October 2023).

Remedial amendments

Section 19E(1)(d) – less prescriptive supply correction information

Prior to the amendment, section 19E(1)(d) required that supply correction information express the difference between the amount of consideration shown for the supply and the correct amount.

Amended section 19E(1)(d) now allows for supply correction information to be expressed in a less prescriptive manner. Section 19E(1)(d) now provides for the "correction to the taxable supply information, including, if relevant, a correction to the amount of tax charged for the supply."

Example 103: Less prescriptive taxable supply information

Prior to amendment

PC enterprises Ltd sells Lucy a computer for $1,500. PC enterprises Ltd subsequently realises that the incorrect price was marked on the computer and Lucy has been overcharged by the shop attendant. The correct price should be $1,000.

Old section 19E(1)(d) required that the supply correction information issued for the supply to express the difference between the amount of consideration shown for the supply and the correct amount. This means supply correction information would need to specify the $500 reduction in the amount of consideration for the supply.

Post amendment

Under amended section 19E(1)(d), PC enterprises Ltd can simply cancel the previous invoice of $1,500 and provide a correct invoice of $1,000.

Section 19N(2) – providing supply correction information

Prior to the amendment, section 19N(2) required a registered person to provide supply correction information by a date as agreed by the parties (19N(2)(a)) or within 28 days of the supply (section 19N(2)(b)).

Amended section 19N(2) simply provides that the registered person must provide supply correction information to the recipient for the supply. This recognises that the supplier will often only realise there is a need to issue supply correction information when they identify an error or change and this may occur more than 28 days after the time of supply.

Section 19N(5) – buyer-created supply correction information

Prior to the amendment, section 19N(5) of the Goods and Services Tax Act 1985, as it applied from 1 April 2023, provided that a registered person can issue buyer-created supply correction information if they meet the requirements to issue buyer-created taxable supply information under section 19K(4).

This was problematic because it would have required a registered person to have an agreement in place to issue buyer-created taxable supply information to be eligible to issue buyer-created supply correction information. There may be circumstances where registered persons wish to issue buyer-created supply correction information but do not need to issue buyer-created taxable supply information (and therefore do not have agreements that specifically deal with issuing buyer-created taxable supply information).

Amended section 19N(5) simply provides that, among other things, buyer-created supply correction information can be issued by the buyer through an agreement between the parties. The requirement that buyer-created supply correction information can only be issued if the requirements to issue buyer-created taxable supply information are met under section 19K(4) has been removed.

Section 19N(9) – flexibility for the Commissioner to allow the omission of supply correction information

The Commissioner has discretion under section 19K(10) to allow taxable supply information to not be issued or for certain particulars to be omitted from the taxable supply information if he is satisfied that there are sufficient records to establish the supply.

New section 19N(9) provides that supply correction information does not need to be issued if the Commissioner is satisfied that there are sufficient records to establish the particulars of the supply or class of supplies, and it would be impractical to require supply correction information to be provided. New section 19N(9) also provides the Commissioner with discretion to allow any 1 or more of the particulars specified in 19E(1) to not be included in the supply correction information.

Section 20(2) – supply correction information must be provided to enable an input tax deduction to be claimed

Under previous law, there was a requirement that no input tax deduction could be claimed for a supply unless a tax invoice, debit note, or credit note for that supply had been provided to the other party to the transaction. In the case of an inaccuracy in a tax invoice, there was an incentive to provide a credit note to ensure the other party knew of the mistake and could correspondingly correct their return, as otherwise there was no ability to claim an input tax deduction.

This specific requirement was inadvertently removed as a result of changes in the 2022 Amendment Act that replaced the rule with a more general requirement that the registered person must simply meet the record-keeping requirements to be able to claim an input tax deduction for a supply. In the case of an inaccuracy, this was insufficient because merely requiring a registered person claiming an input tax deduction to have a record of the supply correction information (formerly a credit note) provides them with no incentive to provide this information to the other party to the transaction so that they can correct their return too.

New section 20(2)(ab) provides that for a supply that a registered person intends to claim a deduction for because of an adjustment made under section 25(2)(b), they must have provided supply correction information if required by section 19N. This amendment has been corrected to apply from 30 March 2022.

Record-keeping requirements

Background

The 2022 Amendment Act introduced new section 19F which provides that a registered person who makes or receives a taxable supply of goods or services must have a record of the taxable supply information and supply correction information for the supply. The record-keeping requirements in section 75 of the GST Act have been retained, aside from an update to the new terminology (for example, tax invoice is now taxable supply information for example).

This means that the requirement to keep accurate and complete records has not changed under these new rules. The introduction of these new rules means that records do not need to be kept in the form of specific documents such as a tax invoice, credit note, or debit note but this does not displace invoicing and record-keeping requirements.

Accurate and complete records for income and expenses must still be kept for 7 years. Examples of records include:

- taxable supply information
- supply correction information
- bank statements
- invoices and receipts
- credit card records – including statements and vouchers
- cash register or point of sale records
- cashbooks.

Remedial amendments

Sections 19F– clarifying that a registered person is not required to keep a record of the GST registration number of the supplier if the amount of consideration for the supply is less than $200

Section 19K(7)(a) provides that a supplier is not required to provide taxable supply information if the amount of consideration for the supply does not exceed $200. As a consequence of this, it may be difficult for the recipient of the supply to obtain the registration number of the supplier.

Sections 19F has been amended to provide that a registered person is not required to keep a record of the GST registration number of the supplier if the amount of consideration for the supply is $200 or less.

Section 19F– clarifying that a registered person only needs to keep records if they are acquiring a supply of goods and services to make taxable supplies

Amended section 19F provides that a registered person who receives goods or services only needs to keep records if they are acquiring the supply to make taxable supplies. This has been achieved by specifying that the person who receives a supply of goods or services to which the record-keeping requirements relate must be receiving the supply for "the purposes of carrying on a taxable activity". This means that a registered person who acquires goods or services for private use or to make an exempt supply is not required to keep records of the supply.

Section 19H – clarifying that a registered person who purchases a taxable supply of second-hand goods only needs to keep records if they are using the second-hand goods as part of their taxable activity

Similar to the above amendment, amended section 19H(1) provides that a registered person who purchases a supply of second-hand goods for more than $200 that is not a taxable supply only needs to keep records of those goods if they have claimed an input tax deduction in respect of them (and therefore intend to use them to make taxable supplies).

Supplier groups

Background

The 2022 Amendment Act introduced the concept of supplier groups. Under these new rules, two or more GST-registered persons can form a supplier group so they can issue 'shared tax invoices' for GST purposes, if they are not part of the same GST group (new section 55B of the GST Act).

Members of a supplier group enter into an agreement confirming 1 member of the group will issue tax invoices, credit notes and debit notes on behalf of the other members.

The member responsible for issuing the tax invoices, credit and debit notes is called the 'issuing member'. The member who actually makes the supply is called the 'supplying member'.

Members must agree:

- the issuing member will issue tax invoices, credit and debit notes for each supply of goods and services made by members of the group.
- no other member of the group can issue tax invoices, credit and debit notes.

The agreement must be in writing and include each member's name (or trade name), address and GST number.

If the reason for entering the agreement is not part of the members' normal terms of business, each member must also record why they have entered the agreement.

If 2 or more registered persons are already part of a GST group, they must use the existing GST group rules instead.

Remedial amendments

Section 19L – supplies by a member of a GST group or supplier group

Section 19L(1) sets out the taxable supply information required for supplies made by members of a GST or supplier group.

Section 19L(1) has been replaced by new sections 19L(1) and (2). Section 19L(1) sets out what taxable supply information for a member supply made by an active member of a GST group under section 55 must include. Section 19L(2) sets out the same for a member supply made by a supplying member of a supplier group under section 55B. The purpose of these amendments is to ensure that the requirement to provide a name and registration number only applies to either the supplying member or the representative/issuing member.

A consequential amendment has also been made to section 19E(2)(f), which sets out what taxable supply information means for a supply under section 19L to give effect to ***this change.***

Section 55B(3)– clarifying that an issuing member of a supplier group is only responsible for record-keeping obligations for the group and not tax liabilities

Prior to this amendment, section 55B(3) stated that the issuing member of a supplier group is responsible for the obligations under the GST Act of a supplying member making a supply. This was problematic as it could be interpreted that the issuing member would be responsible for all obligations of a supplying member under the GST Act (including liabilities for unpaid output tax for example).

Section 55B(3) has been amended to make it clear what the policy intent of the rules is. Amended section 55B(3) clarifies that the issuing member of a supplier group is responsible for the GST record-keeping obligations of a supplying member making a supply that the issuing member has agreed to be responsible for. The effect of the amendment is to restrict responsibility of the issuing member to the record-keeping obligations of the supplying member, and this responsibility only applies for supplies to which the agreement relates.

Minor remedial amendments/maintenance items

Minor remedial amendments or clarifications have also been made to the new invoicing rules to ensure that the rules align with the policy intent. These amendments are set out in the table below:

All section references are to the GST Act in this table unless otherwise stated.

Table 4: Minor remedial amendments to the new invoicing rules

Section	Amendment made
Section 5(4)(b)	The use of the term "peculiar" in the section 2 definition of "recipient details" is ambiguous. This has been replaced with the term "relevant".
Section 5(4)(e)	The reference to "the date of the supply" in the section 2 definition of "supply information" is ambiguous and could refer to various dates. This reference has been replaced with "the date of the invoice, or where no invoice is issued, the time of supply".
Section 19E(2)(a)(iii)	The requirement for address details for the recipient under section 19E(2)(a)(iii) is redundant because "recipient details" in section 19E(2)(a)(ii) already requires identifying details for the recipient. Section 19E(2)(a(iii) has been repealed.

Section	Amendment made
Section 19E(2)(a)(iv)	The reference to "the date of the supply" in section 19E(2)(a)(iv) is ambiguous and could refer to various dates. This reference has been replaced with ""the date of the invoice, or where no invoice is issued, the time of supply".
Section 19G(2)(b)	The reference to "the date on which, or the period during which, the supply was received" in new section 19G(2)(b) is ambiguous and could refer to various dates. This reference has been replaced with "the date of the invoice, or where no invoice is issued, the time of supply".
Section 19G(2)(e)	This amendment repeals section 19G(2)(e), as "the time by which payment of the consideration for the supply is required" is not relevant.
Sections 19E(2)(a), 19E(2)(b), and 19E(2)(c)	References to "consideration in money" have been replaced with "consideration in money or money's worth for the supply." "Consideration in money" is problematic because it makes the treatment of barter transactions unclear. This is because the GST Act does not define money as including "money's worth".
Section 19K(5)	Incorrect reference to "recipient" changed to "supplier" to reflect that the taxable supply information is being provided to the supplier.
Section 19Q	Section 19Q provided that any references to tax invoices, credit notes, and debit notes should be read as including a reference to the new terminology ("taxable supply information" and "supply information") to the extent necessary to reflect sensibly the intent of the document. A further amendment has been made to include references to buyer-created tax invoices, now known as buyer-created taxable supply information.
Section 20(2)	Section 20(2)(a) has been amended to provide that the section applies to supplies generally rather than "taxable supplies". This has been achieved by deleting the word "taxable" and was necessary to ensure that taxpayers would be required to keep records for exempt supplies (for example, if supply correction information was provided to correct a supply from taxable to exempt).
Section 19F	Section 19F has been amended so that record-keeping requirements apply to supplies generally and not just "taxable supplies". This has been achieved by deleting the word "taxable".

Section	Amendment made
Sections 21(1) and 21(2)(a) of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 (the 2022 Amendment Act)	The amendment rectifies an error in effective dates. Section 21(1) of the 2022 Amendment Act, which amends section 20(2) of the GST Act, was scheduled to come into effect on 1 April 2023. The amendment changes this effective date to 30 March 2022. Similarly, section 21(2)(a) of the 2022 Amendment Act came into effect on the date of Royal assent. The amendment changes this effective date to 1 April 2023.

GST secondhand goods input tax deduction

Section 3A(3)(a) of the Goods and Services Act 1985

An amendment has been made to ensure the rules that allow input tax deductions for supplies of secondhand goods to associated persons work as intended. The amendment ensures that an associated GST-registered taxpayer that repurchases an asset from an unregistered associated party is entitled to claim the appropriate secondhand goods input tax deduction for that supply.

Background

The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 contained a remedial amendment to section 3A(3)(a) of the Goods and Services Tax Act 1985 to ensure that input tax deductions for secondhand goods supplied to an associated person were equivalent to the input tax that would be allowed if the supplier had started using the secondhand goods in their own taxable activity instead of making an associated persons' transaction. For more information on that amendment, refer to Tax Information Bulletin Vol 34, No 5 (June 2022): 160.

However, this resulted in the unintended consequence that a GST input tax deduction could not be claimed if an associated unregistered taxpayer sold the asset back to the original associated GST-registered vendor. This type of scenario may arise in a group of associated persons that includes a GST-registered land development business and an unregistered residential property business when land is bought and sold between the two different types of business.

Before 30 March 2022, an associated GST-registered taxpayer repurchasing an asset from an unregistered associated party would have been entitled to a secondhand goods input tax deduction of an amount calculated under section 3A(3)(a) (typically being the tax included in the original cost of goods to the supplier). However, following the 30 March 2022 change to section 3A(3)(a), that section effectively limited the input tax amount to the tax fraction paid by the last non-associated person.

Detailed analysis

The amended section 3A(3)(a) now provides that, in associated persons' transactions, if GST has been charged by a GST-registered supplier on a supply to an unregistered associated person, and the unregistered associated person subsequently supplies the same goods (that is, land) to a registered associated person, then the amount of the secondhand goods input tax deduction that can be claimed is limited to the amount that was last accounted for as output tax on the supply by the registered person to the unregistered person.

Example 104: Sale to unregistered associated company

2KRS Developments Ltd acquires land from an unregistered unassociated party for use in its property development business for $1.15 million. It claims a secondhand goods input tax deduction of $150,000.

A year later, 2KRS Developments Ltd sells the land for $1.265 million (current market value) to an unregistered associated company (Smitty Residential Holdings Ltd). 2KRS Developments Ltd returns output tax on the sale of $165,000.

Smitty Residential Holdings Ltd subsequently realises the land is not fit for purpose for its business and sells the land back to 2KRS Developments Ltd for $1.3 million (then current market value).

The amendment ensures that when 2KRS Developments Ltd repurchases the land, it can claim a secondhand goods input tax deduction based on the amount it accounted for as output tax in the sale it made to Smitty Residential Holdings Ltd ($165,000), rather than the input tax amount being limited to the tax fraction paid by the last non-associated person ($150,000).

If GST has not been charged on a supply between two associated persons, then the secondhand goods input tax deduction for a GST-registered recipient will be limited to the tax fraction of the purchase price when the goods were last acquired from the non-associated person (per the original amendment). See example below.

Example 105: Sale to GST-registered associated recipient

A developer sells a property to Kelvin for $1.15 million, including $150,000 GST. Kevin is not registered for GST. The developer and Kelvin are not associated persons.

Kelvin lives in the property for some time, but due to a subsequent property boom, he realises there is a huge market for townhouses in the area. Kelvin establishes a development company with his friend Lucy, who is an experienced property developer, and sells the property to a company they both set up, KL Developments Ltd, for $1.265 million, including $165,000 GST (market value). KL Developments Ltd is registered for GST.

As KL Developments Ltd is associated with Kelvin, KL Developments Ltd is only able to claim a secondhand goods input tax deduction based on the tax fraction (3/23rds) of the original cost to Kelvin from the non-associated developer. The input tax deduction allowed is therefore $150,000 rather than $165,000.

Effective date

The amendment is effective for a supply of secondhand goods made:

- in a taxable period starting on or after 30 March 2022, or
- under an agreement entered into after 8 September 2021 and paid for on or after the start of the first taxable period starting on or after 30 March 2022.

This is the same effective date as the earlier amendment to section 3A(3)(a) that resulted in the unintended consequence.

Unintended drafting change to voucher rules

Section 5(11G) of the Goods and Services Tax Act 1985 (GST Act)

Background

There was an unintended change to the drafting of section 5(11G) in the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019, such that vouchers may only be treated as taxable upon redemption if it is both impractical to apply GST on the issue of the voucher and the supplier of the goods or services and the issuer of the voucher are different persons. The unintended drafting change was moving the position of the word “if” which meant that suppliers needed to meet both requirements.

Key features

The remedial amendment addresses the unintended drafting change made by moving the position of "if" back to the previous drafting approach, so it appears in both section 5(11G)b(i) and (ii).

This means that suppliers only have to meet the requirement in section 5(11G)b(ii) which is about the supplier of the goods and services and the issuer of the voucher being different persons, if this requirement is relevant to their situation. In cases where this requirement is not relevant because the issuer and redeemer are the same person, a supplier can choose to use the redemption basis if they simply meet the requirement in section 5(11G)b(i) about it being not practical to apply GST to the issuance of the voucher.

Effective date

The remedial amendment came into force on 1 December 2019 which is the date the unintended drafting change took effect.

Other remedials

Tax treatment of expenditure on distribution networks

Sections DB 68, EE 6, EE 7 and YA 1

Amendments have been made to ensure that distribution network owners apply the component items approach, rather than the network approach, for depreciation and repairs and maintenance.

Background

Distribution networks convey services such as electricity, gas, water, and telecommunications. An example is the electricity distribution network of an electricity lines company. Its components include poles, cables, transformers, and switches.

Ownership of a distribution network involves significant regular expenditure on maintaining, improving and extending the network. Identifying the correct tax treatment of this expenditure is an important matter.

Deductions for expenditure on depreciable property are spread over the economic life of the property. Deductions for expenditure on repairs and maintenance are allowed in the year the expenditure is incurred.

In determining whether expenditure is repairs and maintenance of an existing asset, or instead involves the acquisition of new depreciable property, it is necessary to identify the asset. The issue in relation to distribution networks is whether the asset (for both depreciation and repairs and maintenance purposes) is the network or its component items. If the asset is the network, expenditure to acquire or build the network would usually be depreciable over the life of the network and expenditure to replace its more commonplace component items would usually be immediately deductible repairs and maintenance. If the assets are the component items, expenditure to acquire or replace a component item would usually be capitalised and depreciated over the life of the component (which is shorter than the life of the network).

Since the depreciation rules were introduced on 1 April 1993, network owners have, in nearly all instances, been depreciating component items of networks in accordance with the Commissioner's depreciation schedule and treating component items as the relevant item of property for repairs and maintenance purposes (component items approach). The depreciation schedule has never included a depreciation rate for a distribution network and the Commissioner considers it would be inappropriate to apply the default rate to a network.

In 2021, Inland Revenue recognised that this practice was not consistent with the cases decided by the Courts, which had adopted a network approach. The network approach by extension applied to all distribution networks, including those that are not physically connected, such as cell phone towers. The network approach does not affect how the law applies to non-network assets, such as how depreciation applies to distinct chattels within residential property.

The changes described in this item are intended to ensure that the component approach which has been adopted by the Commissioner and most network operators, rests on a firm legal basis, and to rule out the future use of the network approach.

Key features

New definitions of "utilities distribution asset", "utilities distribution network" and "utilities distribution network operator" have been added to section YA 1 of the Income Tax Act 2007.

Under new section DB 68, when a utilities distribution network operator incurs expenditure on a utilities distribution asset or a utilities distribution network, the expenditure is treated as relating to a utilities distribution asset, rather than the utilities distribution network, for determining whether the expenditure was capital in nature.

Effective date

The amendments are effective for the 2008–09 and later income years for distribution network operators that have always applied the component items approach.

For distribution network operators that have either filed a return before 1 April 2022 that did not apply the component items approach OR have a binding ruling that allows the network approach, the amendments are effective for the 2024–25 and later income years.

Detailed analysis

Definition of a "utilities distribution network operator"

A definition of a "utilities distribution network operator" has been added to section YA 1. This definition limits the scope of the other amendments by ensuring the amendments apply only to electricity distribution, water, gas and telecommunication networks. For the avoidance of doubt, the proposed amendments are not intended to cover other networks, such as electricity generation, roads or railways.

Definition of a "utilities distribution asset"

The definition of a "utilities distribution asset" covers the assets that are used, or available for use, by the network operator to provide goods and services. These assets will typically be those included in the Commissioner's depreciation schedule, but the legislation allows a network operator flexibility on how to classify smaller items. For example, a possum guard attached to a power pole could be included in the value of the power pole or could be separately identified (in which case the default depreciation rate would likely apply to that guard).

Likewise, there is flexibility in how divisible assets, such as a length of electrical cable or a pipe can be classified. This may include methods such as identifying as a separate asset a cable for a particular length, geographic area or installed during a specific period.

A utilities distribution asset is not intended to cover groups of disparate assets, especially when those assets are separately identified on the depreciation schedule. Examples of groupings of assets that are not intended to be a utilities distribution asset include an entire network for a large area, such as a town, or a group of disparate assets (for example, power poles, cables, switches and a substation) within a smaller area, such as a suburb.

This amendment does not limit the existing ability to pool assets with a value of under $5,000 per item or those with a greater value with a relatively homogeneous nature under a determination under section 91AAL of the Tax Administration Act 1994.

Whether expenditure is of a capital nature

New section DB 68 confirms that when a utilities distribution network operator incurs expenditure on utilities distribution assets, or their utilities distribution network, it must treat this expenditure as relating to the relevant utilities distribution asset, rather than the network.

The amendment does not change the test as to whether expenditure is deductible revenue account expenditure or non-deductible capital account expenditure. The amendment simply confirms that the existing tests should be applied based on the expenditure being for separate assets, rather than the entire network.

For example, expenditure on replacing a pole transformer with an equivalent replacement item would meet the tests to be capital expenditure on the basis that all of the asset has been replaced. However, if the network was instead chosen as the relevant asset, it is probable that the value of the pole transformer would be low relative to the value of the entire network, and therefore applying the capital/revenue tests may have led to a different conclusion.

Depreciation

Section EE 6(2B) confirms that utilities distribution assets are separate items of depreciable property, and section EE 7(fc) confirms that a utilities distribution network is not depreciable property. This treatment is consistent with the depreciation schedule and officials' understanding of the approach utilities distribution network operators have been applying since 1993. This amendment prevents the distribution network, or a smaller group of disparate assets, from being treated as the item of depreciable property.

Effective date

The amendments are effective for the 2008–09 and later income years for distribution network operators that have always applied the component items approach. Years before that date are covered by the time bar. Making the amendment effective on 1 April 2008 removed the need to amend the Income Tax Act 1976, Income Tax Act 1994 and Income Tax Act 2004 while having no practical effect on earlier returns.

For distribution network operators that have either filed a return before 1 April 2022 that does not apply the component items approach OR have[40] a binding ruling that allows the network approach, the proposed amendments are effective for the 2024–25 and later income years. This allows distribution network operators who have already applied the network approach to continue to apply the previous law until the start of the 2024–25 year.

Student loan time bar

Section 108AC of the Tax Administration Act 1994

This amendment limits the ability to adjust a past student loan repayment obligation once four years have passed and aligns student loan deductions, that relate to amendments to employer information, with other PAYE deductions for time bar purposes.

Background

The Tax Administration Act 1994 (TAA) imposes a four-year time bar on the amendment of tax assessments. The time bar means that, once four years have passed, the Commissioner of Inland Revenue may not amend an assessment to increase the amount assessed or decrease the amount of a net loss. There are a limited number of exceptions to this four-year period, most notably that it does not apply in instances of fraud.

The time bar was extended to include KiwiSaver employer and employee deductions and ACC earners' levy deductions by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022.

However, no equivalent provision extended it for student loan deductions. The Student Loan Scheme Act 2011 (SLSA) deems incorrect student loan deductions to be full and final unless the amount of the under- or over-deduction is significant. However, there was no time bar for significant over- or under-deductions, meaning nothing prevented corrections to previously filed employment income information from amending an assessment of student loan deductions under the TAA.

This created uncertainty for borrowers. An employer could amend employment income information at any time. Such amendments could flow through and impact a borrower's loan repayment obligations and loan balance. An employer could even make an amendment that would result in a previously closed loan having to be re-opened. The lack of a time bar also imposed an administrative burden on Inland Revenue, as Inland Revenue was required to explain to the individual that their student loan repayment obligations or balance had been affected by their employer correcting a past error.

Key Features

The amendment inserts new section 108AC into the TAA. The provision prevents the Commissioner from amending an assessment that includes an amount of salary and wage deductions made under the SLSA after a period of four years.

The existing limited exception to the time bar applies, that is, the time bar will not apply where the employment income information provided by a taxpayer is fraudulent or wilfully misleading. In addition, the new section also provides an exception from the time bar where not allowing an amendment of an assessment would have a significant adverse effect on a borrower.

This amendment will take effect on 1 April 2023. This means that if employment income information was provided by a taxpayer on that date to amend an assessment from before 1 April 2019 that included student loan deductions, it would be subject to the four-year time bar.

Effective date

The amendment takes effect on 1 April 2023.

40 It is not intended that the network operator would have needed to apply that binding ruling, merely that it has a binding ruling would be sufficient to meet this criteria.

Business continuity test – measurement of ownership

Section IB 2B of the Income Tax Act 2007

The amendment modifies the beginning of the period of measurement for shareholder continuity for a company carrying forward tax losses under the business continuity test (BCT) from the date the loss was incurred to the date the company became subject to the BCT to ensure the ownership continuity provisions work correctly.

Background

The BCT, which was enacted in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021, allows a company to carry forward tax losses to future years when it has a change in ownership if there is no major change in the nature of the business activities of the company.

For the purposes of the BCT, continuity of ownership is usually counted from the date a loss is incurred to the date the loss is used or the business continuity period ends. However, for a company that is maintaining losses under the BCT, this period is no longer appropriate, given the initial breach. In that case, the appropriate period would be from the date the company became subject to the BCT to the date the loss is used or the business continuity period ends.

Key feature

The amendment changes the shareholder continuity test for the BCT to ensure it works correctly once there has been an initial shareholding breach by shifting the beginning of the measurement period to the date the company became subject to the BCT (that is, immediately after the initial shareholder continuity breach).

Effective date

The amendment is effective for the 2020–21 and later income years.

Detailed analysis

To enable tax losses to be carried forward to future years a company must maintain 49% shareholder continuity from the date the loss was incurred until the date the loss is utilised. The BCT was introduced with effect for the 2020–21 and later income years to modify that rule. It permits the carry forward of tax losses to the extent that a company continues to satisfy the BCT, that is, no major change in the business of the company has occurred.

The BCT applies to most companies from the date of the initial shareholding breach until the end of the fifth tax year after that date or until the losses are used, whichever is earlier. This is the business continuity period (BCP).

Overlaying the shareholder continuity rules on the BCT can result in the situation where a less than 49% change in shareholding resets the five-year BCP.

Example 106: Position before current amendment

Midnight Oils Limited (MOL), a scented oil company, has been struggling in recent times and, as at 31 March 2026, has carry forward tax losses of $350,000 that were incurred in the 2022–23 income year. Peter, the owner, decides to sell 52% of the company to Dreamworld Limited (Dreamworld), an eco-bedding company, with a view to expanding the market for MOL's product.

Dreamworld acquires 52% of MOL on 1 April 2026. This will breach shareholder continuity, but the tax losses can then be carried forward under the BCT. Dreamworld has a policy of selling part of its holdings to a charitable trust that is independent of Dreamworld, and it does this by selling 10% of MOL to the charity, Rising Seas, on 1 April 2027.

On 1 April 2028 Peter decides to reward one of his loyal employees, Rob, as he starts to wind down his involvement in the business by selling him 20% of the company. Following that, on 1 April 2029, Dreamworld decides to sell 30% of the company to Bones, an Angel investor.

During this period, MOL meets all the requirement under the BCT to continue to carry forward its losses.

Under the previous continuity of shareholding rules, the above transactions would result in shareholding changes being measured from the date the loss was incurred until the loss was utilised and would result in the following (using the minimum voting interest for the respective period per section IA 5):

Shareholder	31 March 2026	1 April 2026	1 April 2027	1 April 2028	1 April 2029
Peter	100%	48%	48%	28%	28%
Dreamworld	-	0%	0%	0%	0%
Rising Seas	-	-	0%	0%	0%
Rob	-	-	-	0%	0%
Bones	-	-	-	-	0%
Result	**N/A**	**FAIL**	**FAIL**	**FAIL**	**FAIL**

This result is inconsistent with the actual continuity of ownership as the changes on 1 April 2027 and 1 April 2028 only result in 30% of the company changing hands. This profile means the BCP is reset on each of 1 April 2027, 2028 and 2029 even though it is only on 1 April 2029 that more than 51% of the company has been traded.

The example assumes all the other requirements under the BCT are satisfied.

This amendment alters the shareholder continuity measurement period for a company that is subject to the BCT. It moves the starting date for the period to the date immediately after the shareholding change that put the company into the BCT rather than when the loss was incurred.

Example 107: Amended treatment

Assuming the same facts as example X above, the continuity of ownership is now represented as:

Shareholder	31 March 2026	1 April 2026	1 April 2027	1 April 2028	1 April 2029
Peter	100%	48%	48%	28%	28%
Dreamworld	-	0%	42%	42%	12%
Rising Seas	-	-	0%	0%	0%
Rob	-	-	-	0%	0%
Bones	-	-	-	-	0%
Result	**N/A**	**FAIL**	**PASS**	**PASS**	**FAIL**

This result is consistent with the continuity rules as there has been a less than 51% change in the shareholding until the sale to Bones. Therefore, there is no ownership breach until 1 April 2029, and the BCP is only reset on 1 April 2029.

The example assumes all the other requirements under the BCT are satisfied.

Early payment discount and tax pooling

Sections RP 17 and RP 19 of the Income Tax Act 2007

This change corrects the effective date of previous amendments to the early payment discount (EPD) and tax pooling rules so that they are effective for the 2017–18 and later income years, rather than 2019–20 and later.

Background

Amendments were made to sections RP 17 and RP 19 of the Income Tax Act 2007 by sections 168 and 170 of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 (2022 amendments). The 2022 amendments were needed to ensure the treatment of the EPD and tax pooling was the same throughout Inland Revenue's transition from its former tax software platform, FIRST, to its new tax software platform, START. The 2022 amendments were backdated, as requested by submitters, to be effective for the 2019–20 and later income years, as this was when tax pooling and EPD began to be processed in START.

However, cases relating to earlier income years were also processed in START (for example, late filers for the 2017–18 income year), but these cases were not able to enjoy the benefit of the 2022 amendments. The 2022 amendments were intended to cover all the affected cases.

Effective date

The amendments took effect on 30 March 2022.

Financial arrangements rules – debt-equity swaps

Section EW 46D of the Income Tax Act 2007

New section EW 46D ensures that arrangements for an insolvent company debtor to issue shares for consideration on the basis that all or part of that consideration is used to repay a debt owed to the shareholder are treated in the same way as a direct issue of shares in repayment of debt.

Background

Under general tax principles, the forgiveness of a debt gives rise to taxable income because the debtor is in a better economic position than they were prior to the debt being forgiven.

Previously debt-forgiveness income could be avoided by using a two-step debt-equity swap. If shares are issued directly in exchange for a reduction in debt and the shares are worth less than the amount of the reduction, the debtor is taxed on debt forgiveness income. This is because the shares are worth less than the debt forgiven. However, if the arrangement was an issue of shares for cash equal to the amount of the debt and the debtor was required to use that cash to repay the debt, the shares could be treated as worth the same as the debt repayment, regardless of their actual value, and therefore no debt-forgiveness income arose.

New section EW 46D ensures that the financial arrangements rules operate as intended and taxpayers cannot avoid deriving debt-forgiveness income by using a two-step process for debt-equity swaps.

Key features

Section EW 46D applies where there is an arrangement for an insolvent company to issue shares for consideration on the basis that all or part of that consideration is used, directly or indirectly, to make a payment under a financial arrangement to which the company or an associated person is a party.

The part of the consideration for which the shares are issued and the use of that consideration to make a payment under the financial arrangement is disregarded.

The issue of the shares is instead treated as a payment under the financial arrangement. The amount of the payment is the market value of the shares.

Effective date

The amendment came into effect on 1 April 2023

Financial arrangements – impaired credit adjustments

Section EW 15D(3)(a) of the Income Tax Act 2007

The amendments clarify that reversals of impaired credit adjustments to financial assets under the IFRS method are non-assessable to the extent that the reversal offsets a previous decline.

Background

Taxpayers who adopt the IFRS method are required to allocate the annual gain or loss in the value of a financial arrangement to an income year. However, if the financial arrangement is a financial asset, section EW 15D(2)(a) of the Income Tax Act 2007requires that an amount arising from an impaired credit adjustment must not be allocated to an income year.

This means that an adjustment due to the decline in the credit quality of a financial asset under IFRS is not tax deductible. This is the correct policy result, as these adjustments are provisions for doubtful debts. Doubtful debts are not tax deductible until they are written off as bad debts.

Section EW 15D(3)(a) provides that an "impaired credit adjustment" means:

> for a financial arrangement accounted for under the fair value method, the movement in fair value through the decline in credit quality of the arrangement.

Therefore, as the current law only considers declines in credit quality, an adjustment in recognition of a financial asset's credit upgrade that reverses some, or all, of a previously reported credit loss is taxable income, even though the initial recognition was not deductible.

This is an incorrect result and inconsistent with the policy intent of the subsection. In practice, Inland Revenue has been allowing reversals of impaired credit adjustments to be non-assessable. The amendments align the legislation with existing practice.

Key features

- The amendment to section EW 15D(3)(a) ensures that reversals of impaired credit adjustments for financial arrangements accounted for under the fair value method are non-assessable to the extent they offset a previous decline.
- Increases in credit quality above, or in the absence of, a previous decline are still required to be allocated to an income year and remain assessable.
- A corresponding amendment has also be made to section EW 15C(4) of the Income Tax Act 2004 for completeness.

Effective date

The amendments took effect from 1 April 2007.

Example 108: Reversal of an impaired credit adjustment

A company recognises a financial asset under the IFRS method with an initial fair value of $100.

There is a decline in credit quality of the financial asset during the first year. In recognition of an estimated credit loss, the company makes an impaired credit adjustment of $10 at the end of Year 1, resulting in a decrease in fair value of the asset to $90. This adjustment is not tax deductible.

During Year 2 there is an improvement in the credit quality of the financial asset. The company revises its estimated credit loss for the asset and makes an upwards adjustment of $8 to partially reverse the previous impaired credit adjustment. This results in an increase in fair value of the asset to $98.

The amendments ensure that the $8 gain is not required to be allocated to an income year and is not assessable income as it is a reversal of an impaired credit adjustment.

Example 109: Improvement in credit quality above a previous decline

Assume the same facts as in example X above. During Year 3, there is a further improvement in the credit quality of the financial asset. The company revises its estimated credit loss for the asset to a credit gain and makes an upwards adjustment of $5. This results in an increase in fair value of the asset to $103.

The amendments provide that $2 of the $5 adjustment would be non-assessable, as this is the proportion of the adjustment that is offsetting an earlier decline. The remaining $3 is not a reversal of an impaired credit adjustment and will be assessable income.

General and life insurance – replacement of NZ IFRS 4 with NZ IFRS 17

Sections 20, 44, 58, and 98(10), (13), (14) and (25)

The amendments update the Income Tax Act 2007 (ITA) to reflect that the NZ IFRS 4 accounting standard was replaced by a new standard, NZ IFRS 17, from 1 January 2023.

Effective date

The amendments took effect on 1 January 2023.

Detailed analysis

Life and general insurers currently use the NZ IFRS 4 accounting standard when calculating their Outstanding Claims Reserve (OCR). However, NZ IFRS 4 was replaced by the new accounting standard, NZ IFRS 17, from 1 January 2023.

To ensure taxpayers can continue to use IFRS accounting standards to calculate their OCR, the amendments have replaced references to NZ IFRS 4 with references to the new NZ IFRS 17 accounting standard.

Inland Revenue has entered into agreements with taxpayers that govern the spreading method used for life financial reinsurance contracts. As these were entered into under IFRS 4, a grandparenting provision has been included to ensure these agreements remain in force following the introduction of IFRS 17.

Updating legislative references to OECD transfer pricing guidelines

Sections GC 13 and YA 1 of the Income Tax Act 2007 and section 3 of the Tax Administration Act 1994

The amendments update the definition of "OECD transfer pricing guidelines" in section YA 1 of the Income Tax Act 2007 (ITA) to refer to the 2022 version of the guidelines instead of the 2017 version. A savings provision gives taxpayers time to become familiar with the new guidelines.

Background

Transfer pricing rules apply to cross-border transactions between associated persons. Under section GC 6 of the ITA, the domestic transfer pricing rules are to be applied consistently with the "OECD transfer pricing guidelines".

Before this amendment, the definition of "OECD transfer pricing guidelines" in section YA 1 referred to the 2017 version of the guidelines (2017 Guidelines).[41] A deliberate decision was made to refer to a specific version of the guidelines, rather than to the guidelines as updated from time to time. This was so New Zealand did not automatically incorporate into domestic law any changes made at the OECD level without knowing, and considering, those changes.

On 20 January 2022, the OECD published an updated version of the transfer pricing guidelines (2022 Guidelines).[42] New Zealand has now considered the 2022 Guidelines and has incorporated them into domestic law to replace the 2017 Guidelines, which are now out of date.

Key features

The amendments:

- Update the definition of, and legislative cross-references to, "OECD transfer pricing guidelines" in the ITA to refer to the 2022 Guidelines instead of the 2017 Guidelines.
- Include a savings provision so that taxpayers may continue using the 2017 Guidelines in certain circumstances.

Effective date

The amendments take effect on 20 January 2022.

Detailed analysis

Transfer pricing rules apply to cross-border transactions between a New Zealand resident and an associated non-resident. Where the non-resident is in a country with which New Zealand has a double tax agreement (DTA), the transaction is covered by the relevant DTA article based on Article 9 (Associated Enterprises) of the OECD Model Tax Convention (OECD Model). However, where the non-resident is in a country with which New Zealand does not have a DTA, the applicable rules are found in sections GC 6 to GC 14 of the ITA. New Zealand currently has 40 bilateral DTAs in force.

The amendments only affect transactions not covered by a DTA. Cross-border transactions covered by an existing DTA are governed by that DTA. DTAs are generally interpreted using an "ambulatory" approach, which means that guidance issued after the DTA came into force can still be considered in its interpretation. Although this has an element of retrospectivity, the convention is that updates to commentary and guidance are clarificatory only. Substantive changes should instead be made by changing the OECD Model itself, which will not automatically affect existing DTAs.

Consistent with this convention, the differences between the 2017 Guidelines and the 2022 Guidelines are relatively minor and clarificatory in nature. They are also unlikely to affect most New Zealand taxpayers. One change relates to the "transactional profit split" transfer pricing method, which is rarely used in New Zealand. Another change provides guidance on certain hard-to-value intangibles, which are not generally observed in the New Zealand market. The most significant change is the inclusion of a new chapter on financial transactions. However, the guidance in that chapter is consistent with existing general transfer pricing principles and simply provides more detail and examples of how those principles apply to particular transactions.

We also note that the changes in the 2022 Guidelines stem from three OECD reports released in 2018 and 2020. Those reports were subject to public consultation, and therefore most transfer pricing practitioners were already aware of the changes before the 2022 Guidelines were published.

The amendments update the definition of "OECD transfer pricing guidelines" in section YA 1 of the ITA and the corresponding cross-references in section GC 13(1C).

41 OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017.

42 OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022: https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm

Savings provision

The savings provision allows taxpayers to continue using the 2017 Guidelines for the 2022–23 and earlier income years and is intended to give taxpayers more time to familiarise themselves with the new 2022 Guidelines. The savings provision also means taxpayers can continue using the 2017 Guidelines for the period of any existing binding ruling applying the 2017 Guidelines (even if the period of the ruling extends beyond the 2022–23 income year). As noted above, however, the amendments (and therefore the savings provision) only affect transactions not covered by a DTA.

Before this amendment, section GC 13(1C) referred to a particular paragraph of the 2017 Guidelines. This has been updated to refer to the new paragraph number for the relevant paragraph in the 2022 Guidelines. If a taxpayer relies on the savings provision and applies the 2017 Guidelines, they should continue to refer to the relevant paragraph in the 2017 Guidelines.

Income of deceased persons received after date of death

Sections CV 12 and HC 8 of the Income Tax Act 2007

The amendments allow the tax return for a deceased person to include reportable income received up to 28 days after their date of death (DOD).

Background

Section HC 8 of the Income Tax Act 2007 previously provided that, in the case of a deceased person, an amount that would have been income of the person if they had been alive when it was received was treated as income of the trustee of the person's estate. This required the estate of the deceased person to register for an IRD number and file a separate tax return for the estate. When the person had received only reportable income, this requirement appeared excessive and resulted in unnecessary compliance costs, particularly when there was no tax to pay as the income had been fully taxed at source.

This particularly affected payments by the Ministry of Social Development, whose current policy is to make payments to a deceased person up to 28 days after DOD. Such payments were technically not considered to be payments received by the deceased person but rather by the estate. The estate was required to file a return for these payments under an estate IRD number.

Key features

New section HC 8(1B) enables reportable income received up to 28 days after a person's DOD to be treated as income of the deceased person and included in a return filed under their IRD number. This means the executor of the deceased person's estate does not need to apply for an estate IRD number nor file a return for any reportable income received by the deceased person up to 28 days after DOD.

A consequential amendment made to section CV 12 ensures the amount of any such reportable income is not income of the trustee of the estate if it was received within 28 days of the person's DOD.

Effective date

The amendments are effective for the 2022–23 and later income years.

Non-active trusts

Section 43B of the Tax Administration Act 1994

The amendments ensure trusts and estates that derive small amounts of income are not required to file a tax return and are therefore not required to comply with the new trust disclosure requirements.

Background

Section 43B of the Tax Administration Act 1994 provides an exclusion for trustees of non-active trusts and executors or administrators of non-active estates from their tax filing obligations. Given the increased disclosure requirements under the new trust disclosure rules, the definitions in section 43B were overly restrictive and required more trusts and estates to file returns and comply with the new trust disclosure requirements than was intended.

Key features

The amendments include more trusts and estates within the ambit of section 43B. This removes those trusts and estates from tax return filing obligations and increased trust disclosure requirements. In particular, the amendments:

- no longer require a person to provide a declaration to the Commissioner that the trust or estate is non-active if the trust or estate does not have an IRD number
- no longer require a trust to file a tax return where it does not derive assessable income
- increase allowable administration costs from $200 to $1,500
- extend the income exception from bank interest to reportable income[43]
- increase the threshold of the income exception from $200 to $1,000 of reportable income
- clarify that interest is included in the expenditure relating to dwellings owned by the trust
- remove the requirement for a trust to file when it has transactions with a third party that result in income in that third party's hands unless the person receiving that income is an associated person, and
- ensure that testamentary trusts with small amounts of income are not required to file a tax return so that the administrative costs associated with filing returns do not unduly diminish the value of the trust. This applies to a trust that:
  - is a testamentary trust
  - is a complying trust under section HC 10 of the Income Tax Act 2007
  - has provided to the Commissioner a declaration that the trust meets these requirements if the trust has a tax file number
  - earns reportable income not exceeding $5,000 for the income year, and
  - derives assessable income that is non-reportable income and does not exceed $1,000 and the trust has incurred a total amount of deductible expenditure that is not exceeded by the assessable income by more than $200 for the income year.

Trusts continue to be required to notify the Commissioner if the requirements of section 43B are no longer applicable.

Effective date

The amendments are effective for the 2021–22 and later income years.

Provisional tax – standard uplift calculation method for the second instalment

Section RC 5 of the Income Tax Act 2007

The amendments clarify that a taxpayer using the standard method must use 110% of their residual income tax for the tax year before the preceding tax year to calculate their standard "uplift" amount (the 10% uplift) to calculate provisional tax payable for the year if they have not filed the preceding tax year's tax return on or before the second instalment date.

Background

Previously, for taxpayers using the standard "uplift" factor to calculate their provisional tax liability, section RC 5(3) of the Income Tax Act 2007 was unclear which uplift factor should have been used by a taxpayer.

43 Assuming the trust is a natural person for the definition of "reportable income".

The policy intent is that a taxpayer using the standard method to calculate their provisional tax liability for a tax year can initially use the 10% uplift. However, once they file the preceding tax year's return the 10% option becomes unavailable to them, and they must use the 5% uplift factor (based on 105% of their residual income tax for the preceding tax year).[44]

However, as the legislation read, if a taxpayer had not filed their preceding year's tax return before their first instalment date for provisional tax, it was arguable they could then use the 10% uplift for their second instalment date. This was the case even if they filed their preceding tax year's return after the first instalment date but before, or on, the second instalment date. This did not reflect the policy intent.

The policy intent was correctly reflected in the Income Tax Act 2004. The uncertainty appeared to have arisen as an unintended consequence of the rewrite of the legislation. The amendments clarify the position.

In addition, there appeared to be some confusion as to which "uplift" factor must be used when an instalment date fell on a day that was not a working day and taxpayers pay that instalment on the next working day but also filed their preceding year's tax return on that same day.

Effective date

The amendments in sections RC 5(2) and (3) have effect for provisional tax payments for the income years corresponding to the 2008–09 and later tax years.

The amendments in sections RC 5(3)(b) to (d) and RC (5)(3B) are effective for the 2017–18 and later income years.

Income tax treatment of grants paid by public purpose Crown-controlled companies

Section CW 38B of the Income Tax Act 2007

The amendments ensure that grants paid by public purpose Crown controlled companies (PPCCCs) have the same income tax treatment as grants paid by public authorities.

Background

On the advice of Crown Law, Inland Revenue changed its interpretation of a "public authority" in 2015. This resulted in a number of entities no longer qualifying as public authorities.

A new income tax exemption for PPCCCs (section CW 38B of the Income Tax Act 2007) was enacted by the Taxation (Annual Rates for 2028-19, Modernising Tax Administration, and Remedial Matters) Act 2019 with effect from 18 March 2019. Section CW 38B provides an income tax exemption for companies that meet specific criteria, including having a primary purpose of carrying out a public policy objective of the Government. Section CW 38B effectively restored the income tax exemption to certain companies that no longer qualified as public authorities following the change in interpretation.

Grants paid by public authorities are excluded income of the recipient (section CX 47). The recipient is denied a deduction, to the extent of the amount of the grant, for expenditure that corresponds to the grant from the public authority (section DF 1). The Commissioner of Inland Revenue applied administrative discretion to treat PPCCCs as public authorities between the change of interpretation of "public authority" in 2015 and the enactment of section CW 38B on 18 March 2019. This meant that while PPCCCs were considered public authorities, grants paid by PPCCCs were excluded income of the recipient and deductions were denied for the corresponding expenditure. When section CW 38B was enacted on 18 March 2019, no consideration was given to how grants paid by PPCCCs should be treated by the recipients. Since 18 March 2019, these grants have been taxable income to the recipient and deductions have been allowed.

Key features

- The amendments treat grants paid by PPCCCs as excluded income in the hands of the recipients and deny deductions for expenditure relating to the grants.
- This ensures that these grants are treated the same as grants from public authorities.

44 This also applies if the relevant instalment is the final instalment.

Effective date

The amendments will affect grants and subsidies paid by PPCCCs on or after 18 March 2019.

LTC election – Rollover of acquisition date for company assets

Section HB 13(6)

An amendment clarifies that, for a company making an election to become a look-through company (LTC), the LTC has the same acquisition date for the company's assets as the superseded company.

Background

When a company makes an election to become an LTC, it is effectively deemed to have been replaced by the LTC. The policy intent is that the LTC steps into the shoes of the superseded company for all purposes under the LTC rules. Section HB 13(6) therefore provides that an entity that ceases to be a company upon becoming an LTC is treated as having, as an LTC, the same status, intention, purpose and tax book values it had as a company for its assets, liabilities and associated legal rights and obligations. However, the section previously did not explicitly refer to the LTC having the same acquisition date for the assets as the superseded company. An amendment has been made to remedy this by providing that the LTC has the same tax book timings as the superseded company.

Effective date

The amendment has effect on and after 1 April 2011, being the original effective date for section HB 13(6) of the Income Tax Act 2007.

References to adoption in the ITA and the TAA

Sections HA 7, HC 36, YA 1, and YB 4 of the Income Tax Act 2007, and sections 124G and 173M of the Tax Administration Act 1994

The amendments remove redundant references to adopted children from the Income Tax Act 2007 (ITA) and Tax Administration Act 1994 (TAA).

Background

The Adoption Act 1955 provides that, once an adoption order has been made, an adopted child is deemed to become the child of the adoptive parents for all purposes, civil, criminal, or otherwise. The child is also deemed not to be the child of the birth parents. This is subject to the provisions of any enactment that distinguishes in any way between adopted children and other children.

Therefore, the ITA and TAA do not need to specifically refer to children by adoption to ensure they are treated the same as children by birth, as they are already included within references to blood relatives. Both Acts contained several references to adoption, and these could have created a negative inference for other provisions that do not include such a reference.

Key features

The Taxation (Annual Rates for 2022—23, Platform Economy, and Remedial Matters) Act 2023 removes redundant references to adopted children in the ITA and TAA. The amendments do not change the treatment of adopted children, who are already treated as blood relatives unless specifically provided otherwise. The amendments simply remove any potential uncertainty around their treatment under the ITA and TAA.

The amendments are summarised in the table below. Certain references are deliberate and have been retained.

Table 5: References to children by adoption in the Income Tax Act 2007 and Tax Administration Act 1994

References removed	References unchanged
Section HA 7(3)(a) of the ITA	Section HC 36(5) of the ITA and the reference to section 7(4) of the Adoption Act 1955 in the definition of "guardian"
Section HC 36(5) of the ITA in the definition of "relative"	Section 80KB of the TAA
Section YA 1 of the ITA in paragraph (a)(iv) of the definition of "relative"	
Section YB 4(3) of the ITA	
Section 124G(4)(b) of the TAA	
Sections 173M(5) and (6)(c) of the TAA in relation to the definition of 'relative'	

Effective date

The amendments came into effect on 1 April 2023.

Investment in Australian unit trusts

Sections CD 36, CX 57B, EX 20B, EX 20C, EX 52, EX 53 and EX 59 of the Income Tax Act 2007

The amendments introduce changes to the treatment of investments in Australian Unit Trusts (AUTs) to:

- allow New Zealand resident investors who hold 10% or more of the interests in an Australian unit trust to use the fair dividend rate (FDR) method for calculating their attributable foreign investment fund (FIF) income, and
- reduce economic double taxation by removing from taxation in New Zealand the income sourced from certain attributing interests in a FIF and a CFC that will already be subject to tax under the FIF rules.

Background

AUTs are an investment vehicle popular in Australia, particularly for large-scale infrastructure investments like public-private partnerships. AUTs are treated as trusts under Australian tax law but are considered companies under New Zealand tax law.

In many AUTs, the beneficiaries of the unit trust (unit holders) have fixed rights to trust income that are not subject to trustee discretion. Income rights are divided amongst the beneficiaries based on how many units have been issued to them. The AUTs can be treated as 'flow-through' for Australian income tax purposes, with the unit holders treated as receiving the AUT income

The FIF rules tax investments held by New Zealand residents in a range of foreign funds, including foreign unit trusts. The FIF rules apply to portfolio interests (less than 10%) and, in some situations, to non-portfolio interests. The investor is taxed on their income from the investment on accrual. There are several methods available to investors under the FIF rules to calculate their attributable FIF income. FIF distributions are generally not taxed to prevent double taxation. The intent of the FIF rules is to ensure that New Zealand residents do not escape New Zealand income tax on their foreign investments.

Under the FIF rules, the FDR method deems 5% of the opening value of a person's investment to be taxable income. The FDR method is the standard method for many New Zealand residents for calculating attributable FIF income.

The controlled foreign company (CFC) rules apply to interests held by New Zealand residents in foreign companies where generally five or fewer New Zealand residents hold 50% of the shareholding. The CFC rules tax mobile passive income as it accrues so that New Zealand income tax cannot be avoided by sheltering foreign income offshore.

However, the previous FIF and CFC rules could cause undesirable outcomes for New Zealand resident investors in AUTs in certain situations. The amendments rectify this.

Key features

The amendments:

- update the definition of "opening value" of a FIF interest in sections EX 52(5) and EX 53(5) of the Income Tax Act 2007 (ITA) to ensure that taxpayers can calculate their FIF income from an attributable interest in an AUT under the FDR method
- extend the existing treatment of distributions received from an AUT (which are treated as excluded income and not dividends) to include certain distributions from an AUT that are sourced from an attributing interest in a FIF, and
- amend the CFC rules to exclude certain amounts from being an attributable CFC amount. This exclusion applies to distributions received by an AUT CFC from an attributing interest in an AUT FIF, where an appropriate FIF calculation method is applied to that FIF. A consequential change is also made to the CFC rules to limit the funding costs deduction for distributions made by the AUT CFC.

Effective date

The amendments to the availability of the FDR method took effect on 1 July 2014.

The amendments to limit the risk of double economic taxation took effect on 1 April 2023.

Detailed analysis

Inability to use FDR method

New Zealand resident investors who hold 10% or more of the interests in an AUT were previously unable to use the FDR method for calculating their attributable FIF income.

Before 2014, interests of 10% or more in AUTs were exempt from the New Zealand FIF and CFC rules. In 2014, the FIF exemption for most AUTs was removed. However, certain consequential changes to the FIF rules were not made. In particular, the definition of "opening value" in the FDR method calculation rules was not amended to accommodate AUTs, which means that calculating FIF income under the FDR method is not possible. This omission inadvertently limited the options available for a New Zealand resident investor to calculate their FIF income from AUTs.

The amendments ensure that New Zealand resident investors in AUTs can use the FDR method to calculate their FIF income in relevant situations. These changes are effective retrospectively to income years commencing on or after 1 July 2014 to preserve the position of taxpayers that may have calculated attributable FIF income using the FDR method since that date.

Double taxation of FIF income from certain indirect AUT interests

Where a New Zealand tax resident holds a direct interest in a FIF and one of the FIF methods listed in section EX 59 of the ITA are used to calculate income, the rules ensure no further taxation arises from that FIF interest to avoid double taxation. This is done by treating distributions from certain attributing interests in a FIF as excluded income and as not being a dividend. However, there was no corresponding exclusion of distributions from indirect FIF interests held by a CFC, including those held through a chain of CFCs.

This meant if a New Zealand resident held their FIF investment through one or more overseas subsidiaries, rather than directly, a distribution from that indirect FIF interest could be taxable. An example of this is where an AUT that is a CFC holds the FIF interest (whether that FIF interest itself is an AUT or not). Distributions from an AUT generally did not qualify for the foreign dividend exemption and were taxed in New Zealand. This could result in double taxation of a New Zealand investor on the same economic income – once as attributed FIF income, and again as the distribution from the AUT.

The amendment extends the dividend exclusion and excluded income treatment to a distribution paid by an AUT from funds sourced from certain attributing interests in a FIF (including those interests held in FIFs that are not AUTs). This exclusion and treatment extends to certain attributing interests in a FIF held through a chain of CFCs. These changes help to ensure that the economic income of the relevant FIF is only taxed once.

To ensure these changes do not pose an integrity risk, the dividend exclusion will only apply where the requirements of section EX 59(1) of the ITA are satisfied for the entire period the New Zealand resident interest holder, or an associated person, holds the relevant FIF interest(s) that fund the distribution from an AUT. This prevents an AUT distributing an amount funded from indirect FIF interests from years that one of the FIF calculation methods listed in section EX 59(1) have not been applied (and therefore not taxed under the FIF rules), which could have led to the under taxation of the FIF interest.

Over taxation of AUT CFC income

Where a New Zealand resident investor holds an AUT CFC that holds an interest in an AUT FIF, a distribution from the AUT FIF to the CFC may be an attributable CFC amount for the New Zealand resident. The CFC rules provide a deduction for distributions by an AUT CFC in certain circumstances, but this is limited to a proportion based on the CFC's assets that derive attributable CFC amounts relative to its total assets. While an AUT CFC must return the entire distribution from the AUT FIF as income, only a portion of that distribution was deductible when the AUT CFC passed that distribution on to its investors. Double economic taxation could arise because the New Zealand investor returned income under the FIF rules on its indirect investment in the AUT FIF and a portion of this was also returned by the taxpayer as income from its direct interest in the AUT CFC under the CFC rules.

The amendment updates the CFC rules to exclude amounts received by an AUT CFC from an attributing interest in an AUT FIF where the FIF income or loss of the AUT FIF will separately be attributed to a New Zealand resident under one of the methods listed in section EX 59 of the ITA. This ensures that the economic income of the relevant FIF will only be taxed once to the New Zealand investor. An additional change ensures that a deduction is not available under the CFC rules to the extent the AUT CFC on-pays the FIF distribution to its investor(s).

Interest rate swaps held by multi-rate PIEs

Sections EW 24 and HM 35 of the Income Tax Act 2007

Multi-rate portfolio investment entities (PIEs) are now able to reduce volatility by choosing to use Method C in Determination G27 to spread income and deductions from interest rate swaps if they meet the requirements for the method.

Background

Interest rate swaps, which change in value as interest rates change, are usually taxed under the financial arrangements rules. Method C in Determination G27 contains one of the available spreading methods for these swaps. This method effectively ignores unrealised fair value gains or losses on interest rate swaps for tax purposes, meaning only interest rate swap cashflows are taxed. This reduces volatility and is appropriate because, while there can be significant fair value movements (both gains and losses) over the life of a swap, these movements should net to zero if it is held to maturity.

Multi-rate PIEs previously could not use this determination method because of section HM 35(8). This resulted in volatility because fair value movements on interest rate swaps were included in the taxable income of a multi-rate PIE.

Section HM 35(8) of the Income Tax Act 2007 contains a timing rule that requires a multi-rate PIE to allocate income and deductions:

- as reflected in the PIE's valuation of investor interests (for example, unit pricing) if such valuations are made, or
- as shown in the PIE's financial statements if it does not value investor interests.

Section HM 35(8) overrides other timing rules, including, prior to the addition of HM 35(8)(c), the spreading methods in the financial arrangements rules. The intention is to tax PIE income as it accrues to an investor rather than later when the investor may have already exited the PIE.

Key features

A multi-rate PIE can now choose to apply Method C in Determination G27 to their interest rate swaps entered into after the PIE chooses to apply section HM 35(8)(c). There is no formal notification process for making this choice, the PIE simply would document within their own records that they had chosen to apply Determination G27 and the date this would apply from.

This choice would not apply to any swaps entered into but still on-hand at the date of the election, which would continue under their existing treatment. The consistency of use of spreading method requirements in section EW 24 have been amended to allow a PIE making this choice to use two different spreading methods concurrently. Eventually all existing swaps will mature and the PIE would be applying Determination G27 to all interest rate swaps.

If a PIE subsequently chooses to cease applying Determination G27 they must apply the change of spreading method requirements in sections EW 26 and EW 27. There is no equivalent when a PIE chooses to apply Determination G27 as there

will be no change for any existing swaps. There is no limit to the number of times a PIE can choose to apply then not apply Determination G27; however, under section EW 26(2) they will have to have a sound commercial reason for each change.

Effective date

The amendments are effective for the 2023-24 and later income years.

Meaning of highly effective hedging

Section EX 46(10) of the Income Tax Act 2007

The meaning of highly effective hedging for the purpose of non-ordinary shares under the foreign investment funding (FIF) regime has been clarified.

Background

The comparative value (CV) method in section EX 44(1)(c) of the Income Tax Act 2007 must be used to calculate FIF income from all interests that are non-ordinary shares. Following an amendment in 2019, one of the requirements for a non-ordinary share in section EX 46(10)(c)(ii) was that the FIF's assets must be denominated in New Zealand dollars or be hedged to New Zealand dollars by a hedging instrument that is highly effective under IFRS 9. Alternatively, section EX 46(10)(cb)(iii) required that the interest in the FIF itself must be hedged to New Zealand dollars by a hedging instrument that is highly effective under IFRS 9. However, IFRS 9 does not refer to, or define, a highly effective hedge. This meant it was not clear when the CV method must be used.

This problem was the result of a change made to sections EX 46(10)(c)(ii) and (cb)(iii) on 26 June 2019 that updated the accounting standard reference from NZIAS 39 to IFRS 9. Before this change, the non-ordinary share rules required a hedging instrument to be highly effective under NZIAS 39. NZIAS 39 defined a "highly effective hedge" as a hedging instrument that removes 80% to 125% of the foreign currency risk for the hedged item. This was a simple bright-line test for taxpayers to apply.

Key features

Section EX 46(10)(c)(ii) has been amended to require the FIF's assets to be denominated in New Zealand dollars or have a value in New Zealand dollars that is governed by a foreign currency hedge that removes 80% to 125% of the foreign currency risk for the assets.

Section EX 46(10)(cb)(iii) has also been amended to require the interest in the FIF to have a value in New Zealand dollars that is governed by a foreign currency hedge that removes 80% to 125% of the foreign currency risk for the interest.

Effective date

The amendments came into effect on 26 June 2019 – the date the previous reference was changed from NZIAS 39 to IFRS 9.

Petroleum decommissioning

Section LT 1 of the Income Tax Act 2007

An error has been corrected with the petroleum decommissioning rules to ensure a refundable credit is not disallowed in a particular circumstance where the intent is that a refundable credit should be allowed.

Effective date

The amendment came into effect on 30 March 2022 to align with the date that the previous amendments were effective from.

Background

The petroleum decommissioning rules were amended by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to ensure they applied correctly when a petroleum miner abandoned an exploratory well. Further detail on how these rules apply is in Tax Information Bulletin Vol 34, No 5, June 2022.

These amendments included introducing the term "exploration abandonment excess", which is intended to limit a refundable credit when insufficient tax has been paid by the petroleum miner since drilling for the purposes of exploration ceased. This excess is calculated in one of three different ways depending on the circumstances outlined in sections LT 1(4D)(a) to (c).

However, one particular circumstance inadvertently fell within paragraph (c) instead of paragraph (a). This circumstance was where a petroleum miner had not abandoned any exploratory wells but had a loss for the year that was higher than their expenditure on previously unallocated development deductions (section LT 1(1)(a)(i)) and decommissioning development wells (section LT 1(1)(a)(ii)). In this case, the exploration abandonment excess should have been zero (rather than calculated under the formula in section LT 1(4D)(c)) as there was no abandonment expenditure to contribute to the refundable credit.

Key features

Section LT 1(4D)(a) has been amended so that it applies whenever a petroleum miner has not incurred expenditure in plugging and abandoning an exploratory well during the year such that the amount in section LT 1(1)(a)(iii) is zero.

Removing Transitional Provision

Section 139A of the Tax Administration Act 1994

The amendments repeal section 139A(9) of the Tax Administration Act 1994 and make consequential amendments to sections 139A(6) and (7) to remove a redundant transitional provision created for the transition to the START computer system.

Background

Provisions allowing the Commissioner a discretion not to impose penalties when it was necessary due to resource constraints imposed by the co-existence of two Inland Revenue software platforms were included in the Tax Administration Act 1994. As new tax products were progressively introduced into Inland Revenue's new computer system, START, these provisions have been repealed.

However, the last of these provisions, section 139A(9), was retained until the completion of the business transformation programme as there was a concern that penalties could have arisen in relation to late returns when it would have been appropriate to grant remission. As sufficient time has now passed since all tax products were migrated to START, section 139A(9) is now redundant.

Effective date

The amendments have effect for penalties imposed on or after 1 April 2023.

Trusts – imputation credits and distributions

Sections CD 15, LE 5

The amendments ensure that the amount of the tax credits apportioned to a beneficiary of a trust after a dividend distribution, match the imputation credits included in their assessable income to ensure the beneficiary is only taxed on the imputation credits they actually receive.

Background

Section CD 15(1) of the Income Tax Act 2007 provides that the amount of a dividend received by a person includes any imputation credits attached to the dividend. Section LE 1 provides that if the person's assessable income includes an imputation

credit, then they have a tax credit that is equal to the imputation credit (plus any credits from prior years that have been carried forward).

Section LE 5 applies when a person receives an imputed dividend in their capacity as a beneficiary of a trust. The section adjusts the beneficiary's tax credit under section LE 1 so that the amount of tax credit they have under that section is proportionate to the trust distributions they have received.

However, under the Income Tax Act 2004, there was a provision in addition to section LE 5. That additional provision applied if a beneficiary's tax credit was adjusted, and it ensured the beneficiary's imputation credit was also adjusted. This meant the imputation credit included in the beneficiary's assessable income was the adjusted (or limited) amount.

That additional provision was not carried over from the Income Tax Act 2004 to the Income Tax Act 2007. This means that, before the amendments were enacted, a beneficiary could have been taxed on a portion of an imputation credit they had not actually received. This was not an intended change in the rewrite of the Income Tax Act. The amendments corrected this issue.

Key features

The amendments ensure that any limitation on the tax credit a beneficiary receives following a dividend distribution is also applied to limit the associated imputation credit they receive. The amendments ensure that only the amount of imputation credit the beneficiary actually receives is included in their assessable income.

Effective date

The amendments apply from the 2008-09 income year.

Detailed analysis

New section LE 5(2) specifies that the formula prescribed to limit a person's tax credit also applies to limit the associated imputation credit included in the person's assessable income.

New section CD 15(1)(a) then specifies that the imputation credit included in a person's dividend under that section is reduced to take into account any limitation to the imputation credit made under section LE 5. That is, the adjusted imputation credit amount is included in the person's assessable income if section LE 5 applies to limit their tax credit.

The two amendments ensure that a person is only taxed on the imputation credit they actually receive, if the imputation credit is limited because of section LE 5(2), rather than the full imputation credit.

Priority accorded to KiwiSaver employer contributions

Sections 4A and 167 of the Tax Administration Act 1994, schedule 7 of the Companies Act 1993 and section 274 of the Insolvency Act 2006

The amendments clarify that KiwiSaver employer contributions have the same preferential debt status whether the employer is a natural person or a company or association. This is done by aligning the priority of those amounts in the Tax Administration Act 1994, Companies Act 2003 and Insolvency Act 2006.

Background

Where an employer is a natural person who has been bankrupted, unpaid KiwiSaver employer contributions are treated as preferential debt under section 167(2)(a) of the Tax Administration Act 1994 (TAA).

Where an employer is a company or an association that is being liquidated, section 167(2)(b) of the TAA provides that KiwiSaver employer contributions have the ranking provided for in schedule 7 of the Companies Act 1993.

However, KiwiSaver employer contributions were not separately identified in schedule 7. This created confusion regarding whether they were preferential debt because, in all other cases, taxes with preferential status are separately identified in schedule 7.

There was no reason that KiwiSaver employer contributions should have a different status where the employer is a company or association. The amendments clarify this.

Effective date

The amendments take effect on 1 April 2023.

Definition of "company" and foreign companies

Section YA 1 of the Income Tax Act 2007

The definition of "company" has been amended to exclude a "limited partnership" rather than a "partnership", ensuring that foreign companies are included in the definition of a company.

Background

Section YA 1 of the Income Tax Act 2007 (ITA) defines "company" and "partnership". The definition of a "company" previously excluded partnerships. A "partnership" was defined as including a partnership under section 8(1) of the Partnership Law Act 2019 (PLA) or a limited partnership. Section 8(1) defines a partnership broadly as "the relationship that exists between persons carrying on a business in common with a view to profit." The exclusions to this are found in section 9 of the PLA and all relate to entities formed under an Act of the Parliament of New Zealand. Consequently, all companies incorporated outside of New Zealand are not within the exclusions in the PLA, and so they are all technically partnerships. Therefore, they were not "companies" as defined in the ITA.

Foreign companies were therefore not subject to portions of the ITA, such as the foreign investment fund or controlled foreign companies' rules. This outcome was outside the policy intent and frustrated the application of those rules.

Key features

The definition of "company" now excludes a "limited partnership" rather than a "partnership". This means that foreign companies are no longer excluded from the definition of "company", while limited partnerships remain appropriately excluded.

Effective date

The amendment takes effect on 1 April 2008.

Fringe benefit tax – Cost of vehicle and State Sector Decarbonisation Fund

Schedule 5 clause (7C) of the Income Tax Act 2007

A remedial amendment clarifies that the "cost price" and "tax value" of a vehicle for the purposes of the fringe benefit tax rules is the gross cost including any amount funded by the State Sector Decarbonisation Fund.

Background

The State Sector Decarbonisation Fund (the Fund) is available to the state sector for updating its assets to less carbon intensive alternatives to reduce carbon emissions. For example, state sector entities have been using the Fund to help purchase electric and hybrid vehicles. The public does not have access to the Fund.

It was not clear under the fringe benefit tax legislation whether the "cost price" and "tax value" of a vehicle were inclusive of any amount received by the employer from the Fund.

Key features

The amendment clarifies that the "cost price" and "tax value" of a vehicle in Schedule 5 of the Income Tax Act 2007 is the gross cost including any amount funded by the State Sector Decarbonisation Fund.

Effective date

The amendment came into effect on 1 April 2023 and applies to fringe benefits provided on and after 1 April 2023.

Detailed analysis

Fringe benefit tax on a vehicle is calculated with reference to the "cost price" or the "tax value" of the vehicle to the employer or vehicle owner. The calculation is designed to reflect the average after-tax benefit an employee receives through not needing to purchase and maintain their own vehicle.

Fringe benefit tax is designed to equate with the PAYE (pay as you earn) tax that applies to salary and wages. This promotes fairness between employees, whether they are paid in cash or in kind, and helps preserve the integrity of the employment income tax base.

The cost basis for calculating fringe benefit tax needs to be the gross cost of the vehicle inclusive of any amount funded by the Fund to reflect the value of the fringe benefit to a state sector employee of a vehicle funded or part-funded by the Fund. This is consistent with the overall purpose of the FBT regime and original policy intent to tax the value of the benefit that the employee receives equivalent to the payment of additional salary or wages.

Schedule 5 of the Income Tax Act 2007 was therefore amended to clarify that the "cost price" and "tax value" of a vehicle for the fringe benefit tax rules is the gross cost including any amount funded by the Fund. For example, if the vehicle cost the employer $40,000 before any Fund subsidy, that is the cost basis for FBT purposes.

An earlier amendment had clarified that when the employer receives a Clean Vehicle Discount, the "cost price" and "tax value" are reduced by that discount. The key difference with that situation compared with a vehicle subsidised by the State Sector Decarbonisation Fund is that an employee would have been eligible for a Clean Vehicle Discount if they had purchased a vehicle themselves, whereas they are not eligible for a subsidy under the Fund.

R&D loss tax credits – deadline for statements

Section 70C of the Tax Administration Act 1994

The filing requirements for R&D loss tax credit (R&DLTC) statements have been changed to simplify the requirements and to align with the equivalent requirements for the Research and Development Tax Incentive (RDTI).

Effective date

The amendments apply for the 2015–16 and later tax years, except for the amended due date for R&DLTC statements in relation to the 2022-23 or later tax years, which applies for the 2022–23 and later tax years, as detailed below.

Detailed analysis

Removal of requirement to file statement before income tax return

The due date for a R&DLTC statement was previously the earlier of the date a taxpayer filed their income tax return and the due date for the income tax return. This meant that a taxpayer that filed a R&DLTC statement a day after they filed their income tax return for that year was ineligible for R&DLTCs for the year. This outcome was counter to the intent of the R&DLTC regime, where taxpayers have an incentive to file early to cash out their R&D losses sooner.

The order in which the R&DLTC statement is filed relative to the filing of an income tax return for the same period should not affect a taxpayer's eligibility for R&DLTCs. The requirement to file a R&DLTC statement on or before the date that the income

tax return is filed has therefore been removed (and this amendment has been backdated to the start of the regime).

Changes to deadline for statements

In the absence of the requirement to file a R&DLTC statement on or before the date that the income tax return is filed, the previous requirement was then that the statement must be filed by the due date for the income tax return. This due date has been changed to the day that is 30 days after the income tax return due date. This aligns with the supplementary return filing date for the RDTI. This due date applies for the 2022–23 and later tax years.

The equivalent due date for previous tax years (from 2015–16 to 2021–22 inclusive) has been retrospectively changed to 31 March after the end of the relevant tax year. This provides certainty around R&DLTCs already paid out. This applies regardless of whether the person has an approved extension of time for filing their tax return for the year in question.

R&D Tax Incentive – grant-related expenditure exclusion

Schedule 21B of the Income Tax Act 2007

R&D expenditure by businesses that receive a New to R&D Grant has been carved out from the grant-related expenditure exclusion in the Research and Development Tax Incentive (RDTI) to the extent that R&D expenditure exceeds the amount contracted for under the New to R&D Grant.

Effective date

The amendment came into effect on 6 December 2022 to align with the start date of the New to R&D Grant.

Detailed analysis

Carve-out for the New to R&D Grant

Expenditure or loss that is incurred in conjunction with receipt of a government grant is generally not eligible for the RDTI. However, there are some carve-outs to this exclusion. For example, business R&D expenditures funded by Callaghan Innovation Project Grants are carved out to the extent that R&D expenditure exceeds the amount contracted for under the Project Grant. This ensures that expenditures that are not supported by a Project Grant can still be supported by the RDTI.

The New to R&D Grant is replacing the Project Grant. The two types of grants have similar terms: both provide for co-funding of up to 40% of eligible R&D expenditure and are administered by Callaghan Innovation.

The amendment to schedule 21B, part B, item 21 introduces a similar carve-out to the grant-related expenditure exclusion for New to R&D Grants. This ensures that expenditures that are not supported by a New to R&D Grant can still be supported by the RDTI. This is particularly pertinent as one of the policy objectives of the New to R&D Grant is to encourage new businesses (or businesses new to R&D) to establish an R&D programme and potentially move off the New to R&D Grant and onto the RDTI in the future.

R&D Tax Incentive – notification of changes in activities

Sections 68CB and 68CC of the Tax Administration Act 1994

Taxpayers enrolled in the Research and Development Tax Incentive (RDTI) with a multi-year general approval of their activities are no longer required to notify the Commissioner that there have been no material changes in their business. The amendments also clarify when a business is required to apply for a variation to an existing approval to cover any material changes.

Effective date

The amendments apply for the 2020–21 and later income years.

Detailed analysis

Removal of existing notification requirement

Businesses with a general approval of their R&D activities for multiple income years (up to three) were previously required to notify the Commissioner, in each of the second and third years of those approvals, that there had been no material changes for their business for the relevant income year.

Section 68CB(1)(d) of the Tax Administration Act 1994 has been repealed to remove this requirement as it imposes unnecessary compliance costs on businesses. It is more sensible to require businesses to notify the Commissioner when there is a material change in their business rather than when there is not one.

Requirement to apply for variation

In practice, businesses are already required to apply for a variation to an existing approval if there is a material change in their activities or their criteria and methodologies if they want that change to be covered by their existing approval. This is because a business cannot be credited the RDTI for activities or criteria and methodologies that are not covered, or are materially different from those covered, by their approval. Sections 68CB(7) and (7B) (for general approvals) and section 68CC(8) (for criteria and methodologies approvals) set out the Commissioner's powers to approve applications for variations. However, they do not specifically state under what circumstances a business must apply for a variation.

New section 68CB(3B) applies for activities covered by general approvals. It clarifies that if there is a material change in activities after a business has received approval, and the business wants the change to be covered by the existing approval, it would need to apply to the Commissioner for a variation of its existing approval by the deadline provided for in section 68CB(7) or (7B), as applicable.

New section 68CC(4B) applies for criteria and methodologies approvals. It clarifies that if there is a material change in criteria and methodologies after a business has received approval, and the business wants the change to be covered by the existing approval, it would need to apply to the Commissioner for a variation of its existing approval by the deadline provided for in section 68CC(8).

Both new sections are intended to be clarifications only and do not change the existing processes or obligations for when there is a material change in activities or criteria and methodologies. If there is a material change during the income year (for example, a business performs a new R&D activity during the year not initially covered by its existing RDTI approval), but the business does not wish to claim the RDTI for expenditure associated with that change, then there is no obligation to apply for a variation.

Confidentiality of sensitive revenue information

Section 18B(2) of the Tax Administration Act 1994

Summary of the amendment

The term "revenue information" in section 18B(2) of the Tax Administration Act 1994 has been replaced with "sensitive revenue information".

Background

Section 18(2) of the Tax Administration Act 1994 requires persons other than revenue officers to maintain the confidentiality of "sensitive revenue information". Section 18B(2) then requires those persons to complete a certificate of confidentiality for that purpose. However, section 18B(2) incorrectly referred to "revenue information" instead of "sensitive revenue information".

This was a drafting oversight when the relevant legislation was replaced on 18 March 2019.

Effective date

The amendment takes effect on 18 March 2019.

Member departing consolidated imputation group

Sections OB 23B, OP 16B, OP 41B and OP 41C and Tables O1, O19 and O20 of the Income Tax Act 2007

Amendments have been made to the rules governing the imputation credit regime that change the allocation of imputation credits upon a member's departure from a consolidated imputation group.

Background

Under the Income Tax Act 2007 (ITA), a group of wholly-owned companies may form a consolidated imputation group. This group has one imputation credit account (ICA) and any debits or credits that would have arisen in individual members' ICAs arise in the consolidated imputation group's ICA.

Members of a consolidated imputation group, which may be individual entities or consolidated income tax groups, may leave the imputation group. However, there were no legislative provisions regarding the allocation of imputation credits accrued to the group's ICA but associated with the tax payments of the departing member. All imputation credits remained in the consolidated imputation group's ICA. This could result in tax refunds not being able to be issued due to a lack of imputation credits in the departed members' ICA.

This amendment introduces rules that allow the allocation of imputation credits associated with the tax payments of the departing member not yet credited to a tax liability to that member.

Key features

- A consolidated imputation group may elect to receive an imputation debit to its ICA equivalent to the imputation credits arising from tax payments of a departing member that have not yet been credited to a tax liability.
- If the parent group elects to receive an imputation debit to its ICA then the departing member may elect to receive an equivalent imputation credit to its ICA.
- The departing member may be a company or a consolidated imputation group.
- The debits and credits to the ICAs will arise on the same day as the original credit that arose in connection to the corresponding tax payment.

Effective date

The amendments came into force on 1 April 2021.

Detailed analysis

Sections OB 23B and OP 41B set out the debits and credits that may occur when an individual company that is part of a consolidated imputation group leave the consolidated imputation group. OP 41B governs the debit to the consolidated imputation group's ICA, while OB 23B governs the credit to the account of the departing company.

OP 41B enables the consolidated imputation group to elect to have a debit to its ICA if a member departing from the consolidated imputation group has made a payment to Inland Revenue or to a tax pooling account that has not yet been applied to a tax liability and has given rise to a credit in the group's ICA. The imputation debit will be equivalent to the size of the imputation credit that arose because of the corresponding tax payment and will arise to the group's ICA on the original day of credit to the group's ICA.

If the consolidated imputation group elects to have this debit, section OB 23B enables the departing member to elect to have a credit to its ICA of equivalent size to the debit to the ICA of the consolidation group's ICA. This mechanism allows for imputation credits associated with a company's tax payments that have not been applied to a tax liability to be transferred to the company when it leaves the consolidated imputation group.

This mechanism is replicated in sections OP 16B and OP 41C for consolidated imputation groups that are members of a "parent" consolidated imputation group. Section OP 41C governs the debit to the parent consolidated imputation group and OP 16B governs the credit to the departing consolidated imputation group. The provisions relate to imputation credits associated with both tax payments of the group and its underlying members.

Example 110: Group departing consolidated imputation group

Spare Ltd is a member of Royal Ltd Consolidated Group. Royal Ltd Consolidated Group is a consolidated imputation group that maintains one ICA for all members of the group. Spare Ltd has made a tax payment in advance of its obligations that has led to an imputation credit of $1,000,000 to the ICA of Royal Ltd Consolidated Group. It has not filed a tax return to have that $1,000,000 applied to a tax liability (other than provisional tax).

As part of an internal restructure, Spare Ltd has elected to leave the Royal Ltd Consolidated Group consolidated imputation group. Royal Ltd Consolidated Group chooses to have a debit to its ICA of $1,000,000, the amount of the imputation credits associated with the tax payment of Spare Ltd. Spare Ltd may choose to receive a credit to its ICA of $1,000,000.

When Spare Ltd files its tax return for the year it ends up having a tax loss and asks for the $1,000,000 payment to be refunded. As Spare Ltd has an ICA credit balance of 1,000,000 this refund can be issued.

Similar treatment would apply if Spare Ltd was a consolidated imputation group.

Write-off of tax by Commissioner

Section 177C of the Tax Administration Act 1994

Tax write-offs that occur as part of Inland Revenue's "auto-calc" process will no longer result in a tax loss extinguishment.

Background

Section 177C of the Tax Administration Act 1994 (TAA) required a taxpayer with a tax loss who receives a tax write-off to have all or part of their tax loss extinguished. This included write-offs under sections 22J, 174AA and 177C of the TAA. Some of these write-offs are mandatory, while others are discretionary. In practice, several of these tax write-offs occur via Inland Revenue's "auto-calc" process, the process via which tax liabilities are automatically calculated for those taxpayers who receive only income with tax deducted at source (for example, salary and wages). This process does not automatically generate a corresponding tax loss extinguishment for taxpayers with tax losses.

The amendment to section 177C reconciles the legislation and existing administrative practice by removing the requirement for the tax write-offs implemented via the auto-calc process to have a corresponding tax loss extinguishment.

Effective date

The amendment is effective for the 2018–19 and later income years.

Annual imputation return for members of a consolidated imputation group

Section 69 of the Tax Administration Act 1994

The amendment provides that the requirement to file an annual imputation credit account (ICA) return does not apply to an ICA company that is a member of a consolidated imputation group if the ICA for the company has a nil balance at all times during the relevant tax year.

Background

Section 69 of the Tax Administration Act 1994 requires a company that maintains an ICA to file an annual ICA with the Commissioner.

When a company joins a consolidated imputation group, the member's individual ICA is effectively frozen, with no debits or credits occurring to that account other than permitted transfers of credits to the consolidated imputation group's ICA.

This can lead to individual members of the group having nil ICA balances over time. Section 69 previously required these companies to continue to file ICA returns, notwithstanding they were not required to file an income tax return due to the consolidated group filing a single income tax return for all the members of the group.

This created a compliance cost to those companies with no corresponding benefit to the Inland Revenue of the information being provided.

Effective date

The amendment is effective for the 2020–21 and later tax years.

Maintenance items

The amendments in Table 6 reflect minor technical maintenance items arising from the rewrite of income tax legislation and subsequent changes.

Effective date

The amendments take effect on the dates outlined in Table 6.

Minor maintenance items

The amendments in table 6 correct any of the following:

- ambiguities
- compilation issues
- cross-references
- drafting consistency, including readers' aids – for example, the defined terms lists
- grammar
- consequential amendments arising from substantive rewrite amendments, and
- inconsistent use of terminology and definitions.

Table 6: Maintenance amendments

Enactment	Section	Amendment	Effective date
Income Tax Act 2007	AA 1	Correcting terminology	1 April 2023 (day after date of Royal assent)
	CQ 5(1)(c)(viii)	Correcting terminology	29 September 2018
	CX 10(2)(b)	Correcting terminology	29 March 2018
	CX 35(2)(b)	Correcting terminology	29 March 2018
	DB 53(1)(b)	Correcting terminology	1 April 2020
	DH 7(2)	Correcting terminology	27 March 2021
	DH 12(2)	Correcting terminology	27 March 2021
	DN 6(1)(c)(viii)	Correcting terminology	29 September 2018
	EW 46C(6)	Correcting terminology	29 March 2018
	EX 38(1)(f)	Correcting terminology	29 September 2018
	GB 28(6)(a)	Correcting terminology	1 April 2023 (day after date of Royal assent)
	HM 40	Correcting terminology	1 April 2020
	HR 12(3)(d)	Correcting terminology	1 April 2023 (day after date of Royal assent)
	IC 4(2)	Correcting terminology	29 March 2018
	YA 1 (profit distribution plan)	Correcting terminology	29 March 2018
	YA 1 (profit distribution plan)	Correcting terminology	29 September 2018

Enactment	Section	Amendment	Effective date
	YA 1 (unit trust)	Correcting terminology	29 March 2018
Goods and Services Tax Act 1985	60C(2)	Correcting terminology	1 April 2023 (day after date of Royal assent)
Tax Administration Act 1994	89AB(3)	Removing redundant provision	1 April 2009
	89AB(4)	Removing redundant provision	1 April 2009
	91C(4)	Removing redundant provision	1 April 2009
	141(7C) and (7D)	Removing redundant provision	1 April 2009
	142B(2)	Removing redundant provision	1 April 2023 (day after date of Royal assent)
	177B(7)	Correcting cross-reference	1 April 2009
	Schedule 7, part C, clause 21(2)	Removing redundant provision	1 April 2009
Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022	YA 1 of the Income Tax Act 2007 (cryptocurrency, non-fungible token)	Correction of application and commencement dates	30 March 2022 (to ensure the definitions apply from 1 January 2009)

SL2023/080 – Order in Council: Privacy (Information Sharing Agreement between Inland Revenue and Ministry of Social Development) Amendment Order 2023

Background

This Order amends the Privacy (Information Sharing Agreement between Inland Revenue and Ministry of Social Development) Order 2017 to enable the Ministry of Social Development (MSD) to dispense with the requirements to give notice of an adverse action against an individual if the information shared is child support information shared by Inland Revenue with MSD for the purposes of charging the child support as income for benefit purposes. This order also specifies the requirements that MSD must comply with before taking adverse action.

Key features

This Order amends the Privacy (Information Sharing Agreement between Inland Revenue and Ministry of Social Development) Order 2017 as well as gives effect to the Information Sharing Agreement between MSD and Inland Revenue that was signed in April 2023.

The Privacy Act 2020 requires a party to an information sharing agreement to give 10 working days' notice prior to taking any adverse action that is identified from sharing information under the agreement. However, the Privacy Act also enables this notice requirement to be varied by an information sharing agreement. This Order amends the original information sharing agreement to provide for such a waiver.

The Government has announced that from 1 July 2023, child support is to be passed on to beneficiaries on a sole parent rate of main benefit. Currently when a receiving carer is on a sole parent rate of main benefit, the child support is retained by the government to offset the cost of the benefit.

From 1 July, when beneficiaries receive child support, if the child support and any other income received is above the benefit abatement income level, the amount of the benefit will reduce.

When a beneficiary receives child support, providing a 10-day notification period prior to reducing the benefit may result in beneficiaries incurring debt, which will have to be repaid. To reduce the extent that debts are created, any benefit adjustment needs to occur close to the date of receipt of the child support. To achieve this, a waiver of the 10-day notification period is required.

The Order also sets out the procedures that MSD must comply with before taking any adverse actions; namely, comply with all applicable internal policies and guidelines and the Solicitor-General's Prosecution Guidelines (as applicable).

Also, MSD must, immediately after any decision to reduce or suspend a benefit, take steps that are reasonable to notify the individual of the details of their benefit change; and their right to review and appeal the Ministry's decision.

Other amendments

The Order also makes a number of amendments as outlined below.

Schedule 2 of the Privacy Act 2020 is amended to update the description of the purposes for sharing information under the agreement to include improving the administration of the benefit system, and for research, and analysis purposes.

Amendments are made to the principal Order to:

- update references to the Privacy Act 2020 and Tax Administration Act 1994;
- reflects changes to the information sharing agreement that have been made since September 2021, namely:
  - the sharing of information to test systems and processes to enable the administration of the benefits, subsidy, and tax systems, and
  - the sharing of information for statistical analysis and research purposes relating to the benefit, subsidy, and tax systems.

The information that is shared solely for the purpose of testing systems and processes and shared for statistical and research purposes may only be used for that purpose.

Effective date

This Order comes into force on 1 July 2023.

Further information

The new regulations can be found at:

https://www.legislation.govt.nz/regulation/public/2023/0080/latest/LMS836486.html

SL2023/119 – Order in Council: Income Tax (Accommodation Expenditure – North Island Flooding Events) Order 2023

Background

Between 8 January 2023 and 16 February 2023, a number of adverse weather events affected large parts of the North Island.

These weather events have impacted upon taxpayer's businesses and livelihoods. In response to the events, the government enacted a number of provisions that provided tax relief from income tax and fringe benefit tax for certain cash and benefits provided by employers to flood affected employees.

In addition, the government enacted a provision that provides for the tax-free provision of accommodation to employees who are required to relocate to work on projects of limited duration for the rebuilding or recovery in areas covered by the North Island floods.

The provision requires workers to move to the new location within six-month after the start of the relevant flooding event. This timeframe does not match the timeframe that was permitted in respect of the Canterbury earthquakes.

The Government has agreed that this discrepancy be amended with retrospective effect in the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill, however, the six-month timeframe for employees to commence work that is currently in the legislation will expire prior to that bill being enacted leaving taxpayers with no certainty around the tax implications of the provision of accommodation in the interim.

Key features

The order extends the current time frame in section CZ 29B from six-months after the start of the relevant flooding event to 1 April 2024. This will allow time for the bill which contains the proposed correction to be enacted.

Effective date

The order was made on 6 June 2023 and will come into force on 6 July 2023.

Further information

The new regulation can be found at:

https://www.legislation.govt.nz/regulation/public/2023/0119/4.0/LMS848586.html

SL2023/134 – Order in Council: Income Tax (Deemed Rate of Return for Attributing Interest on Foreign Investment Funds for the 2022-23 Income Year) Order 2023

Background

The deemed rate of return is set annually and is one of the methods that can be used to calculate income from foreign investment fund interests. The rate is calculated by taking an average of the five-year Government bond rate at the end of each quarter, plus a margin of four percent.

Key features

The deemed rate of return for taxing interests in foreign investment funds is 8.15% for the 2022–23 income year, an increase of 2.14% from the previous income year.

Effective date

The new rate was set by Order in Council on 12 June 2023 and came into force on 16 June 2023.

Further information

The new regulation can be found at:

http://www.legislation.govt.nz/regulation/public/2023/0134/4.0/contents.html

LEGISLATION AND DETERMINATION

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.

NAMV 2023: National Average Market Values of Specified Livestock Determination 2023

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2023".

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 2022-2023 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 2022-2023 income year, are as set out in the following table.

National Average Market Values of Specified Livestock

Type of Livestock	Classes of Livestock	Average Market Value per Head $
Sheep	Ewe hoggets	136.00
	Ram and wether hoggets	134.00
	Two-tooth ewes	205.00
	Mixed-age ewes (rising three-year and four-year old ewes)	177.00
	Rising five-year and older ewes	144.00
	Mixed-age wethers	120.00
	Breeding rams	372.00
Beef cattle	*Beef breeds and beef crosses:*	
	Rising one-year heifers	742.00
	Rising two-year heifers	1153.00
	Mixed-age cows	1334.00
	Rising one-year steers and bulls	920.00
	Rising two-year steers and bulls	1353.00
	Rising three-year and older steers and bulls	1686.00
	Breeding bulls	3533.00
Dairy cattle	*Friesian and related breeds, Jersey and other dairy breeds:*	
	Rising one-year heifers	693.00
	Rising two-year heifers	1436.00
	Mixed-age cows	1628.00
	Rising one-year steers and bulls	579.00
	Rising two-year steers and bulls	1012.00
	Rising three-year and older steers and bulls	1346.00
	Breeding bulls	1779.00

Deer	*Red deer, wapiti, elk, and related crossbreeds:*	
	Rising one-year hinds	219.00
	Rising two-year hinds	410.00
	Mixed-age hinds	440.00
	Rising one-year stags	273.00
	Rising two-year and older stags (non-breeding)	595.00
	Breeding stags	2425.00
	Other breeds:	
	Rising one-year hinds	110.00
	Rising two-year hinds	164.00
	Mixed-age hinds	168.00
	Rising one-year stags	127.00
	Rising two-year and older stags (non-breeding)	197.00
	Breeding stags	579.00
Goats	*Angora and angora crosses (mohair producing):*	
	Rising one-year does	125.00
	Mixed-age does	160.00
	Rising one-year bucks (non-breeding)/wethers	90.00
	Bucks (non-breeding)/wethers over one year	108.00
	Breeding bucks	491.00
	Other fibre and meat producing goats (Cashmere or Cashgora producing):	
	Rising one-year does	108.00
	Mixed-age does	143.00
	Rising one-year bucks (non-breeding)/wethers	79.00
	Bucks (non-breeding)/wethers over one year	88.00
	Breeding bucks	423.00
	Milking (dairy) goats:	
	Rising one-year does	248.00
	Does over one year	289.00
	Breeding bucks	614.00
	Other dairy goats (culls)	79.00
Pigs	Breeding sows less than one year of age	273.00
	Breeding sows over one year	333.00
	Breeding boars	359.00
	Weaners less than 10 weeks of age (excluding sucklings)	120.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	165.00
	Growing pigs over 17 weeks of age (baconers)	239.00

This determination was signed by me on the 23rd day of May 2023.

Matthew Evans

Technical Lead, Technical Standards, Legal Services

Inland Revenue

References

Legislative References

Income Tax Act 2007: s EC 15, Schedule 17

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 23/01

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 Fonterra Co-operative Group Limited (Fonterra).

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CD 4, CD 5, CD 6, CX 56, CX 56B, DA 1, DB 23, subpart HM, and the definition of "foreign investment variable-rate PIE" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the operation of the Fonterra Shareholders' Fund (FSF). The FSF is a New Zealand–resident unit trust through which non–milk-supplying investors (Public Investors) and farmers supplying milk to Fonterra (Supplying Shareholders) can invest in Units. Units in the FSF give economic rights in Fonterra shares (Shares), but do not give Unit Holders any legal interest in the Shares.

The FSF was established in November 2012. Trading in FSF Units commenced on the NZX Main Board on 30 November 2012. A total of 95,454,545 Units were on issue at that date, for a total consideration of $525 million. As at 28 March 2023, the FSF had 107.4 million Units issued.

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement

1. The parties to the Arrangement are:
    a) Fonterra,
    b) the FSF (through the Manager or Supervisor),
    c) Donald Hammond, John Nicholls and Ian Brown in their capacity as trustees of the Fonterra Farmer Custodian Trust (Farmer Trustees),
    d) the Custodian,
    e) the Supervisor,
    f) FSF Management Company Limited as manager of the FSF (Manager),
    g) Supplying Shareholders, and
    h) Public Investors.
2. Supplying Shareholders, Farmer Trustees, Fonterra and Public Investors may invest in the FSF. Together, they are referred to as the Unit Holders.

3. The Farmer Trustees hold one Unit in the FSF (the Fonterra Unit) which has special, essentially veto, rights (cls 4.5 to 4.8 of the Trust Deed). These special rights mean the Farmer Trustees must approve, for example, an amendment to, removal of or alteration of a provision in the Trust Deed where that amendment, removal or alteration would change the:
   a) governance structure of the board of the Manager,
   b) scope and role of the FSF,
   c) obligation of the trust to facilitate the exchange of a Share for a Unit or a Unit for a Share, or
   d) 15% limit on the number of Units that any person or their associated persons (other than Fonterra or a wholly-owned subsidiary of Fonterra) can hold, or
   e) terms of the Fonterra Unit.
4. The rights of the Fonterra Unit to proceeds and distributions from the FSF are the same as for all other Units (cl 4.5(h) of the Trust Deed).

Documents relevant to the Arrangement

5. The following documents are relevant to the Arrangement:
   a) Fonterra Shareholders' Fund Trust Deed dated 23 October 2012 and as amended and restated on 1 November 2016 and on 17 June 2019 (which established the FSF) (Trust Deed),
   b) Fonterra Shareholders' Fund Authorised Fund Contract dated 25 October 2012 and as amended and restated from 1 November 2016, under which the FSF was established as an "Authorised Fund" under Fonterra's Constitution,
   c) Deed of Trust establishing the Fonterra Farmer Custodian Trust dated 25 October 2012, which holds all shares in the Custodian and the Fonterra Unit,
   d) Custody Trust Deed for the Fonterra Economic Rights Trust dated 25 October 2012, under which the Custodian holds the legal title to Shares and holds the economic rights in Shares on trust for the Supervisor, and
   e) Constitution of Fonterra Co-operative Group Limited (Constitution), which was approved by shareholders on 9 December 2021 and which will be effective on a date to be advised by the Fonterra board when it is satisfied all steps necessary to implement the new structure have been or will be implemented. (This is to occur on and with effect from 28 March 2023).

Background to the Arrangement

6. Fonterra is simultaneously registered as a co-operative dairy company under Part 3 of the Co-operative Companies Act 1996 and as a company under the Companies Act 1993. The Dairy Industry Restructuring Act 2001 (DIRA) governs many aspects of Fonterra's structure and operation.

Trading Among Farmers Structure

7. Prior to November 2012, s 98 of the DIRA required Fonterra to pay a surrender value for Shares when a Supplying Shareholder gave a notice of withdrawal under s 97 of the DIRA. The ability for farmers to surrender their Shares in this way led to volatility in Fonterra's capital, referred to by Fonterra as redemption risk.
8. To address this redemption risk, Fonterra introduced its Trading Among Farmers (TAF) structure in 2012, which included:
   a) enabling farmers to acquire up to 100% of the number of Shares they must hold under the share standard as dry Shares,
   b) establishing the FSF to enable public investment, and
   c) creating a "private market" (the Fonterra Shareholders' Market (FSM)) for the trading of Shares between Supplying Shareholders, and Fonterra (together referred to as Permitted Persons).
9. The DIRA was also amended to remove the requirement for Fonterra to accept the surrender of Shares on request. This amendment was brought into force in November 2012 by Order-in-Council and removed the redemption risk.

Capital Restructure

10. In December 2021, Fonterra shareholders voted in favour of a change to Fonterra's capital structure (Capital Restructure) to replace the previous TAF capital structure. In April 2022, the Government announced its support for the changes. The Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Act 2022 (Amendment Act) received royal assent on 28 November 2022. The Amendment Act was introduced to support the Capital Restructure (including an amendment requested by Fonterra to reduce the risk that legal action could be taken against Fonterra under section 109M of the DIRA).
11. The Capital Restructure takes effect from 28 March 2023.
12. A key change under the Capital Restructure is capping the size of the Fund by removing the exchangeability of Shares for Units in the FSF on a day to day basis. As a result, Shares will be tradeable in the FSM only and no new Units will be issued in the FSF on a day to day basis.
13. Previously, in accordance with Fonterra's Constitution, the FSF could hold economic rights to no more than 20% of Fonterra Shares. That percentage will be reduced to 10% on implementation of the Capital Restructure.
14. In addition, prior to the Capital Restructure, Supplying Shareholders generally needed to hold such number of Shares as is determined by the share standard, being one share for each kilogram of milksolids obtainable from the average milk supplied by the farmer in the previous three seasons. On implementation of the Capital Restructure, the share standard remains unchanged however the minimum shareholding that Supplying Shareholders will be required to hold will be one share for every three kilograms of milksolids obtained from the average milk supplied by the farmer (being 33% of the share standard).
15. Shares up to the share standard are informally known as "wet" shares, as they are backed by the supply of milk.
16. In addition to their "wet" Shares, Supplying Shareholders may acquire further Shares (under the Capital Restructure the acquisition limit in relation to such shares is 4 times the share standard for the Supplying Shareholder). These Shares held above the share standard are informally known as "dry" Shares, as they are not backed by the supply of milk. Despite the informal distinction between wet Shares and dry Shares, all Shares of Fonterra belong to a single class of share.

The Arrangement

17. The FSF is a passive investment vehicle through which a Public Investor can invest indirectly in Fonterra. The FSF was initially established as a unit trust under the Unit Trusts Act 1960 on 23 October 2012. Following the repeal of the Units Trust Act 1960 in December 2014, the FSF became a managed investment scheme (as defined in section 9 of the Financial Market Conducts Act 2013).
18. The FSF has elected to be a "foreign investment variable-rate PIE" (as defined in s YA 1) and to use the exit calculation option (under s HM 42). The Commissioner confirmed this by letter dated 13 November 2012.
19. The FSF is a vehicle for investors to access the underlying economic rights in a Share. While Supplying Shareholders may invest in the FSF, most of the Unit Holders are not Supplying Shareholders.

Registered volume provider

20. The role of the RVP is to facilitate trades and liquidity in the FSM. Prior to the Capital Restructure, the RVP could sell economic rights in relation to Shares to the FSF, which promoted price convergence between the FSM and FSF. With the size of the Fund capped, from implementation of the Capital Restructure, the RVP will no longer be able to sell economic rights of Shares into the FSF.

Supervisor, Manager and Custodian

21. Fonterra appointed the initial Supervisor as trustee of the FSF. The Supervisor is licensed under the Financial Markets Supervisors Act 2011.
22. Fonterra also appointed the initial Manager of the FSF. The Manager is a company wholly owned by Trustees Executors Limited. Under the Financial Markets Conduct Act 2013, the role of the Manager is to manage the investments of the FSF. The Manager manages the FSF as an investment vehicle and does not undertake an active role (such as actively soliciting farmers to sell economic rights in their Shares). Fonterra provided a licence (the Licence) to the Manager to use Fonterra's name and brand for the purposes of the FSF.

23. The Supervisor and Manager are party to an arrangement (the Funding Arrangement) with Fonterra under which Fonterra provides the FSF with funds at the start of each financial year to cover the reasonable expenses incurred by the FSF, or the Manager, on behalf of the FSF (Operating Expenses) in accordance with a budget agreed between the parties.
24. The Custodian is a limited liability company set up to hold legal title to the Shares. The Custodian holds legal title to any Shares in which economic rights have been sold to the FSF and holds the economic rights in Shares on trust for the Supervisor (under the Fonterra Economic Rights Trust).
25. The Custodian is wholly owned by the Farmer Trustees, as trustees of the Fonterra Farmer Custodian Trust. The Fonterra Farmer Custodian Trust is a trust set up for the sole purpose of holding the shares in the Custodian and the Fonterra Unit. The Farmer Trustees are three farmer representatives (a farmer directly elected by Supplying Shareholders, a director of Fonterra elected by Supplying Shareholders, and a member of the Fonterra Shareholders' Council). The discretionary beneficiaries of the trust are Supplying Shareholders, and Fonterra is the final beneficiary of the trust.
26. The Custodian (and the FSF) does not have voting rights in Fonterra under the Constitution, which restricts voting rights to Supplying Shareholders (that is, production-based voting rights), except at a meeting of an interest group where there would otherwise be no shareholder entitled to vote at that meeting under cl 24.2(c) of the Constitution. Under cl 7.8 of the Constitution, the Authorised Fund Contract is required to prohibit the FSF and the Custodian from exercising, controlling or exerting any influence over any voting rights attached to the Shares. The Trust Deed and Custody Trust Deed also contain provisions preventing the FSF and the Custodian from exercising any influence over voting rights attached to the Shares.
27. Under cl 7.1 of the Custody Trust Deed, the income of the Fonterra Economic Rights Trust includes amounts of deemed income that arise under tax law, and the Custodian is permitted to distribute this income to the FSF.

Operation of the Fonterra Shareholders' Fund

28. The FSF provides outside investors the opportunity to invest in the performance of Fonterra by way of investing in Units. Units are listed on the NZX Main Board and on the ASX in the same way as other listed securities.
29. Under the Trust Deed, each Unit issued in the FSF evidences the holder's entitlement to the economic benefits (including distributions and other benefits) in the whole of the trust fund. As the number of Units the FSF issues equals the number of Shares the Custodian holds (in which economic rights are being held in favour of the Supervisor), in effect, each Unit provides rights to receive the distributions and other benefits in respect of one Share. Individuals and their associates must not hold more than 15% of the lesser of the total number of Units on issue or the total voting rights in the FSF (cl 6.1 of the Trust Deed).
30. The Units in the FSF (including the Fonterra Unit) carry in respect of the FSF a right to vote or participate in any decision-making concerning at least one of the following:
    a) a dividend or other distribution to be paid or made by the FSF, or
    b) any variation to the Trust Deed.
31. Clause 4.1(c) of the Trust Deed sets out that the Units do not confer any interest in certain amounts under the Trust Deed, as follows:

    > c) Unless the Manager directs otherwise, Units shall not confer any interest in interest income of the Trust. Units shall not confer any interest in monies paid to the Supervisor or the Manager to meet their fees or to reimburse either of those parties for (or any advance payment in respect of) any expenses, liabilities, losses and costs incurred by them respectively in or about acting as Supervisor or Manager (as the case may be) under this Deed. In all cases, all interest income and such monies will be applied by the Manager to meet the fees and expenses, liabilities, losses and costs incurred by the Manager or the Supervisor in or about acting as Manager or Supervisor (as the case may be).

32. The FSF Units trade on a registered market (the NZX Main Board and ASX) in which Supplying Shareholders, Fonterra and other Public Investors may participate. Standard listing rules (but with various exemptions to those rules recognising that it is a managed investment scheme and to accommodate other characteristics apply to the FSF. Fonterra and the FSF co-operate with each other in relation to matters such as disclosure of information to enable the FSF to comply with the listing rules applicable to the FSF.
33. Supplying Shareholders and Fonterra can exchange Units for Shares subject to various limits. After the Capital Restructure, there is likely to be a price differential between the Units and Shares (in which case Supplying Shareholders and Fonterra may prefer to sell their Units and use the proceeds to purchase Shares).

34. Under cls 6.5 and 7.8 of the Constitution and cl 15.2 of the Trust Deed, neither the RVPs nor the FSF (or the Custodian in relation to either) is entitled to exercise any voting rights attached to Shares that the Custodian, from time to time, holds for them (except on an interest group resolution where otherwise no shareholder can vote: cl 24.2(c) of the Constitution).
35. No Unit Holder may require the transfer to themselves of any of the property of the FSF or any Share. The Supervisor covenants that it will not call for a transfer of the Shares (cl 4.8 of the Custody Trust Deed). In addition, no Unit Holder may redeem their Units for cash other than as described in cl 15.1(h) of the Trust Deed. However, Unit Holders may sell their Units to other investors on the NZX Main Board or ASX.
36. In addition to dividends, which are expected to be paid twice a year, other potential distributions in respect of the Shares include:
    a) taxable and non-taxable bonus issues,
    b) in-specie distributions of property,
    c) share buy-backs,
    d) dividend reinvestment schemes,
    e) renounceable and non-renounceable rights issues, and
    f) notional distributions.
37. Section 16 of the Dairy Industry Restructuring Amendment Act 2012 inserted ss 161A and 161B into the DIRA to allow Fonterra to hold Units in the FSF. Fonterra maintains a unit-holding in the FSF that may increase or decrease but will always hold at least one Unit. In respect of Units Fonterra holds, the DIRA prevents Fonterra from exercising any voting rights carried by those Units (s 161A(i)).
38. The FSF may derive income other than from the Shares the Custodian holds on its behalf such as interest on cash held in a bank account and amounts received under the Funding Arrangement (Other Income). To the extent the Fund derives Other Income, cl 4.1(c) of the Trust Deed provides that no Unit Holder has an interest in such Other Income, unless the Manager directs otherwise. Any Other Income that is available to the FSF is paid to the Supervisor as part of the fees due to the Supervisor.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The requirements of ss HM 55D(5), (6) and (7), HM 55E, HM 55F and HM 55FB are met in relation to notified foreign investors in the FSF.
b) The FSF is not treated under any double tax agreement as not being resident in New Zealand.
c) The FSF is not in the business of life insurance.
d) 90% or more of the FSF's investments (by value of its assets) are investments of a type referred to in s HM 11, other than an interest in land in New Zealand or a right or option in relation to land in New Zealand, in accordance with s HM 19C(1).
e) 90% or more of the income derived by the FSF is of a type referred to in s HM 12, other than an amount derived from an interest in land in New Zealand or the disposal of an interest in land in New Zealand, in accordance with s HM 19C(2). For the avoidance of doubt, this condition will not be breached if any failure to meet the requirement of s HM 12 is not "significant and within control of the FSF" and is remedied by the last day of the next quarter, in accordance with s HM 25.
f) The FSF has not lost its PIE status through the application of s HM 25, s HM 27 and/or s HM 29.
g) The FSF has not changed its election to use the exit calculation option in s HM 42.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Arrangement as follows:

a) The FSF qualifies as a "foreign investment variable-rate PIE" (as defined in s YA 1).

b) The FSF's interest in the Shares is an investment of a type referred to in s HM 11.

c) Income derived by the FSF from its interest in the Shares is income of a type referred to in s HM 12.

d) Income attributed by the FSF to its investors is "excluded income" (as defined in s BD 1(3)) of the investor under s CX 56(3) provided that:

   (i) the prescribed investor rate for the investor is more than zero and not more than the investor's notified investor rate when the PIE calculates its income tax liability under s HM 47, or makes a voluntary payment under s HM 45, or

   (ii) the investor is one of those listed in s CX 56(1B), or

   (iii) the investor is one of those listed in s CX 56(1C) and has made the necessary election under s HC 33, and

   (iv) the amount is not an amount of attributed PIE income that is derived by a trustee who has chosen a prescribed investor rate referred to in sch 6, table 1, row 5 or 7, as applicable, and

   (v) the investor is not a new New Zealand resident to whom s HM 57B would have applied but who has chosen not to apply that section to determine their prescribed investor rate for a "resident year" (as defined in s HM 57B(3)), and

   (vi) the amount is not an amount of PIE schedular income derived by a natural person who is an investor in the PIE.

e) Where a Permitted Person acquires a Share on redemption of a Unit, and is entitled to a deduction under ss DA 1 and/or DB 23, the cost or amount of expenditure incurred in acquiring the Share for the purposes of those sections will be the market value of the redeemed Unit on the day it was redeemed.

f) The redemption of a Unit in the FSF by a Unit Holder, in exchange for a Share, will not give rise to a dividend under ss CD 4 to CD 6.

g) Any distributions from the FSF are excluded income of each Unit Holder under s CX 56B (and therefore not taxable), other than where the FSF elects to pay non-resident withholding tax in accordance with s HM 44B in respect of the distribution.

h) An investor in the FSF who is a natural person will have no adjustment to their terminal tax liability under s HM 36B in respect of income attributed by the FSF to the investor if that investor has notified the correct prescribed investor rate and the FSF has satisfied the investor's tax liability by applying that notified rate.

i) The Arrangement is not subject to s BG 1.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 28 March 2023 (being the date on which the Capital Restructure is implemented by Fonterra) and ending on 31 July 2028.

This Ruling is signed by me on the 15th day of May 2023.

Fiona Wellgreen

Senior Tax Counsel

12 May 2023

Notice of Withdrawal of Product Ruling

1. This is a notice of withdrawal of a product ruling under section 91FJ of the Tax Administration Act 1994.
2. Product ruling BR Prd 21/02 is hereby withdrawn to allow for a replacement ruling to be issued.
3. Product ruling BR Prd 21/02 applied for the period 1 January 2021 to 31 January 2026. It was published in the *Tax Information Bulletin* in June 2021 (Vol 33, No 5).
4. It is withdrawn on 12 May 2023.

Fiona Wellgreen

Senior Tax Counsel

BR Pub 23/07: Income tax – application of the employee share scheme rules to employer issued cryptoassets provided to an employee

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation laws | Ture tāke

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

This Ruling applies in respect of ss CE 1(1)(d), CE 2, and CE 7.

The arrangement to which this Ruling applies | Te whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is the provision of cryptoassets by an employer (or another company in the same group) to an employee in connection with their employment in circumstances where:

- the employer (or other group company) is issuing the cryptoassets (for example, through an Initial Coin Offering or a Token Generating Event);
- the cryptoasset is a "share" as defined in s YA 1 (i.e. it provides an interest in the capital of a company);
- the employee is not required to pay market value for the cryptoassets; and
- the cryptoassets are not provided under an exempt ESS as described in s CW 26C.

The Ruling applies only to employees and does not apply to providers of goods or services or self-employed taxpayers.

How the taxation laws apply to the Arrangement | Ko te pānga o te ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The provision of the cryptoassets by the employer (or other group company) to the employees is an "employee share scheme" as defined in s CE 7.
- Section CE 2 will apply to determine the value of the taxable benefit received by the employees.
- The amount of the taxable benefit will be the employees' employment income under s CE 1(1)(d).

The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply from 1 December 2022 to 30 November 2027.

This Ruling is signed by me on 15 May 2023.

James McKeown

Tax Counsel, Tax Counsel Office | Roia Tāke, Te Tari Tohutohu Tāke

Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/07

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 23/07 ("the Ruling").

Summary | Whakarāpopoto

1. This Ruling is a reissue of BR Pub 19/04, which expired on 30 November 2022. There have been no changes to the original ruling. The Ruling uses the term "cryptoasset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1] and the term "equity token" to cover a specific subset of cryptoasset.
2. This Ruling is related to BR Pub 23/06 (Income Tax – Employer issued cryptoassets provided to an employee) and considers the income tax treatment of specific types of employer-issued cryptoassets provided to employees. It covers the situation where a cryptoasset issued by the employer is a "share" in the employer (as defined in s YA 1). The commentary briefly discusses the application of the employee share scheme rules to the Arrangement. It also briefly discusses the definition of a "share" for tax purposes, and when cryptoassets may satisfy this definition.

Background | Horopaki

3. This Ruling sets out the Commissioner's view on the situation where an employee receives cryptoassets issued by their employer or another company in the same group (referred to together as "the employer" for ease of reference) that is a "share". This could occur in the context of an Initial Coin Offering, a Security Token Offering, an Initial Exchange Offering, a Token Generating Event or by other means.
4. The purpose of this Ruling and commentary is to raise awareness that a cryptoasset that provides an interest in the capital of a company may be subject to the employee share scheme rules. This Ruling does not provide detailed guidance on applying the employee share scheme rules. Detailed guidance on applying the rules is provided in *Tax Information Bulletin* Vol 30 No 5 (June 2018): 52.
5. Under employment law, salary or wages must be paid in money. However, an employee who is entitled to receive salary or wages payable in money may provide written consent to a deduction being made from the salary or wages and used to acquire shares under an employee share scheme. Arrangements of this nature must meet the requirements of the Wages Protection Act 1983 and Minimum Wage Act 1983. If you are an employer who is entering into an employee share scheme with an employee, we recommend that you seek advice to ensure that the payments meet the requirements of this legislation.

Application of the legislation | Whakapānga o te whakature

When do the employee share scheme rules apply?

6. Section CE 1 sets out when an amount derived by a person in connection with their employment will be their income. Under s CE 1(1)(d), a benefit received by an employee under an "employee share scheme" is income derived in connection with their employment.
7. Section CE 7 provides for the meaning of an "employee share scheme" as follows:

   CE 7 Meaning of employee share scheme

   Employee share scheme means-

   (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person-

      (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

1 These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

BINDING RULINGS

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but…

(b) does not include an arrangement that-

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

8. Accordingly, an employee share scheme is an arrangement that involves the issue or transfer of shares in a company to a person who is an employee (or a person who has been or will be an employee) of that company or of another company in the same group as the first company. The employee share scheme rules may also apply if the shares are issued to an associated person of the employee in connection with the employee's employment.

9. The employee share scheme rules do not apply to arrangements that require employees to:

- pay market value for the shares on the "share scheme taxing date" (generally the date on which the employee holds the shares like any other shareholder); or
- put at risk shares they acquired for market value, where the scheme provides no protection to the person against a fall in the value of the shares.

10. The employee share scheme rules also do not apply to an exempt employee share scheme (referred to in the legislation as an "exempt ESS"), which is defined in s CW 26. This is discussed further from [18].

11. Section CE 2 provides that an employee who has acquired shares under an employee share scheme receives a benefit as calculated under that section. In essence, the calculation refers to the difference between the value of the shares and what was paid for them.

12. The timing of the benefit is provided in s CE 7B, which, in brief, is the time at which the shares are held by (or for the benefit of) the employee, where there is no material risk that the ownership may change (for example, if the employee must remain employed for a certain period).

13. Where the cryptoassets are not held by (or for the benefit of) the employee, or there is a risk of a change of ownership of the cryptoassets or that the benefit may be cancelled, the share scheme taxing date will not be satisfied under s CE 7B. TIB Vol 30 No 5 (June 2018) contains numerous examples of how the share scheme taxing date is determined. For example, if cryptoassets are held on trust and an employee must remain in employment for 12 months before the cryptoassets are transferred to the employee, the share scheme taxing date is not satisfied until the employee becomes entitled to the cryptoassets.

14. The rules operate to tax any benefit conferred on an employee by the issuance of shares in an employee share scheme in the same way as if the employee had received an equivalent cash payment followed by an acquisition of shares.

15. Section RD 7B provides that an employer may choose whether to withhold and pay an amount of tax relating to the benefit, but it does not have to. If an employer does not choose to withhold and pay tax, the employee will be liable for tax on their employment income under s CE 1(1)(d) if they are a New Zealand resident, or a non-resident who has earned the amount here (s YD 4(4)). This is the case regardless of whether the employer is a resident or non-resident.

16. The employee share scheme rules apply only to employees and do not apply to arrangements that involve issuing shares to other providers of goods or services.

What is a "share" for tax purposes?

17. As noted above, the employee share scheme rules apply where shares in a company are issued to people who are employees (or who have been or will be employees) of that company or of another company in the same group as the first company (and the employees do not pay market value for those shares). A "share" is not specifically defined for the purposes of s CE 7. A "share" is defined broadly in s YA 1 as follows:

    share -

    (a) includes any interest in the capital of a company:

    (b) includes a debenture to which section FA 2 (Recharacterisation of certain debentures) applies:

    (bb) includes a stapled debt security to which section FA 2B(2) (Stapled debt securities) applies:

    (c) includes a unit in a unit trust:

    (d) includes an investor's interest in a group investment fund if-

    (i) the fund is not a designated group investment fund; and

    (ii) the interest does not result from an investment from a designated source; and

    (iii) the investor's interest does not result from an investment made in the fund on or before 22 June 1983, including an amount treated as invested at that date as pre-1983 investments under section HR 3(8) (Definitions for section HR 2: group investment funds):

    (e) does not include a withdrawable share in a building society, except in the definitions of investment society dividend and withdrawable share:

    (f) [Repealed]

    (g) is further defined in section CW 26F (Meaning of share) for the purposes of section CW 26C (Meaning of exempt ESS)

18. The Commissioner considers that the most relevant definition for the purposes of this Ruling is that contained in para (a) above. This definition includes "any interest in the capital of a company". The definition of a "share" also specifically includes many instruments that are not shares under the Companies Act 1993 (CA 1993) such as profit related debentures, stapled debt securities, units in a unit trust, and interests in a group investment fund. These are all types of instruments that exhibit general features of equity.

19. Paragraph (g) above contains a specific definition in the context of employee share schemes. Section CW 26F provides:

    CW 26F Meaning of share

    For the purposes of section CW 26C, share means, for a company whose shares are made available under an exempt ESS, a fully paid ordinary share that ranks equally with, and has the same designation as, an existing ordinary voting share in the company.

20. This definition is limited to s CW 26C, which relates to an exempt ESS. Accordingly, this specific definition of a share (being one that is a fully paid ordinary share ranking equally with existing ordinary voting shares) is relevant only for determining whether there is an exempt ESS for the specific purposes of s CW 26C. This is because an exempt ESS must be widely offered to almost all employees and provide the same rights to all employees. This narrow definition of a share for these specific purposes would relate to all types of shares (whether in the more traditional sense or any cryptoassets that satisfy the definition in s YA 1).

21. The definition of "exempt ESS" is set out in the Appendix. Whether or not there is an exempt ESS in any particular circumstances is outside the scope of this Ruling.

What does "any interest in the capital of a company" mean?

22. The phrase "any interest in the capital of a company" reflects the common law meaning of a "share" rather than the CA 1993. For income tax purposes, this definition first appeared in the definition of a "shareholder" in the Land and Income Tax Act 1916 and has remained essentially unchanged from its original enactment (at which time the Companies Act 1903 was in force), despite the companies legislation undergoing significant changes since that time.

23. The Concise Oxford English Dictionary (12th ed, 2011) defines an "interest" as:

    interest … 4 a share or involvement in an undertaking. a legal concern, title, or right in property…

24. The ordinary meaning of "any interest" is broad, and can include a share, legal concern, title, right or claim. The use of the word "any" also indicates that the term takes a broad meaning for these purposes.

25. "Capital" is also a broad term and a company's capital may generally include assets, the sum of shareholders' contributions to a company, the stock with which a company enters business and accumulated wealth.

26. In *IRC v Woolf* [1962] 1 Ch 35, the English Court of Appeal was considering whether debenture holders were "members" of a company, which was defined with reference to whether they had "an interest in the capital or profits or income" of the company. Upjohn LJ said at 46 and 47:

    The share or interest of a member in the capital of a company has no precise legal signification. In the context it may refer to the share or interest of the member in the issued share capital, or it may refer to his ultimate right to receive a dividend in liquidation after all creditors have been discharged…

    …

    … Further, the debenture-holder has no interest in the capital of the company. If "capital" refers to the share capital, that is obviously so. If it refers to the surplus in a winding-up, the debenture-holder will have been paid off before the surplus can be ascertained.

27. Upton LJ considered there needed to be a right or an expectation to share in a company's share capital or net capital (being the difference between assets and liabilities), even if that were through a liquidation of the company. A creditor does not hold an interest in the capital of a company, but rather holds an interest in its assets. These comments indicate that an "interest in capital" is a participating interest, suggesting a participation in the surplus assets on winding up of a company. A contractual debt interest is not sufficient.

28. Similarly, Donovan LJ said at 45:

    The word "capital", where it occurs as part of the definition of "member", may mean issued share capital or the net capital, being the difference between assets and liabilities, or it may mean both. …

    Accordingly, in *Woolf*, a reference to "capital" of a company was taken to mean share capital and net capital (assets less liabilities) and included the right to receive distributions on a winding up, after all creditors have been paid.

29. Earlier case law on the meaning of a "share" (for companies law purposes) took a narrower view of capital, referring more specifically to "share capital". For instance, in *Borland's Trustee v Steel Brothers and Co Ltd* [1901] 1 Ch 279 Farwell J stated at 288:

    A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second… A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.

30. In *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 (HL) Lord Wrenbury stated at 767:

    … A share is, therefore, a fractional part of the capital. It confers on the holder a certain right to a proportionate part of the assets of the corporation, whether by way of dividend or of distribution of assets in winding-up.

31. The concept of a share relating to a fractional part of capital is no longer relevant under the CA 1993, which provides that a share is personal property and provides a bundle of rights (being the rights generally set out in s 36 of the CA 1993, but which may be varied by the constitution or terms of issue of the share).

32. The decision in *Inland Revenue Commissioners v Tring* [1939] 2 All ER 105 (CA) also focused on whether a person held an interest in the capital of the company. The Court of Appeal upheld Macnaghten J's decision in the lower court *(Inland Revenue Commissioners v Tring [1939]* 1 All ER 148). Macnaghten J had stated at 152:

    I think that the words "share or interest in the capital or profits or income of a company" mean just what they say - anybody who has either a share in the capital or profits or income or has any interest in the capital or profits or income. I think the word "capital" there may cover, not only share capital, but also the pecuniary capital of a company, its capital assets.

33. Accordingly, "any interest in the capital of a company" for the purposes of the definition of a "share" in s YA 1 may refer to the person's interest in issued share capital, and a right to a share in the surplus assets on a wind up, and may include rights to other distributions. An interest in a company's capital is an interest in the performance of the company that is of an equity nature (rather than a debt or contractual right to receive payments).

34. In the GST context, the High Court in *CIR v Gulf Harbour Development Ltd* [2004] 2 NZLR 768 (HC) considered whether redeemable preference shares (RPS) were an "equity security" for GST purposes. An "equity security" is similarly defined for GST purposes as a "share in the capital of a body corporate". The RPS provided rights to membership in a club, but excluded voting rights, dividends and a share of surplus assets over and above what the members had put in. The High Court noted

that the reference to a "share in the capital of a body corporate" was based on the companies legislation although (at [42] to [43]) noted that the CA 1993 had removed any reference to capital from the share definition, and instead introduced the solvency test. The court concluded:

> [47] It is undeniable that "membership shares" are "redeemable shares" within the meaning of s 68. It is also undeniable that the holder of the redeemable share contributes to "the capital of a body corporate" where, as here, the holder of the redeemable share has an entitlement in the event of liquidation within 75 years to return of the investment. That is in a very real sense "an interest in or right to a share in the capital" despite that fact that after 75 years the company may redeem the share for payment of $1 and the "share" will be a tiny fraction of the consideration originally paid.

35. The RPS holder contributed to the capital of the company where they had an entitlement in a liquidation (within 75 years) to a return of the investment. Relevantly for the present context, the decision indicates that an instrument that allows the holder to receive a return of the amounts contributed in a liquidation could satisfy the phrase "any interest in the capital of a company".

When could cryptoassets issued by an employer be a share?

36. This Ruling applies to certain types of cryptoassets (which may commonly be described as "equity" tokens) that provide ownership interests in entities. An equity token is a type of security token representing ownership or an interest in a venture. Equity tokens may provide holders with voting interests and an entitlement to a share in profits of a venture but these may not necessarily be a share unless they provide an interest in the company's capital. This distinction is important. The Ruling does not apply to all equity tokens, but only those that provide an interest in the capital of the company that issues them. In addition, the Ruling does not apply to other types of tokens (e.g. other security tokens, intrinsic tokens, asset tokens or utility tokens) unless they contain hybrid features and include interests in the capital of the company. The token issuance could occur as part of an Initial Coin Offering or Token Generating Event undertaken by the employer, or in other circumstances.
37. Cryptoassets that provide an interest in the capital of a company, such as the right to receive a share in the surplus assets on a winding up of the company and potentially other distributions from the company, will be a "share" for income tax purposes. To qualify as a share, the interests need to be by way of an equity interest in the company's performance, and not simply a debt or other contractual right to receive payments. For completeness, the relevant interest must be in a company, so this would not include any interests in a decentralised autonomous organisation that operates over the blockchain, nor would it include a token that only provides interests in a platform.
38. Given that this will be highly fact specific and will depend on the terms of each particular cryptoasset issued, this Ruling does not rule on when a cryptoasset will be a "share". To determine whether a cryptoasset is a "share" it will be necessary to carefully consider the terms and conditions on which the cryptoasset is issued. This commentary can be used as guidance.
39. As an aside, given the broad definition of a "share" for tax purposes, there is often different categorisation of instruments for company law and regulation purposes. Cryptoassets that are a "share" for tax purposes may not necessarily be a "share" for the purposes of the CA 1993 or an "equity security" under the Financial Markets Conduct Act 2013 (FMCA 2013). For example, a profit-related debenture is a "share" for income tax purposes, a "debt security" for GST purposes, a "debt security" under the FMCA 2013, and is not a share under the CA 1993. The intention of including various equity instruments as a share for tax purposes is to generally treat instruments that have equity features as being a share if they involve distributions of company profits to the holder (and the holder has essentially borne the economic cost of the tax paid by the company).
40. Accordingly, cryptoassets issued by an employer that provide employees with certain rights such as a right to share in surplus assets on a wind up, will be a "share" under s YA 1 (even if not a "share" for the purposes of the CA 1993 or an "equity security" under the FMCA 2013). The issue of such cryptoassets to employees will be within the definition of an "employee share scheme" in s CE 7, and subject to s CE 2. If an employee receives cryptoassets from an employer under an employee share scheme and pays less than market value, the difference between the market value and any amount they paid will be employment income under s CE 1(1)(d).
41. Accordingly, the Commissioner considers that the employee share scheme rules will apply in circumstances where an employer issues cryptoassets to employees in connection with their employment, and:
    - the cryptoassets provide an interest in the capital of the company;
    - the employer does not require the employees to pay market value for the cryptoassets; and
    - the provision of the cryptoassets is not an exempt ESS.

Examples

42. The following two examples explain the application of the law.

Example 1: Cryptoassets that provide interests in a platform

DigitalKeyChain Ltd, a New Zealand incorporated limited liability company, is developing a new blockchain based platform for property sales. DigitalKeyChain Ltd issues its own cryptoasset, D-KEYs, by way of an ICO.

DigitalKeyChain Ltd employs five full time employees. As DigitalKeyChain Ltd is unable to pay competitive rates, it proposes to provide each of the full-time employees with D-KEYs issued in the ICO to the value of NZD$5,000.

The D-KEY whitepaper provides that a certain number of D-KEYs are required for users to access the platform and provides holders with voting rights over the operation of the platform.

The D-KEYs are not "shares" as they do not provide an interest in the capital of DigitalKeyChain Ltd. Accordingly, the employee share scheme rules do not apply. However, other employment income rules are likely to apply to the benefit received by the employees (as set out in BR Pub 23/06: Income Tax – employer issued cryptoassets provided to an employee).

Example 2: Cryptoassets that provide rights on a wind-up

Assume that, in addition to the facts set out above, the whitepaper and relevant terms and conditions of issue provide that D-KEY holders will receive (at the discretion of the directors) a right to distributions of DigitalKeyChain Ltd's profits.

The whitepaper and relevant terms and conditions also provide D-KEY holders with a right to a share in surplus assets on a liquidation of DigitalKeyChain Ltd after all creditors have been paid. In these circumstances, the D-KEYs are "shares" under s YA 1.

The employee share scheme rules will apply to the D-KEYs issued to the five employees. The employees did not pay anything for the receipt of the D-Keys, so the full market value will be employment income.

References | Tohutoro

Expired rulings | Whakatau mōnehu

BR Pub 19/04: Income tax - application of the employee share scheme rules to employer issued cryptoassets provided to an employee"

Legislative references | Tohutoro whakatureture

Companies Act 1993, s 36

Financial Markets Conduct Act 2013

Income Tax Act 2007, ss CE 1(1)(d), CE 2, CE 7, CE 7B, CW 26, CW 26F, RD 7B, YA 1 (definition of "share")

Case references | Tohutoro kēhi

Borland's Trustee v Steel Brothers and Co Ltd [1901] 1 Ch 279

Bradbury v English Sewing Cotton Co Ltd [1923] AC 744

CIR v Gulf Harbour Development Ltd [2004] 2 NZLR 768 (HC)

Inland Revenue Commissioners v Tring [1939] 2 All ER 105

IRC v Woolf [1962] 1 CH 35

Other references | Tohutoro anō

Subject references

Capital of a company, cryptocurrency, cryptoassets, employee, employee share schemes, income tax, share

Related rulings

BR Pub 23/04: Income tax – salary and wages paid in cryptoassets

BR Pub 23/05: Income tax – bonuses paid in cryptoassets

BR Pub 23/06: Income tax – employer-issued cryptoassets provided to an employee

Publications

Concise Oxford English Dictionary (12th ed, 2011)

"Employee share schemes", Tax Information Bulletin Vol 30, No 5 (June 2018): 52

Legislation

The relevant provisions in the Income Tax Act 2007 are as follows:

CE 1 Amounts derived in connection with employment

Income

(1) The following amounts derived by a person in connection with their employment or service are income of the person:

(a) salary or wages or an allowance, bonus, extra pay, or gratuity:

(b) expenditure on account of an employee that is expenditure on account of the person:

(bb) the value of accommodation referred to in sections CE 1B to CE 1E:

(c) [Repealed]

(d) a benefit received under a share purchase agreement:

(e) directors' fees:

(f) compensation for loss of employment or service:

(g) any other benefit in money.

....

CE 2 Benefits under employee share schemes

Benefit

(1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or (ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—

share value − consideration paid + consideration received − previous income.

Definition of items in formula

(2) In the formula in subsection (1),—

(a) **share value** is the market value of the shares or related rights owned by an employee share scheme beneficiary 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:

(b) **consideration paid** is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:

(c) consideration received is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:

(d) previous income is the total amount of income under section CE 1(1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.

Negative amount: deduction

(3) A negative amount calculated using the formula in subsection (1) is a deduction of the person.

Positive and negative amount: cost of revenue account property

(4) A positive or negative amount calculated using the formula in subsection (1) is added to the consideration paid by the person for acquiring the shares, for the purposes of section DB 23 (Cost of revenue account property).

Apportionment

(5) For the person's benefit under subsection (1), the portion of that benefit calculated using the formula is treated as non-residents' foreign-sourced income—

benefit before reduction × offshore period ÷ earning period.

Definition of items in formula

(6) In the formula in subsection (5),—

(a) benefit before reduction is the amount of the benefit under subsection (1):

(b) offshore period is the number of days in the item earning period on which—

(i) the person is not resident in New Zealand; and

(ii) any services the person performs for the relevant employer give rise to an amount of income that is a foreign-sourced amount:

(c) earning period is the period ending with the vesting of shares or relevant rights in the employee share scheme beneficiary and starting with the earlier of—

(i) the first date used to measure the person's right in relation to the vesting of shares or relevant rights:

(ii) the first date that the person has a right in relation to the vesting of shares or relevant rights.

When subsection (8) applies

(7) Subsection (8) applies when an employer is required to provide employment income information under sections RD 22(3) (Providing employment income information to Commissioner) and 23E to 23H of the Tax Administration Act 1994, as modified by section 23K of that Act, in relation to a benefit received under an employee share scheme.

Deferral of income recognition

(8) Despite section CE 1(1)(d), the employee share scheme beneficiary is treated as deriving employment income in relation to the benefit on the ESS deferral date.

Meaning of ESS deferral date

(9) For the purposes of this section and sections RD 6 and RD 7B (which relate to employee share schemes), the ESS deferral date is the 20th day after the share scheme taxing date for the employee share scheme beneficiary.

CE 7 Meaning of employee share scheme

Employee share scheme means—

(a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—

(i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but

(b) does not include an arrangement that—

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

CE 7B Meaning of share scheme taxing date

Meaning

(1) Share scheme taxing date means, in relation to shares or related rights under an employee share scheme, the earlier of the following dates:

(a) the first date when the shares are held by or for the benefit of an employee share scheme beneficiary (beneficial ownership) and after which, under the provisions of the scheme,—

(i) 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; and

(ii) there is no benefit accruing to the employee share scheme beneficiary in relation to a fall in value of the shares; and

(iii) there is no material risk that there will be a change in the terms of the shares affecting the value of the shares:

(b) the date when the shares or related rights of an employee share scheme beneficiary are cancelled or are transferred to a person who is not associated with a beneficiary described in section CE 7(a)(i) or (ii).

Exclusions

(2) For the purposes of applying subsection (1), the following requirements and rights are ignored:

(a) a right or requirement in relation to transfer by the employee share scheme beneficiary for market value consideration at the time of the transfer:

(b) a right or requirement that is not contemplated by the employee share scheme's provisions:

(c) a right or requirement that, at the time it came into existence, had no material risk of operating or no material commercial significance:

(d) a right or requirement in relation to the transfer of shares, if the right or requirement is 1 that also applies to shares not under the employee share scheme.

CW 26C Meaning of exempt ESS

Exempt ESS

(1) **Exempt ESS** means—

(a) a scheme that had the Commissioner's approval under section DC 12 (Loans to employees under share purchase schemes) before that section's repeal by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018:

(b) an arrangement of which the Commissioner has been notified under section 63B(1) of the Tax Administration Act 1994, if—

(i) the arrangement meets the criteria in subsections (2) to (9) of this section; and

(ii) the Commissioner has received all forms due under section 63B(2) and (3) of the Tax Administration Act 1994.

Purchase of shares

(2) The arrangement must provide that—

(a) the shares are available for no more than their market value at the date of purchase or subscription; and

(b) the market value of the shares purchased or subscribed for by an employee, or a trustee for an employee, under the arrangement is less than or equal to $5,000 in a year; and

(c) the difference between the market value of the shares purchased or subscribed for by an employee or a trustee and the amount that an employee spends on buying shares under the arrangement is less than or equal to $2,000 in a year.

Eligibility

(3) The arrangement must provide that—

(a) a full-time permanent employee to whom an offer under the arrangement is made is eligible to participate in the arrangement, on an equal basis with 90% or more of other full-time permanent employees to whom an offer under the arrangement is not subject to foreign security disclosure rules; and

(b) if it applies to part-time employees, those employees to whom an offer under the arrangement is made are eligible to participate in the arrangement, on an equal basis with 90% or more of other part-time employees to whom an offer under the arrangement is not subject to foreign security disclosure rules; and

(c) if it applies to seasonal workers, those employees to whom an offer under the arrangement is made are eligible to participate in the arrangement, on an equal basis with 90% or more of other seasonal workers to whom an offer under the arrangement is not subject to foreign security disclosure rules; and

(d) if it requires that an employee spend a minimum amount on buying shares, it requires no more than $1,000 to be spent in a year; and

(e) if it requires that an employee must have a minimum period of employment or service before the employee is eligible to participate, it requires—

(i) no more than 3 years full-time work, for full-time employees; and

(ii) no more than an accumulated period that is the equivalent of 3 years full-time work, for other employees.

Payments

(4) The arrangement must provide that—

(a) if it requires that an employee must buy the shares for more than nominal consideration,—

(i) a loan for the cost of the shares is available to the employee; or

(ii) the employee may pay for or buy the shares in regular instalments of a month or less, and any regular instalments are subject to paragraph (d)(ii); and

(b) any loan to an employee to buy shares is free of interest and other charges; and

(c) any loan or regular instalments have a maximum term of 60 months and a minimum term of 36 months; and

(d) any loan to an employee to buy shares is repayable by regular instalments of a month or less, but—

(i) the loan is repayable early in full or in part at the employee's discretion; and

(ii) in the case of an employee who is on unpaid or parental leave for more than a month, the regular instalments are suspended while on leave and the term of the loan is extended as appropriate.

Serious hardship

(5) The arrangement must provide, in the case of serious hardship that results or may result from an employee's continued participation in the exempt ESS, that, with the employee's agreement,—

(a) any regular instalments and any other terms related to payment by the employee may be varied; or

(b) the employee may withdraw from the arrangement, and any shares are bought from the employee for their market value on the day of withdrawal, subject to the repayment of any outstanding loan.

Withdrawal

(6) The arrangement must provide that the employee may withdraw from the arrangement on giving 1 month's notice to the relevant party. Any shares must be bought from the employee for the lesser of their market value on the day of withdrawal and their cost to the employee, subject to the repayment of any outstanding loan.

Period of restriction

(7) The arrangement must provide that,—

(a) if the employee has not acquired the shares for market value, there is a period of restriction during which the shares must not be disposed of and that period of restriction is the shorter of—

(i) a period of 3 years starting on the date the employee acquired the shares, or the period of repayment of a loan made to them under the scheme for this purpose, whichever is longer; and

(ii) a period starting on the date the employer acquired the shares and ending on the date the employee ends their employment with the company that employs them, or a company in the same group of companies if the employee is transferred; or

(b) if the employee has acquired the shares for market value, there is a period of restriction during which the shares must not be disposed of and that period of restriction is no longer than the shorter of—

(i) the shortest period in paragraph (a)(i) and (ii); and

(ii) any period of restriction provided by the arrangement, if that period finishes on or after the date on which the employee has no further repayment obligations for a loan made to them under the scheme.

End of period of restriction: general rule

(8) When the period of restriction provided by subsection (7) ends, the arrangement must provide that—

(a) the shares are transferred to the employee if the employee is still employed by the relevant company and they have not already been transferred; or

(b) if the employee chooses, the shares are purchased for the lesser of—

(i) the cost of the shares to the employee:

(ii) the market value of the shares on the date the period of restriction ends.

End of period of restriction: certain cases

(9) Despite subsection (8), when a period of restriction ends because the employee's employment ends through their death, accident, sickness, redundancy, or retirement at normal retiring age, the arrangement must provide that—

(a) the shares are transferred to the former employee if they have not already been transferred, or transferred to the legal representative of the employee's estate, as appropriate; or

(b) if the employee chooses, the shares are purchased for the lesser of—

(i) the cost of the shares to the employee:

(ii) the market value of the shares on the date the period of restriction ends.

CW 26F Meaning of share

For the purposes of section CW 26C, share means, for a company whose shares are made available under an exempt ESS, a fully paid ordinary share that ranks equally with, and has the same designation as, an existing ordinary voting share in the company.

RD 7B Treatment of employee share schemes

When this section applies

(1) This section applies for employees or a former employee in relation to benefits under an employee share scheme, if—

(a) an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (3); or

(b) an employer chooses to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (4).

Irrevocable obligation

(2) An employer who has made an irrevocable election described in subsections (1)(a) and (3) must comply with subsection (4)(a) to (c) for—

(a) the relevant benefit and employee under the scheme:

(b) benefits offered or provided to the employee in replacement of the relevant benefit.

Irrevocable obligation: form

(3) For the purposes of subsection (1)(a), an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee, if it is a term of the offer of the benefit, or of the scheme under which the benefit is provided, that the employer must withhold and pay tax under this section.

Withholding and paying

(4) For the purposes of subsection (1)(b), an employer chooses to withhold and pay tax for some benefits for some employees by—

(a) calculating the amounts of tax that must be withheld for the relevant benefits and employees, and paying the amounts to the Commissioner as described in section RD 4(1); and

(b) including the amounts in the employer's employment income information under subpart 3C of the Tax Administration Act 1994, treating the relevant ESS deferral date as the relevant payday; and

(c) making the disclosure referred to in paragraph (b) within the time required under section RD 6(3)(a).

YA 1 Definitions

In this Act, unless the context requires otherwise,—

amount—

(a) includes an amount in money's worth:

…

BINDING RULINGS

BR Pub 23/06: Income tax – employer issued cryptoassets provided to an employee

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation laws | Ture tāke

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

This Ruling applies in respect of ss CX 2, RD 27 and RD 40(1).

The arrangement to which this Ruling applies | Te whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is the agreement to provide cryptoassets to an employee in connection with their employment in circumstances where:

- the employer is issuing cryptoassets (for example through an Initial Coin Offering, an Initial Exchange Offering, a Security Token Offering, or a Token Generating Event);
- the employee will receive the cryptoassets only if they are still employed by the employer at a specified future date (the condition); and
- the employee cannot sell or otherwise transfer the cryptoassets until the specified future date.

The Ruling applies only to salary and wage earners, not to self-employed taxpayers.

The Ruling does not apply where:

- the cryptoasset provided is a "share" for income tax purposes that is received under an "employee share scheme" as defined in s CE 7; or
- Public Ruling "BR Pub 23/04: Income Tax – salary and wages paid in cryptoassets" or Public Ruling "BR Pub 23/05: Income Tax – bonuses paid in cryptoassets" applies.

How the taxation laws apply to the Arrangement | Ko te pānga o te ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- A fringe benefit will be provided under s CX 2 when the condition is met and the employee becomes entitled to the cryptoassets.
- Where the employer is selling its cryptoassets to arm's length buyers at the time the cryptoassets are provided to the employee, the value of the fringe benefit is the "market value" determined under s RD 40.
- Where s RD 40 does not apply and at the time the cryptoassets are provided to the employee it can be purchased on the open market, the value of the fringe benefit is the "market value" determined under s RD 27(3).
- Where there is no "market value" under s RD 27 or s RD 40, the Commissioner will need to determine the value of the fringe benefit.

The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply from 30 July 2022 to 30 November 2027.

This Ruling is signed by me on 15 May 2023.

James McKeown

Tax Counsel, Tax Counsel Office | Roia Tāke, Te Tari Tohutohu Tāke

Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 23/06 ("the Ruling").

Summary | Whakarāpopoto

1. This Ruling is a reissue of BR Pub 19/03, which expired on 29 July 2022. There have been no changes to the original ruling. The Ruling uses the term "cryptoasset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
2. The Ruling considers the income tax treatment of employer-issued cryptoassets provided to employees. In particular, it covers the situation where the cryptoassets are subject to conditions that the employee must satisfy to become entitled to the cryptoassets. The commentary discusses the application of the fringe benefit tax (FBT) rules to the Arrangement. It also briefly discusses the FBT treatment of similar arrangements.

Background | Horopaki

3. The Ruling sets out the Commissioner's view on the situation where an employee receives cryptoassets issued by their employer (or an associated person). Often this will occur in the context of an Initial Coin Offering (ICO), an Initial Exchange Offering, a Security Token Offering, or Token Generating Event.
4. The Ruling considers the situation, as is common in arrangements of this type, where the cryptoassets are provided subject to a condition that must be satisfied before an employee becomes entitled to the cryptoassets. The condition considered in the Ruling is that the employee remains employed by the employer. However, the same reasoning applies for other conditions that must be satisfied for the employee to become entitled to the cryptoassets – for example, meeting certain performance targets.

Application of the legislation | Whakapānga o te whakature

5. Section CE 1 sets out when an amount derived by a person in connection with their employment will be their income. The cryptoassets covered by this Ruling will not come within any of the paragraphs of s CE 1. Consequently, it is necessary to consider how FBT applies.
6. Section CX 2(1) defines "fringe benefit" as:

   (1) A **fringe benefit is a benefit that—**

   (a) is provided by an employer to an employee in connection with their employment; and

   (b) either—

   (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

   (ii) is an unclassified benefit; and

   (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

7. Broadly, a fringe benefit is a benefit an employer provides to an employee in connection with their employment. The following analysis considers:
   - whether there is a "benefit";
   - when the benefit is "provided"; and
   - what the value of the benefit is.

Whether there is a benefit

8. Cryptoassets are not included in ss CX 6, CX 9, CX 10, and CX 12 to CX 16. Therefore, if it is a benefit, it is an unclassified benefit under s CX 37.

1 These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

9. The Act does not define the term "benefit" for the purposes of the FBT rules. Therefore, "benefit" should be given its ordinary meaning.
10. The Concise Oxford English Dictionary (12th edition, Oxford University Press, New York, 2011) relevantly defines "benefit" as "an advantage or profit gained from something".
11. In *Case M9* (1990) 12 NZTC 2,069, the Taxation Review Authority (TRA) considered the FBT status of contributions to a superannuation fund and the provision of motor vehicles that were available for the private use and enjoyment of two employees. The TRA commented on the general meaning of "benefit" (at 2,074):

> The section itself to an extent explains what is a benefit, for the purposes of a fringe benefit; so long as something is provided by an employer to an employee that can be reasonably, practically and sensibly understood as a benefit to the employee in itself and is not expressly excluded, [that] would be sufficient for it to be a benefit for the purposes of the definition of "fringe benefit" as provided by the section.

12. It can be seen from the quotation above that "benefit" has a wide meaning and includes anything that can be "reasonably, practically and sensibly understood as a benefit to the employee". Cryptoassets provided to an employee would, therefore, be a "benefit".
13. A benefit is treated as being received from an employer where the employer arranges with a third party to provide a benefit to an employee (s CX 2(2)). In the current context, this would apply, for example, when an employer entered into an arrangement for an associated company to provide cryptoassets to the employer's employees.
14. A benefit provided to an associate of an employee is treated as if it were provided by the employer to the employee (s CX 2(5)(b)).

When the benefit is provided

15. Where ownership of the cryptoassets will not pass unless certain requirements are met, the Commissioner's view is that no benefit is provided until the requirements are met. For example, if transfer of the cryptoassets is subject to an employee remaining in employment for six months or meeting certain performance targets, there will be no benefit for FBT purposes until those conditions are satisfied and the employee becomes entitled to the cryptoassets.
16. This is because, until the conditions are satisfied, it is not clear whether the employee will receive the cryptoassets – provision of the cryptoassets is contingent on future events that may or may not happen.

What the value of the benefit is

17. Sections RD 27 to RD 57 set out how to determine the value of a benefit for FBT purposes. The potentially relevant provisions are:
    - s RD 40(1)(a), which applies where an employer provides an employee with "goods" the employer has produced; and
    - s RD 27(2), which applies where none of the other valuation provisions applies.
18. Section RD 40(1)(a) states:

> Market value or cost
>
> (1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:
>
> (a) when the person providing the goods manufactured, produced, or processed them, their market value:

Whether cryptoassets are "goods" for FBT valuation purposes

19. Section RD 40 raises an issue as to whether cryptoassets are "goods" for FBT purposes. The word "goods" is not defined. Further, no case law considers the meaning of "goods" in this context. In the absence of a definition, "goods" takes it meaning from the context in which it is used. In concluding that securities (in the form of bearer bonds or coupons) were "goods", the Privy Council in *The Noordam (No 2)* [1920] AC 904 made the following comments (at 908):

> At first sight the word "goods" might seem to be an equally inappropriate description. It must, however, be observed that the word is of very general and quite indefinite import, and primarily derives its meaning from the context in which it is used.
>
> …
>
> The content of the word "goods" differs greatly according to the context in which it is found and the instrument in which it occurs. … the word may sometimes be of the narrowest and sometimes of the widest scope.

20. The High Court in *Waimea Nurseries Ltd v Director-General for Primary Industries* [2019] 2 NZLR 107 cited The Noordam (No 2) favourably. Cooke J stated (at 124) that the meaning to be given to "goods" "will be highly dependent on the context".

BINDING RULINGS

21. Potential wide and narrow interpretations were discussed in *Spring House (Freehold) Ltd v Mount Cook Land Ltd* [2002] 2 All ER 822 (CA), where Ward and Rix LJJ stated (at 828):

> It is common ground, as the dictionary definition makes clear, that "goods" can be widely understood to mean "property or possessions", or more narrowly "saleable commodities, merchandise, wares" or … "tangible moveable property viewed as an item or items of commerce".

22. It can be seen from the above discussion that "goods" can be interpreted widely enough to include cryptoassets (which would, for example, be "property or possessions"). [2] Whether this is appropriate depends on the context of s RD 40 and the FBT provisions more generally.

23. Section RD 40 provides a valuation methodology for the situation where an employer provides an employee with "goods" the employer has produced. Section RD 41 provides a similar provision for services the employer provides as part of their business. Where neither provision applies, unclassified benefits fall to be valued under the default provision (and may require the Commissioner to determine the value). Where s RD 40(1) applies, the value of the benefit provided is based on the amount the employer sells those goods to the public for. There seems to be no reason to limit the type of goods that the provision applies to (for example, by distinguishing between tangible and intangible goods). Doing so would mean no specific valuation provision exists for those types of property. Consequently, in the Commissioner's view, cryptoassets are "goods" for the purposes of s RD 40.

Application of s RD 40

24. Section RD 40(1)(a) provides that:

> (1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:
>
> (a) when the person providing the goods manufactured, produced, or processed them, their market value:

25. "Market value" is defined for the purposes of s RD 40 in s RD 40(3) as:

> **market value** means the lowest price, at the time at which the goods were provided to the employee, for which identical goods were sold by the same person to an arm's length buyer, whether wholesaler, retailer, or the public, in the open market in New Zealand in a sale freely offered and made on ordinary trade terms

26. Therefore, s RD 40(1) applies only where the employer is selling the cryptoassets to arm's length buyers at the time the cryptoassets are provided to the employee.[3] In such a case, the "value" of the cryptoassets will be the lowest price for which the employer was selling identical cryptoassets to arm's length buyers in the open market in New Zealand.

27. Where the employer is not selling the cryptoassets at the time it is provided to the employee (which may be the case, for example, before or after an ICO), s RD 40(1) will not apply.

Valuation where s RD 40 does not apply

28. Section RD 27(2) applies where the value of a benefit cannot be determined under other provisions. It provides that the value of the fringe benefit is the market value or a value determined by the Commissioner:

> *When value cannot be ascertained*
>
> (2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.

29. Section RD 27(3) defines "market value" for the purposes of s RD 27(2). Unlike the definition of "market value" for the purposes of s RD 40(1), s RD 27(3) does not require the employer to be selling the cryptoassets. However, it does require the existence of an open market accessible to the public:

> *Meaning of market value*
>
> (3) In subsection (2), **market value** means the price normally paid, at the time when the fringe benefit is received by the employee, for the fringe benefit in a sale—
>
> (a) in the open market; and
>
> (b) freely offered; and
>
> (c) made on ordinary trade terms; and
>
> (d) to a member of the public at arm's length.

2 In *Ruscoe v Cryptopia Ltd (in liquidation)* [2020] NZHC 728 the High Court held that cryptoassets were "property" for the purposes of s 3 of the Companies Act 1993.

3 Although unlikely to occur in this context, an exception to this statement applies where the employer's sale price is greater than the open market value. In such a case, the open market value calculated under s RD 40(2) applies.

30. Where there is no market value, the Commissioner needs to determine the value of the fringe benefit. In the Commissioner's view, valuation in these circumstances should be determined as follows:
    - Where the cryptoassets are provided to the employee before sale to the public, the employer should use the price at which the cryptoassets will first be sold to the public if such a price has been determined. For example, if the cryptoassets will initially be sold to the public as part of an ICO at $1 per token, cryptoassets provided to employees before the ICO should also be valued at $1. Where the first public sale price has not yet been determined, the employer can use a value based on the last arm's length sale price (if applicable). For example, if seed capital has been invested in return for a share of cryptoassets, a cryptoasset value could be determined from this.
    - Where the cryptoassets are provided to the employee after the employer has ceased selling to the public but before there is an established market for the cryptoassets, the employer should use the price at which the cryptoassets were last sold to the public.
    - If none of the above situations apply, the employer should contact Inland Revenue to discuss their particular situation.

Similar situations

31. This Ruling considers the situation where cryptoassets are promised to an employee at a future date if certain conditions are met. There are other similar arrangements under which an employer could provide its cryptoassets to employees.
32. Determining when a benefit has been provided requires a careful consideration of the legal arrangements between the employer and the employee. Arrangements with similar effect could have different treatments depending on their legal form.
33. Two potential scenarios are briefly considered below. These are both situations where the employee is not required to meet any conditions to be entitled to the cryptoassets.

Cryptoassets transferred to employee without any conditions or restrictions on sale

34. Where cryptoassets are transferred to the employee without any conditions, a benefit will be provided for FBT purposes at the time of transfer.
35. The value of the benefit will be determined under ss RD 40(1) and RD 27 as discussed in paras 17 to 30.

Legal or beneficial ownership transferred to employee subject to restrictions on sale

36. Sometimes cryptoassets are transferred to an employee subject to restrictions on their sale (for example, the cryptoassets cannot be sold for three months). In the Commissioner's view, a benefit would be provided for FBT purposes at the time the employee becomes legally entitled to receive the cryptoassets (regardless of any restrictions on disposal). This is different to the situation considered in the Ruling where the employee does not become legally entitled to the cryptoassets until certain conditions are met.
37. In the Commissioner's view, a benefit will also be provided where the cryptoassets are not physically provided to the employee but are held on trust for the employee until the restricted sale period is over.[4] In such a case, beneficial ownership of the cryptoassets passes to the employee. Any trust would be non-discretionary as there are no conditions that the employee must satisfy to be entitled to the cryptoassets.
38. Where the benefit being provided to the employee is a beneficial interest in the cryptoassets or the cryptoassets are subject to restrictions on sale, there is unlikely to be a "market value" for the benefit provided (under either s RD 40 or s RD 27).5 In such a case, the Commissioner would need to determine the relevant value, which may differ from the market value for cryptoassets not subject to restrictions.

4 Where the cryptoassets are held on a trust of this type, it would generally be expected that any entitlements subsequently arising from the cryptoassets (such as "interest" or "dividend" type payments) would also be held for the benefit of the employee. These additional benefits would not be subject to FBT as they arise after the benefit has been provided to the employee.

5 A possible exception would be if the employer were also offering cryptoassets with the same restrictions to arm's length parties.

Examples

39. The following examples illustrate the application of the law.

Example 1: Cryptoassets provided as an employee incentive

Bionic Animal Services Ltd (Bionic) is developing a new cryptoasset (Bio-record) to be used with a blockchain-based database that stores animal records. Bionic has hired two full stack developers, Lesley and Mei, to assist with the project.

To provide an incentive to Lesley and Mei to stay with Bionic until the project is completed, Bionic has agreed to provide Lesley and Mei with 1,000 Bio-record tokens if they are still employed by Bionic in 12 months' time. Bionic is currently offering Bio-record for sale to the public as part of an ICO. The current purchase price is $10 per token.

Bionic wants to know whether it should return FBT now. No FBT is payable at the current time as no benefit has been provided to the employees yet.

Lesley leaves Bionic within the 12-month period, so does not receive any Bio-record. After 12 months, Mei is still working for Bionic, so she becomes entitled to receive 1,000 Bio-record. Bionic is no longer selling Bio-record to the public. However, it is available through a local cryptocurrency exchange for $12 per token.

Bionic is liable for FBT at the time Mei becomes legally entitled to the Bio-record tokens. The value of the benefit for FBT purposes is $12,000 (1,000 tokens x $12 per token).

Example 2: Cryptoassets provided subject to restrictions

Bionic also hires a new manager, Raju. Bionic want to incentivise Raju to stay employed with them. However Bionic also wants to avoid its employees affecting the market for Bio-record tokens by selling as soon as they become entitled to their Bio-record.

Bionic agrees to provide Raju with 2,000 Bio-record tokens if he is still employed by Bionic in 12 months' time. However, the Bio-record will be provided subject to a restriction preventing Raju from selling the tokens for a further six-months.

Bionic wants to know when it should return FBT. No FBT is payable at the current time as no benefit has been provided to Raju yet. FBT will be payable if Raju is still employed with Bionic in 12 months' time, as this is when Raju becomes legally entitled to the Bio-record tokens.

As the Bio-record tokens will be subject to a six-month restriction on sale, this may affect their value. Bionic should contact Inland Revenue to discuss an appropriate value for FBT purposes.

Expired rulings | Whakatau mōnehu

BR Pub 19/03: Income tax – employer issued crypto-assets provided to an employer

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss CE 7, CX 2 ("fringe benefit"), CX 6, CX 9, CX 10, CX 12 – CX 16, CX 37, GB 32, RD 27 – RD 57

Case references | Tohutoro kēhi

Case M9 (1990) 12 NZTC 2,069 (TRA)

Noordam (No 2), The [1920] AC 904 (PC)

Spring House (Freehold) Ltd v Mount Cook Land Ltd [2002] 2 All ER 822 (CA)

Waimea Nurseries Ltd v Director-General for Primary Industries [2019] 2 NZLR 107 (HC)

Other references | Tohutoro anō

Related rulings

BR Pub 23/04: Income tax – salary and wages paid in cryptoassets

BR Pub 23/05: Income tax – bonuses paid in cryptoassets

Br Pub 23/07: Income tax - application of the employee share scheme rules to employer issued cryptoassets provided to an employee

Subject references

Cryptoasset

Cryptocurrency

Employee

Fringe benefit tax

Income tax

Dictionary

Concise Oxford English Dictionary (12th edition, Oxford University Press, New York, 2011)

Legislation

40. The relevant provisions in the Income Tax Act 2007 are as follows:

CX 2 Meaning of fringe benefit

Meaning

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

GB 32 Benefits provided to employee's associates

When this section applies

(1) This section applies when—

(a) a benefit is provided to a person who is associated with an employee of an employer; and

(b) the benefit would be a fringe benefit if provided to the employee; and

(c) the benefit is provided either by the employer or by another person under an arrangement with the employer for providing the benefit; and

(d) the exemptions in subsections (2) and (2B) do not apply.

Exemption for shareholder-employees and corporate associates

(2) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is a company; and

(b) the employee is a shareholder in the company; and

(c) the person associated with the employee is a company; and

(d) the benefit is not provided under an arrangement that has a purpose of providing the benefit either—

(i) in place of employment income; or

(ii) free from fringe benefit tax.

Exemption for LTCs and partnerships

(2B) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is—

(i) a look-through company (an LTC):

(ii) a partnership or limited partnership; and

(b) the person associated with the employee, described in subsection (1)(a), is—

(i) an owner of the relevant LTC:

(ii) a partner of the relevant partnership or limited partnership.

Benefit treated as provided to employee

(3) For the purposes of the FBT rules, the benefit is treated as provided by the employer to the employee.

Application of section CX 18

(4) Section CX 18 (Benefits provided to associates of both employees and shareholders) applies to determine when a benefit provided to an associate of both an employee and a shareholder is treated as a fringe benefit and not a dividend.

RD 27 Determining fringe benefit values

What sections RD 28 to RD 53 do

(1) Sections RD 28 to RD 53 set out the rules for determining the value of a fringe benefit provided by an employer to an employee in connection with their employment. The taxable value of a fringe benefit when an employee pays an amount for receiving the benefit is dealt with in sections RD 54 to RD 57.

When value cannot be ascertained

(2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.

Meaning of market value

(3) In subsection (2), market value means the price normally paid, at the time when the fringe benefit is received by the employee, for the fringe benefit in a sale—

(a) in the open market; and

(b) freely offered; and

(c) made on ordinary trade terms; and

(d) to a member of the public at arm's length.

RD 40 Goods

Market value or cost

(1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:

(a) when the person providing the goods manufactured, produced, or processed them, their market value:

(b) when the person providing the goods otherwise acquired them, or paid for them to be acquired, dealing at arm's length with the supplier of the goods, the cost of the goods to the person:

(c) if the person providing the goods is a company included in a group of companies, then, as the person chooses, the value of the benefit under either paragraph (a) or (b), applying the provisions as if the group of companies were 1 company.

Sale in open market

(2) Despite subsection (1), if the value of the fringe benefit as determined under that subsection would be more than the amount that would have been paid to the employer for the purchase of the goods in a sale described in paragraphs (a) to (d), then the value is treated as that amount. The sale must be—

(a) at retail in the open market in New Zealand; and

(b) freely offered; and

(c) made on ordinary trade terms; and

(d) to a member of the public with whom the employer is at arm's length.

Some definitions

(3) In this section,—

…

market value means the lowest price, at the time at which the goods were provided to the employee, for which identical goods were sold by the same person to an arm's length buyer, whether wholesaler, retailer, or the public, in the open market in New Zealand in a sale freely offered and made on ordinary trade terms

…

BR Pub 23/05: Income tax – bonuses paid in cryptoassets

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation laws | Ture tāke

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

This Ruling applies in respect of s RD 3.

The arrangement to which this Ruling applies | Te whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is the payment of an amount of cryptoassets to an employee in connection with their employment as an incentive or bonus.

This Ruling applies only to salary and wage earners, not self-employed taxpayers, and where the cryptoassets being paid are an agreed deduction from a monetary amount.

This Ruling does not apply where the cryptoasset provided is a "share" for income tax purposes that is received under an "employee share scheme" as defined in s CE 7.

How the taxation law applies to the Arrangement | Ko te pānga o te ture tāke ki te Whakaritenga

The taxation law applies to the Arrangement as follows:

- The cryptoasset payment is a "PAYE income payment" under s RD 3 and is subject to the PAYE rules.

The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply from 2 December 2022 to 30 November 2027.

This Ruling is signed by me on 15 May 2023.

James McKeown

Tax Counsel, Tax Counsel Office | Roia Tāke, Te Tari Tohutohu Tāke

Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/05

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 23/05 ("the Ruling").

Summary | Whakarāpopoto

1. This Ruling is a reissue of BR Pub 21/02, which expired on 1 December 2022. There have been no changes to the previous ruling. The Ruling uses the term "cryptoasset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
2. Under employment law, a bonus is part of a person's salary or wages and must be paid in money. However, an employee who is entitled to receive a bonus payable in money may provide written consent to a deduction being made from the bonus and an equivalent amount being paid out in cryptoassets provided the deduction is reasonable. Arrangements of this nature must meet the requirements of the Wages Protection Act 1983 and Minimum Wage Act 1983. If you are an employer who pays cryptoassets to an employee, we recommend that you seek advice to ensure that the payments meet the requirements of this legislation.
3. In either case, if a bonus is paid out in money or an equivalent amount of cryptoassets, PAYE will be payable on the full amount of the bonus.

Background | Horopaki

4. The Ruling sets out the Commissioner's view on the situation where an employee receives a bonus and agrees for an amount of that bonus to be paid in cryptoassets.

Application of the legislation | Whakapānga o te whakature

Whether cryptoassets received under a valid salary sacrifice are subject to PAYE or FBT

5. The first step is to consider whether the payment is subject to PAYE. This is because, to the extent that an employment-related benefit is taxable to an employee, it will not be a fringe benefit (s CX 4). Therefore, if the provision of cryptoassets to an employee falls within the PAYE rules, PAYE will apply even if the FBT rules would also otherwise apply.
6. Section CE 1 sets out the "amounts" that are treated as employment income. Relevantly, these include bonuses:

   CE 1 Amounts derived in connection with employment

   Income

   (1) The following amounts derived by a person in connection with their employment or service are income of the person:

   (a) salary or wages or an allowance, **bonus**, extra pay, or gratuity:

   (b) expenditure on account of an employee that is expenditure on account of the person:

   (bb) the value of accommodation referred to in sections CE 1B to CE 1E:

   (c) [Repealed]

   (d) a benefit received under a share purchase agreement:

   (e) directors' fees:

   (f) compensation for loss of employment or service:

   (g) any other benefit in money.

   [Emphasis added]

7. "Amount" "includes an amount in money's worth" (s YA 1). Therefore, s CE 1 is drafted widely enough to include amounts derived that are "money's worth" (but not money). In any event, an amount specifically includes a bonus.

1 These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

Meaning of "bonus"

8. "Bonus" is not defined in the Act. Therefore, it is necessary to consider its ordinary meaning.

9. The Court of Appeal considered the meaning of "bonus" in *CIR v Smythe* [1981] 1 NZLR 673. Richardson J stated at 676:

> A bonus may be a gratuity or it may be something which an employee is entitled to on the happening of a condition precedent and which is enforceable when the condition is fulfilled (Sutton v Attorney-General (1923) 39 LTR 294,297; Great Western Garment Co v Minister of National Revenue [1974] Ex CR 458, 467; [1948] 1 DLR 225, 233). In either case it is an addition to regular salary or wages. It is a payment above the normal and it is often, but not always, paid for extraordinary work or service. Its special character is that it is an additional amount, not part of the regular permanent remuneration.

10. McMullin J stated at 678:

> One of the meanings given in the Oxford English Dictionary to the word bonus is: "Money or its equivalent, given as a premium, or as an extra or irregular remuneration, in consideration of offices performed, or to encourage their performance". Often enough a bonus will take the form of something for which no entitlement exists. In that sense it will be a favour, a bounty, largess, something over and above what the donee is entitled to expect. And it may be in some cases quite unexpected and a windfall. But I do not think that the word "bonus" is limited to those payments only for which no entitlement can be established. Indeed, it is not infrequently the case in present conditions of employment that a payment is made to an employee by way of a bonus even though it is directly related to his industry and productivity.

11. It can be seen from this that a bonus is a payment to an employee over and above their regular salary or wages. It is generally paid for good performance. A bonus can be something to which an employee is contractually entitled (if certain conditions are met) or a purely voluntary payment.

12. Under employment law, a bonus is part of a person's salary or wages and must be paid in money. However, employees can agree to a deduction being made from the monetary amount, and opt to receive the bonus in cryptoassets (provided that requirements in the Wages Protection Act 1983 and Minimum Wage Act 1983 are satisfied).

13. PAYE will apply regardless of whether the bonus is paid in cash, an equivalent amount of cryptoassets as an agreed deduction, or a combination of both.

14. It is useful, at this point, to consider whether there is anything in the scheme of the Act that suggests that non-monetary payments in cryptoassets (paid as an agreed deduction) should not be treated as employment income.

Scheme of the Act

15. As noted above, the Act first requires determining whether the PAYE rules apply. FBT applies only where a payment is not assessable income (s CX 4).

16. Payments in money are generally subject to PAYE and non-monetary payments are generally subject to FBT. This is because of the types of payments the PAYE rules apply to. The PAYE rules apply to "PAYE income payments", which for employees is defined as a payment of "salary or wages" or an "extra pay". "Salary or wages" is defined in s RD 5. Most of the items listed are payments that would generally be expected to be made in money. These include salary, wages, allowances, bonuses, commissions, gratuities, and various benefit, grant and compensation payments. However, employer-provided accommodation under s CE 1(1)(bb) is also expressly included.

17. Similarly, "extra pay" is defined in s RD 7 relation to payments that would generally be made in money. However, it also includes a benefit under certain share purchase agreements.

18. It can be seen from this that the Act broadly distinguishes between monetary and non-monetary payments to employees with the former being subject to PAYE and the latter to FBT. The reference in s CE 1(1)(g) to "any other benefit in money" is also consistent with this. However, this distinction is not absolute. Some non-monetary benefits are expressly included in the PAYE rules. Also, non-monetary payments are not expressly excluded from items that make up "salary or wages" (which includes bonuses).

Are cryptoassets money or its equivalent?

19. In the Commissioner's view, cryptoassets are property.[2] Cryptoassets are not "money" as commonly understood (at least not at the present time). In particular, because cryptoassets are not currently issued by any government, it is not legal tender anywhere. Further, although acceptance of certain cryptoassets as payment for goods and services is increasing, they are not "generally accepted" as payment. Given the extreme volatility experienced to date, there are also issues around some cryptoassets' ability to be a store of value.

2 This view is consistent with the decision in *Ruscoe v Cryptopia Ltd* (in liquidation) [2020] NZHC 728.

20. Under New Zealand employment law, any payment of cryptoassets as a bonus must be made by way of an agreed deduction from a monetary amount. PAYE is applicable on the monetary amount of the bonus, whether it is paid in money or as an equivalent amount of cryptoassets.

Conclusion

21. An amount of cryptoassets paid to an employee, in connection with their employment, as an agreed deduction from an incentive or bonus payment will be a "bonus" under s CE 1.
22. A "bonus" comes within the meaning of "salary or wages" for the purposes of s RD 5. Therefore, it is a "PAYE income payment" under s RD 3 and the PAYE rules apply to it.

Implications of conclusion

PAYE is calculated on the full amount of the bonus

23. Where payment is provided in cryptoassets (as an agreed deduction from a monetary amount), the employer must account for the gross amount of the bonus being provided to the employee when calculating PAYE.
24. Where the employee's employment contract sets out the gross amount (ie amount before tax is deducted) payable in NZD, this will not be an issue. Assume, for example, an employment contract provides for an employee to be paid a bonus of $10,000 (gross) and the employee agrees to a deduction of the full amount for a payment in cryptoassets. Assume also that the bonus is an "extra pay" under s RD 7 which is subject to PAYE at a flat rate of 33%. In such a case, $6,700 worth of cryptoassets would be payable to the employee and $3,300 (NZD) must be paid to Inland Revenue as PAYE.
25. If a cryptoasset payment is not denominated in NZD (for example, if an employee is paid a bonus of 0.001 of a cryptoasset), this may be contrary to employment legislation and you may need to seek advice.
26. There are various circumstances where obligations, eligibility, or entitlements may be calculated based on an employee's salary or wages (for example Kiwisaver, Working for Families Tax Credits, and student loan repayments). The cryptoasset payments must be taken into account when calculating these.

Example

27. The following example is included to help explain the application of the law. For simplicity the example does not consider the potential application of, Kiwisaver, student loan, child support or other deductions. The Employer's Guide (IR 335) (available on the Inland Revenue website www.ird.govt.nz) can be used to assist with calculating these.

Example: Calculating PAYE on a bonus

Anaru is employed by Cryptowonderland Ltd. In addition to his $150,000 salary, Anaru's contract provides for a NZ$10,000 (gross) bonus if Cryptowonderland's profit exceeds the previous year's. Under New Zealand employment law bonuses must be payable in money, but an employee may agree that a deduction will be made from a bonus payable in money and an equivalent amount paid out in cryptoassets. Anaru requests that his bonus be paid out in cryptoassets.

Cryptowonderland has an exceptional year and Anaru receives his bonus in cryptoassets as requested. The bonus is subject to PAYE at a flat rate of 33%. NZ$3,330 ($10,000 x 0.33) must be paid to the Commissioner (in New Zealand dollars). As a result of Anaru's request, the net amount of $6,670 worth of the cryptoasset will be transferred to Anaru's cryptoasset wallet as a deduction from his cash bonus.

References | Tohutoro

Expired rulings | Whakatau mōnehu

BR Pub 21/02: Income tax – bonuses paid in crypto-assets

Legislative references | Tohutoro whakatureture

Income Tax Act 2007 – ss CE 1, CE 7, CX 2, CX 4, RD 3, RD 5, RD 7 and the s YA 1 definition of "amount"

Case references | Tohutoro kēhi

CIR v Smythe [1981] 1 NZLR 673

Other references | Tohutoro anō

Subject references

Bonus, cryptoasset, cryptocurrency, FBT, PAYE, salary, wages

Related rulings

BR Pub 23/04: Income tax – salary and wages paid in cryptoassets

BR Pub 23/06: Income tax – employer-issued cryptoassets provided to an employee

BR Pub 23/07: Income tax - application of the employee share scheme rules to employer issued cryptoassets provided to an employee

Legislation

28. The relevant provisions in the Income Tax Act 2007 are as follows:

CE 1 Amounts derived in connection with employment

Income

(1) The following amounts derived by a person in connection with their employment or service are income of the person:

(a) salary or wages or an allowance, bonus, extra pay, or gratuity:

(b) expenditure on account of an employee that is expenditure on account of the person:

(bb) the value of accommodation referred to in sections CE 1B to CE 1E:

(c) [Repealed]

(d) a benefit received under a share purchase agreement:

(e) directors' fees:

(f) compensation for loss of employment or service:

(g) any other benefit in money.

CE 7 Meaning of employee share scheme

Employee share scheme means—

(a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—

(i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but

(b) does not include an arrangement that—

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

CX 2 Meaning of fringe benefit

Meaning

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

CX 4 Relationship with assessable income

To the extent to which a benefit that an employer provides to an employee in connection with their employment is assessable income, the benefit is not a fringe benefit.

RD 3 PAYE income payments

Meaning generally

(1) The PAYE rules apply to a PAYE income payment which—

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:

(iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.

RD 5 Salary or wages

Meaning

(1) Salary or wages—

(a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and

(b) includes—

(i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

(ii) a payment described in subsections (2) to (8); and

(iii) an accident compensation earnings-related payment; and

(iiib) a payment of earnings compensation under the Compensation for Live Organ Donors Act 2016; and

(iv) Repealed.

(c) does not include—

(i) an amount of exempt income:

(ii) an extra pay:

(iii) a schedular payment:

(iv) an amount of income described in section RD 3(3) and (4):

(v) an employer's superannuation contribution other than a contribution referred to in subsection (9):

(vi) a payment excluded by regulations made under this Act.

(d) Repealed.

Employees' expenditure on account

(2) A payment of expenditure on account of an employee is included in their salary or wages.

…

Accommodation benefits

(8) A benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment) is included in salary or wages.

Cash contributions

(9) An amount of an employer's superannuation cash contribution that an employee chooses to have treated as salary or wages under section RD 68 is included in salary or wages.

RD 6 Certain benefits and payments

When this section applies

(1) This section applies when an employee receives—

(a) a benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment); or

(b) another benefit in kind that is included in their salary or wages; or

(c) 1 or more of the following payments:

(i) a superannuation payment:

(ii) a pension:

(iii) a retiring or other allowance:

(iv) an annuity; or

(d) a benefit under section CE 2(2) and (4) (Value and timing of benefits under share purchase agreements) in relation to which the employer has made an election under section RD 7B.

RD 7 Extra pay

Meaning

(1) An extra pay—

(a) means a payment that—

(i) is made to a person in connection with their employment; and

(ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and

(iii) is not overtime pay; and

(iv) is made in 1 lump sum or in 2 or more instalments; and

(b) includes a payment of the kind described in paragraph (a) made—

(i) as a bonus, gratuity, or share of profits; or

(ii) as a redundancy payment; or

(iii) when the person retires from employment; or

(iv) as a result of a retrospective increase in salary or wages, but only to the extent to which it accrues from the start of the increase until the start of the first pay period in which the increase is included in salary or wages; and

(bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax; and

(c) includes an amount of income that a person derives under section CE 9 (Restrictive covenants) or CE 10 (Exit inducements) if the income is derived in connection with an employment relationship between the person and the person who paid the amount; and

(cb) includes an unrepaid PAYE income overpayment that is treated as all or part of an amount of extra pay under section RD 8B(2)(b); and

(d) does not include a payment of exempt income.

YA 1 Definitions

In this Act, unless the context requires otherwise,—

amount—

(a) includes an amount in money's worth:

…

BR Pub 23/04: Income tax – salary and wages paid in cryptoassets

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation laws | Ture tāke

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

This Ruling applies in respect of s RD 3.

The arrangement to which this Ruling applies | Te whakaritenga i pāngia e tēnei Whakataunga

The arrangement is the payment of remuneration to an employee in cryptoassets in circumstances where the cryptoasset payments (whether denominated in NZD or in cryptoassets):

- are for services performed by the employee under an employment agreement;
- are for a fixed amount; and
- are part of the employee's remuneration package.

This Ruling applies only to salary and wage earners, not self-employed taxpayers; and where the cryptoassets being paid:

- are not subject to a "lock-up" period;
- can be converted directly into a fiat currency (on an exchange); and either:
  - a significant purpose of the cryptoasset is to function like a currency; or
  - the value of the cryptoasset is pegged to one or more fiat currencies.

This Ruling does not apply where the cryptoasset provided is a "share" for income tax purposes and is received under an "employee share scheme" as defined in s CE 7.

How the taxation law applies to the Arrangement | Ko te pānga o te ture tāke ki te Whakaritenga

The taxation law applies to the Arrangement as follows:

- The cryptoasset payments are "PAYE income payments" under s RD 3 and are subject to the PAYE rules.

The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply from 2 December 2022 to 30 November 2027.

This Ruling is signed by me on 15 May 2023.

James McKeown

Tax Counsel, Tax Counsel Office | Roia Tāke, Te Tari Tohutohu Tāke

Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/04

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 23/04 ("the Ruling").

Summary | Whakarāpopoto

1. This Ruling is a reissue of BR Pub 21/01, which expired on 1 December 2022. There have been no changes to the previous ruling. The Ruling uses the term "cryptoasset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
2. The commentary discusses when cryptoassets will be treated as part of an employee's salary or wages (for tax purposes) and, therefore, be subject to PAYE. It also discusses the implications arising from cryptoasset payments being subject to PAYE (such as potentially affecting an employee's student loan repayments, Kiwisaver, and Working for Families entitlements). Payments of cryptoassets not subject to PAYE will be fringe benefits and subject to FBT.
3. Employers are required to meet the requirements of New Zealand employment legislation including the Minimum Wages Act 1983 and the Wages Protection Act 1983. In situations where an employer pays cryptoassets to an employee and the cryptoassets are salary or wages for tax purposes, those requirements will include the following:
   - The cryptoassets must be paid as part of an overall remuneration package that includes a component of salary or wages that is payable in money; and
   - the amount of salary or wages payable in money must be at least equal to the statutory minimum prescribed under the Minimum Wages Act 1983.
4. Alternatively, if an employee's remuneration consists of salary or wages payable in money only, the employee may provide written consent to a deduction being made from the salary or wages and an equivalent amount being paid out in cryptoassets, provided the deduction is reasonable.
5. In any case, if you are an employer who pays cryptoassets to an employee, we recommend that you seek advice to ensure that the payments meet the requirements of New Zealand employment legislation.

Background | Horopaki

6. The Ruling sets out the Commissioner's view on the situation where an employee is regularly paid part of their remuneration in cryptoassets. The Commissioner's initial views on this issue were set out in issues paper IRRUIP 11: "Whether remuneration paid to an employee in cryptocurrency is subject to PAYE or FBT", which was released for consultation in June 2018. The submissions received were taken into account in drafting BR Pub 21/01 and the following related Rulings:
   - BR Pub 19/03: Income Tax – employer issued crypto-assets provided to an employee;
   - BR Pub 19/04: Income Tax – application of the employee share scheme rules to employer issued crypto-assets provided to an employee; and
   - BR Pub 21/02: Income Tax – bonuses paid in crypto-assets.
7. The related Rulings set out above have also expired and been reissued as follows:
   - BR Pub 23/05: Income Tax – bonuses paid in cryptoassets;
   - BR Pub 23/06: Income Tax – employer issued cryptoassets provided to an employee; and
   - BR Pub 23/07: Income Tax – application of the employee share scheme rules to employer issued cryptoassets provided to an employee.

Application of the legislation | Whakapānga o te whakature

Introduction

1 These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

8. An agreement to pay an employee in cryptoassets could be structured in two ways. The first way is as an agreed deduction from the employee's gross salary or wages (where the employee's after-tax remuneration is, in effect, being traded for a payment of cryptoassets). It is well-settled law that the employee is subject to PAYE on the full amount in this situation.
9. The second way is as a reduction in calculating the employee's gross salary or wages (also known as a salary sacrifice), where the cryptoassets are paid as part of an overall remuneration package. The following analysis considers how the provision of cryptoassets will be treated when a salary sacrifice arrangement is valid, in particular, whether PAYE or FBT applies.[2]

Whether cryptoassets received under a valid salary sacrifice are subject to PAYE or FBT

10. The first step is to consider whether the payment is subject to PAYE. This is because, to the extent that an employment-related benefit is taxable to an employee, it will not be a fringe benefit (s CX 4). Therefore, if the provision of cryptoassets to an employee falls within the PAYE rules, PAYE will apply even if the FBT rules would also otherwise apply.
11. Section CE 1 sets out the "amounts" that are treated as employment income. Relevantly, these include "salary or wages":

CE 1 Amounts derived in connection with employment

Income

(1) The following amounts derived by a person in connection with their employment or service are income of the person:
- (a) **salary or wages** or an allowance, bonus, extra pay, or gratuity:
- (b) expenditure on account of an employee that is expenditure on account of the person:
- (bb) the value of accommodation referred to in sections CE 1B to CE 1E:
- (c) [Repealed]
- (d) a benefit received under a share purchase agreement:
- (e) directors' fees:
- (f) compensation for loss of employment or service:
- (g) any other benefit in money.

[Emphasis added]

12. The situation being considered is an employee receiving part of their regular remuneration in cryptoassets. Therefore, the potentially relevant part of s CE 1 is "salary or wages".[3]
13. It could be argued that the reference in paragraph (g) of s CE 1 to "any other benefit in money" supports the view that the paragraphs that come before it were intended to be limited to benefits in money. However, the fact s CE 1(1) includes benefits that are not in money (for example, the value of employer-provided accommodation) could suggest that this is not the case.
14. Also, "amount" "includes an amount in money's worth" (s YA 1). Therefore, s CE 1 is drafted widely enough to include amounts derived that are "money's worth" (but not money). However, for cryptoassets (which are money's worth) to be included, they must also be "salary or wages".

Meaning of "salary" and "wages"

15. "Salary or wages" is defined in s RD 5 for the purposes of the PAYE rules:

RD5 Salary or wages

Meaning

(1) Salary or wages-
- (a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and
- (b) includes-
  - (i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

  ....

2 The leading case on when a salary sacrifice will be valid is *Heaton v Bell* [1970] AC 728. See also *Watts v MNR* 61 DTC 592, *Co-operative Insurance Society Ltd v Commissioners of Customs and Excise* (1992) VATTR 44, and *Goodfellow v The Commissioners* (1986) VATTR 119.

3 Inland Revenue's view is that cryptoassets are not "money" (see [20] for further discussion of this). Therefore, s CE 1(1)(g) is not relevant in this case.

16. Neither "salary" nor "wages" is further defined in the Act, so it is necessary to consider their ordinary meanings. "Salary" is relevantly defined in the Concise Oxford English Dictionary (Oxford University Press, 12th ed, 2011) as:

    > a fixed regular payment made usually on a monthly basis by an employer to an employee, especially a professional or white-collar worker.

17. "Wage" is similarly defined as:

    > a fixed regular payment for work, typically paid on a daily or weekly basis.

18. *Deputy Commissioner of Taxation v Applied Design Development Pty Ltd* (in liq) 2002 ATC 4,193 considered the ordinary meaning of "salary" and "wage". Mansfield J defined the terms in the following way (at 4,195):

    > Of particular importance in the present application is the absence of statutory definitions of the words "salary" or "wage". In the absence of statutory definitions, meaning should be given to those words according to the ordinary meaning conveyed by the text of the provision, and taking into account their context in the legislative scheme and the objects of the Act. The words "salary" and "wage" denote an amount of money payable, the consideration for which is the performance of work or services. That meaning is reflected in the definitions provided for the terms in the Oxford English Dictionary, 2nd ed:
    >
    > Salary: fixed payment made periodically to a person as compensation for regular work.
    >
    > Wage: a payment to a person for services rendered.
    >
    > I adopt those definitions in the determination of these proceedings.

19. The hallmarks of salary and wages were also discussed in a case on the meaning of "allowance". In *Stagg v IRC* [1959] NZLR 1252 the Supreme Court referred to the ordinary meaning of an allowance as "sums of money". The provision in question read:

    > All salaries, wages or allowances (whether in cash or otherwise) including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind, in respect of or in relation to the employment of the taxpayer.

20. Hutchison ACJ held that the normal meaning of "allowances" was coloured by the words "salary" and "wages" and was to be read consistently with, or in light of, those words. His Honour considered that the characteristics of salaries that have bearing on the meaning of "allowances" were that they are:

    - for an employment or service;
    - payable under the contract of service and not as a gratuity (although this factor was affected by the later part of the paragraph that included some gratuities within "salaries, wages, or allowances");
    - paid in money (although this factor was affected by the words "whether in cash or otherwise", which meant non-cash allowances could be paid if they were convertible); and
    - paid periodically.

21. In summary, this suggests salary and wages are generally considered to be payments that are:

    - in return for work undertaken;
    - fixed, ie of a predetermined amount or rate (not, for example, a share of profits);
    - regular, ie recurring on a regular basis (usually weekly, fortnightly or monthly); and
    - in money.

22. Where an employee has agreed to receive cryptoassets as part of a remuneration package, most of these requirements would be met (for tax purposes). The payments would be fixed, regular amounts received in return for work undertaken. Cryptoassets can also have many of the characteristics of money; for example, the types of cryptoassets covered by this Ruling are readily transferable mediums of exchange, divisible, fungible, durable and hard to counterfeit.

23. In the Commissioner's view, cryptoassets are property.[4] Cryptoassets are not "money" as commonly understood (at least not at the present time). In particular, because cryptoassets are not issued by any government, they are not legal tender anywhere. Further, although acceptance of certain cryptoassets as payment for goods and services is increasing, they are not "generally accepted" as payment. Given the extreme volatility experienced to date, there are also issues around some cryptoassets' ability to be a store of value.

4 This view is consistent with the decision in *Ruscoe v Cryptopia Ltd* (in liquidation) [2020] NZHC 728.

Legislation Act 2019

24. Notwithstanding that cryptoassets are not "money" in the technical sense, it remains to be considered whether the terms "salary" and "wages" in s CE 1 are wide enough to include payments in cryptoassets. Clearly, at the time "salary" and "wages" were first referred to in the Income Tax Act, Parliament would not have contemplated payments of cryptoassets being within the scope of salary and wages as cryptoassets did not exist.
25. However, s 11 of the Legislation Act 2019 (formerly s 6 of the Interpretation Act 1999)[5] provides for an ambulatory approach to statutory interpretation:

    legislation applies to circumstances as they arise.

26. This requires old legislation to be interpreted as applying to modern circumstances, that is, the: [6]
    - new developments to which the Act is to be applied are within the mischief that the Act was meant to cure; and
    - words of the Act, albeit by liberal interpretation, are capable of covering these new developments.
27. Or, put another way: [7]

    The Court's task in deciding such cases is to remain faithful to the original Parliamentary intent, yet to produce a result that is workable in the different world of today.

28. This interpretive approach has been used where technological developments or changes in the way society views something have made old legislation outdated. For example, in *R v Walsh* [2007] 1 NZLR 738, the Court of Appeal applied the previous version of s 11 (s 6 of the Interpretation Act 1999) to interpret the meaning of "false document" taking into account the digital age.[8] In *R v Misic* [2001] 3 NZLR 1 the Court of Appeal held that a computer program and disk were documents for the purposes of s 229A of the Crimes Act 1961.
29. Originally, the concept of salary and wages would have been limited to payments in physical notes and coins. Later, payment may have been made by cheque. Now payment is likely to be made by direct credit to an employee's bank account. As such, the concept of salary and wages has shifted over time with different payment methods. Cryptoassets and the blockchain on which they are based have been around since 2009. Cryptoassets have become more widely used in recent times.
30. The question is whether the ordinary meanings of "salary" and "wages" for tax purposes are now wide enough to encompass payments in cryptoassets. Unlike the moves from physical notes and coins to cheques to direct credit (which are all payments of money), the shift to paying in cryptoassets is a more significant one. However, this does not prevent s 11 of the Legislation Act 2019 applying. There is nothing in the Income Tax Act that limits the interpretation of salary and wages to monetary payments. Rather the ordinary meanings apply, and these can change over time. The Commissioner's view is that the meanings of "salary" and "wages" for tax purposes are capable of including payments in cryptoassets. However, employers should be aware of employment legislation, and in particular the Minimum Wage Act 1983 and the Wages Protection Act 1983.

PAYE generally applies only to monetary benefits

31. The alternative view is "salary" and "wages" should be interpreted narrowly and, consequently, PAYE will not apply. If a payment of cryptoassets was not subject to PAYE, it would be a fringe benefit and subject to FBT[9].
32. The primary argument for FBT applying is that the scheme of the Income Tax Act suggests that payments in money are subject to PAYE and non-monetary payments are subject to FBT (except where specifically provided for). The PAYE rules apply to "PAYE income payments", which for employees is defined as a payment of "salary or wages" or an "extra pay". "Salary or wages" is defined in s RD 5. Most of the items listed are payments that would generally be expected to be made in money. These include salary, wages, allowances, bonuses, commissions, gratuities, and various benefit, grant and compensation payments. However, employer-provided accommodation under s CE 1(1)(bb) is also expressly included.
33. Similarly, "extra pay" is defined in s RD 7 in relation to payments that would generally be made in money. However, it also includes a benefit under certain share purchase agreements.

5 Section 6 provided that "[a]n enactment applies to circumstances as they arise".

6 J Burrows and J Fogerty (presenters) "Statutory Interpretation" (New Zealand Law Society seminar, 2011).

7 Bigwood, R (ed) *The Statute Making and Meaning* (LexisNexis, 2004).

8 The Supreme Court (*R v Walsh* [2007] 2 NZLR 109) later held that such an interpretation was not necessary.

9 A cryptoasset payment would satisfy the definition of "fringe benefit" in s CX 2 and not fall within any of the exemptions in subpart CX.

34. It can be seen from this that the Act broadly distinguishes between monetary and non-monetary payments to employees with the former being subject to PAYE and the latter to FBT. The reference in s CE 1(1)(g) to "any other benefit in money" is also consistent with this. However, this distinction is not absolute, with some non-monetary benefits being included in the PAYE rules. It is less clear whether non-monetary benefits that are not expressly included could also be subject to PAYE.

Section RD 6

35. Section RD 6 seems to contemplate other non-monetary benefits being subject to the PAYE rules. It provides timing and valuation rules for non-monetary benefits. Relevantly, it applies to:

RD6 Certain benefits and payments

When this section applies

(1) This section applies when an employee receives-

(a) a benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment); or

(b) another benefit in kind that is included in their salary or wages; or

(c) 1 or more of the following payments:

(i) a superannuation payment:

(ii) a pension:

(iii) a retiring or other allowance:

(iv) an annuity; or

(d) a benefit under section CE 2(2) and (4) (Value and timing of benefits under share purchase agreements) in relation to which the employer has made an election under section RD 7B. [Emphasis added]

36. As well as including the specific non-monetary benefits (employer-provided accommodation and benefits under share purchase schemes) s RD 6 also provides for other benefits in kind that are included in an employee's salary or wages. This suggests there may be other situations where non-monetary benefits are included in an employee's salary and wages for PAYE purposes. However, it is not clear when this will be the case.

37. The original predecessor to s RD 6 (s 9 of the Income Tax Assessment Act 1957) was introduced at the same time as the PAYE rules. The wording of the original subsection was:

9 Benefits and superannuation and other payments deemed to be salary and wages-

(1) Where in respect of his employment an employee receives a benefit referred to in section eighty-nine of the principal Act[10], **or any other benefit in kind which is included in his salary or wages,** or receives a payment by way of superannuation, pension, retiring allowance, or other allowance, or annuity which is included in salary or wages as defined in section two of this Act, the value of the benefit (whether in money or otherwise) or, as the case may be, the amount of the payment shall be deemed to accrue from day to day, and accordingly in each case the amount so accrued for any days in a pay period of the employee shall be deemed to be his salary or wages for the pay period, or, as the case may be, part of his salary or wages for the pay period. [Footnote and emphasis added]

"Salary or wages" was relevantly defined as meaning "salary, wages, or allowances (whether in cash or otherwise)". Consistent with the current legislation, the value of accommodation was also included in the definition. The wording has remained broadly similar through to the Income Tax Act 2007.

38. There is limited contemporaneous material discussing what "other benefits in kind" in s 9 of the Income Tax Assessment Act 1957 was intended to cover. During the second reading of the Income Tax Assessment Bill 1957, Hon. Mr Watts explained clause 9 of the Bill as follows (8 October 1958, 314 NZPD 2,894):

> Under clause 9 any benefits in kind, for example, the value of a free house, or free meat, or other benefits of that type, are to be taxed at the end of each pay period. If the employee is paid weekly he will also pay on the value of his benefits for the week. Where superannuation is paid and is treated as salary and wages it will be deemed to have accrued from day to day over the period for which it is paid.

39. Many of the taxable benefits that would have been subject to PAYE when s 9 of the Income Tax Assessment Act 1957 was enacted will now be subject to FBT. However, the fact s RD 6(1)(b) is included in the current legislation suggests some non-monetary benefits (other than those specifically mentioned in other paragraphs of s RD 6(1)) may come within the definition of "salary or wages".

10 Section 89 of the Land and Income Tax Act 1954 included in "assessable income" the value of any employer-provided board, lodging and house allowances.

Conclusion

40. It is unclear on the face of the legislation whether an employee who regularly receives cryptoassets as a part of their normal remuneration package is subject to PAYE or whether FBT applies. Both views are arguable.

41. Broadly, the scheme of the Act is that consideration in money is subject to PAYE, whereas non-monetary benefits are subject to FBT. Cryptoassets are not money in the technical sense (although they share some of the characteristics of money). This might suggest that payments in cryptoassets should be subject to FBT. However, the distinction between monetary and non-monetary payments is not hard and fast. Statutory exceptions make some non-monetary benefits (such as employer-provided accommodation) subject to PAYE. Further, the PAYE rules are drafted widely enough to potentially include some other non-monetary payments.

42. Ultimately, the issue turns on whether regular payments in cryptoassets come within the ordinary meaning of "salary or wages" for tax purposes. The answer to this is not certain. While a regular payment received in cryptoassets has many of the hallmarks of salary and wages, historically salary and wages have been payments in money. However, s 11 of the Legislation Act 2019 requires legislation to be interpreted as applying to modern circumstances. While not free from doubt, on balance, the Commissioner's view is that for tax purposes, the concepts of "salary" and "wages" are wide enough to encompass some regular payments in cryptoassets (although employers will need to be aware of employment legislation). Consequently, these payments are "salary or wages" under s RD 5 for tax purposes. Therefore, they are "PAYE income payments" under s RD 3 and the PAYE rules apply to them.

43. Because the payments are subject to PAYE, the FBT rules will not apply.

Which cryptoassets are subject to PAYE?

44. In the Commissioner's view, not all types of cryptoassets will be subject to PAYE. To be considered "salary or wages" for tax purposes, the cryptoassets need to be sufficiently similar to existing notions of salary and wages. In the Commissioner's view, this will be the case where the cryptoassets have the following features:
    - They are not subject to a "lock-up" period;
    - They can be converted directly into a fiat currency (on an exchange); and either:
        - a significant purpose of the cryptoasset is to function like a currency; or
        - the value of the cryptoasset is pegged to one or more fiat currencies.

45. Each of these is discussed in more detail below. Taxpayers can contact Inland Revenue if they are having difficulty determining whether a particular cryptoasset satisfies these criteria.

46. For cryptoasset payments that are not subject to PAYE, the FBT rules will apply.

Not subject to a "lock-up" period

47. In the Commissioner's view, cryptoassets that cannot be converted or sold by the employee for a material period of time after payment does not sufficiently resemble a payment of salary or wages.

The cryptoassets can be converted directly into a fiat currency

48. Most mainstream cryptoassets can generally be traded on an exchange directly for fiat currency (for example, New Zealand dollars (NZD) or United States dollars). For other cryptoassets, this may not be available. Instead, the cryptoassets must first be converted into a more mainstream cryptoasset and then converted into fiat currency. In the current environment where cryptoassets are not readily accepted as payment for goods and services, the Commissioner's view is that cryptoassets that cannot be converted directly into fiat currency on an exchange (that meets the requirements set out in [60] - [62]) are not sufficiently "money-like" to be considered salary or wages for tax purposes.

A significant purpose of the cryptoassets is to function like a currency

49. The range and functions of cryptoassets have evolved in recent times. It is now possible to get cryptoassets that function in a similar way, for example, to vouchers, shares, or debt securities.

50. Some cryptoassets are designed to function as an alternative to fiat currency in the sense they provide a general-purpose peer-to-peer payment system. Some cryptoassets are designed with other functions in addition to use as a currency, but the currency purpose is still a significant one. The Commissioner's view is that payment in these types of cryptoassets (where conversion directly into a fiat currency on an exchange is possible) is sufficiently "money-like" to come within the ordinary meaning of salary or wages.

51. These can be contrasted with cryptoassets that are designed primarily for other purposes. Common examples are:
    - rights to access, operate, use or control a platform or other property/services (often referred to as "utility tokens");
    - providing rights to underlying tradable assets such as precious metals or real estate (often referred to "asset tokens"); and
    - providing ownership or control of a financial asset (often referred to as "securities tokens").
52. These cryptoassets can also usually be traded peer-to-peer or on an exchange. Therefore, in a sense, they can function in a similar way to currency. However, this can be seen as the equivalent of trading in gold, shares, or gift cards for example. That is, although they share some of the features of currency, they are not intended to operate as such.

The value of the cryptoassets is pegged to one or more fiat currencies

53. This refers to so-called "stablecoins" that have their value pegged to one or more fiat currencies. Regardless of whether these cryptoassets are designed to function like currencies (in the sense discussed above at [49]-[52] the Commissioner's view is that payment in a stablecoin (where conversion directly into a fiat currency on an exchange is possible) is sufficiently "money-like" to come within the ordinary meaning of salary or wages for tax purposes.

Implications of conclusion

PAYE calculations

54. Where an employee's remuneration package includes cryptoassets and salary or wages paid in money, PAYE is calculated on the aggregate of the value of the cryptoassets and the money (the valuation of cryptoassets is discussed at [58] to [63] below). For instance, if in each pay period an employee receives $2,000 and cryptoassets with a value of $1,000, the amount on which PAYE is calculated is $3,000.
55. Similarly, if the employee receives $2,000 and a fixed number of cryptoassets (rather than an amount of cryptoassets denominated in NZD), PAYE is calculated in the same way, however the amount will vary to the extent that the value of the cryptoasset changes from pay period to pay period. If the employee is entitled to 100 cryptoassets and the value of one cryptoasset is $12.50, the amount on which PAYE is calculated is $3,250. This amount is calculated by adding the $2,000 monetary payment to the $1,250 cryptoasset payment. The value of the latter is calculated by multiplying the value of the cryptoasset by the number of cryptoassets received (ie,100 X $12.50 = $1,250). If in the following pay period the value of one cryptoasset has increased to $16.50, the amount on which PAYE is calculated is $3,650 (ie, $2,000 + (100 X $16.50) = $3,650).
56. An employer may agree to meet the cost of a tax liability that arises in relation to cryptoassets paid to an employee. In such a case, the value of the tax paid by the employer is assessable income of the employee and must be included in the amount on which PAYE is calculated. For example, assume the employer in the example at [54] above agrees that it will pay the tax relating to the $1,000 cryptoasset payment the employee receives. The total of the employee's cryptoasset income and tax paid by the employer will be calculated under the following "gross-up" formula where the employee's tax rate is their marginal rate of 33%:

$$\$1{,}000 \times 1 / (1 - \text{tax rate}) = \$1{,}492.54$$

57. Adding the result of this calculation to the $2,000 payment in money will give the amount on which PAYE is calculated ie, $1,492.54 + $2,000 = $3,492.54. The components of income that are included in this amount are set out in the table below.

Income	Value
Payment in money	$2,000.00
Cryptoassets	$1,000.00
Tax paid by employer	$492.54
Total	$3,492.54

Converting cryptoasset payments to NZD

58. Generally, arrangements of this type will provide for an employee to be paid an amount of cryptoassets denominated in NZD. In this case, there will be no need to convert the cryptoassets into NZD to calculate the PAYE payable.

59. However, where a cryptoasset payment is not denominated in NZD (for example, if an employee is paid 0.001 of a cryptoasset per fortnight as part of a remuneration package), it is necessary to calculate the NZD value of the cryptoassets on the date it is paid to the employee.
60. Conversion rates may be obtained from any centralised data repository site that may be listed from time-to-time on the Inland Revenue website.
61. Alternatively, conversion rates may be obtained from a public exchange that has comprehensive know-your-customer/anti-money-laundering procedures in place. Which exchange (or exchanges) is appropriate will depend on the circumstances. Using a New Zealand-based exchange listed on the Financial Service Providers Register will be appropriate.
62. If the appropriate valuation cannot be obtained from a New Zealand-based exchange, an overseas-based exchange can be used. For some cryptoassets it may be necessary to convert into US dollars, or another fiat currency, and then convert into NZD.
63. Rates can vary significantly between different exchanges and currencies. Therefore, taxpayers should use a consistent exchange and conversion approach (for example, using a consistent time of day to determine the conversion rates).

Other implications

64. There are various circumstances where obligations, eligibility, or entitlements may be calculated based on an employee's salary or wages (for example Kiwisaver, Working for Families Tax Credits, and student loan repayments). The cryptoasset payments must be taken into account when calculating these.

Example

65. The following example is included to help explain the application of the law.

Example: Employee paid in cryptoassets as part of salary package

Ken is employed by Cryptowonderland Ltd. His gross salary is NZD$5,000 per month, which is payable in NZD direct credited to his bank account. Ken's remuneration package also includes gross payments of NZD$5,000 in cryptoassets per month. The payments are not subject to a lock up period, the cryptoasset can be converted into fiat currency on an exchange, and a principal purpose of the cryptoasset is to function like a currency. The cryptoassets are paid into Ken's cryptoasset wallet.

Ken's employer has not agreed to fund the tax liability that arises in relation to the cryptoasset payments.

PAYE should be calculated on the $10,000 gross payment and withheld and paid to the Commissioner (in New Zealand dollars). The net amount is payable to Ken.

If Ken is a Kiwisaver member or is subject to, for example, child support or student loan deductions, the Employer's Guide (IR 335) and the PAYE calculator (both available on the Inland Revenue website www.ird.govt.nz) can be used to assist with calculating these.

References | Tohutoro

Expired rulings | Whakatau mōnehu

BR Pub 21/01: Income tax – salary and wages paid in cryptoassets

Legislative references | Tohutoro whakatureture

Income Tax Act 2007 – ss CE 1, CE 7, CX 2, CX 4, RD 3, RD 5, RD 6, RD 7, YA 1 definitions of "amount" and "salary or wages"

Legislation Act 2019 – s 11

Case references | Tohutoro kēhi

Co-operative Insurance Society Ltd v Commissioners of Customs and Excise (1992) VATTR 44

Deputy Commissioner of Taxation v Applied Design Development Pty Ltd (in liq) 2002 ATC 4,193

Goodfellow v The Commissioners (1986) VATTR 119

Heaton v Bell [1970] AC 728

R v Misic [2001] 3 NZLR 1

R v Walsh [2007] 1 NZLR 738

R v Walsh [2007] 2 NZLR 109

Stagg v IRC [1959] NZLR 1252

Watts v MNR 61 DTC 592

Other references | Tohutoro anō

Related rulings

BR Pub 23/05: Income tax – bonuses paid in cryptoassets

BR Pub 23/06: Income tax – employer-issued cryptoassets provided to an employee

BR Pub 23/07: Income tax - application of the employee share scheme rules to employer issued cryptoassets provided to an employee

Publications

J Burrows and J Fogerty (presenters) *"Statutory Interpretation"* (New Zealand Law Society seminar, 2011).

Bigwood, R (ed) *The Statute Making and Meaning (LexisNexis, 2004).*

Concise Oxford English Dictionary (Oxford University Press, 12th ed, 2011)

Legislation

66. The relevant provisions in the Income Tax Act 2007 are as follows:

CE 1 Amounts derived in connection with employment

Income

(1) The following amounts derived by a person in connection with their employment or service are income of the person:

(a) salary or wages or an allowance, bonus, extra pay, or gratuity:

(b) expenditure on account of an employee that is expenditure on account of the person:

(bb) the value of accommodation referred to in sections CE 1B to CE 1E:

(c) [Repealed]

(d) a benefit received under a share purchase agreement:

(e) directors' fees:

(f) compensation for loss of employment or service:

(g) any other benefit in money.

CE 7 Meaning of employee share scheme

Employee share scheme means—

(a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—

(i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but

(b) does not include an arrangement that—

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

CX 2 Meaning of fringe benefit

Meaning

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

CX 4 Relationship with assessable income

To the extent to which a benefit that an employer provides to an employee in connection with their employment is assessable income, the benefit is not a fringe benefit.

RD 3 PAYE income payments

Meaning generally

(1) The PAYE rules apply to a PAYE income payment which—

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:

(iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.

RD 5 Salary or wages

Meaning

(1) Salary or wages—

(a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and

(b) includes—

(i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

(ii) a payment described in subsections (2) to (8); and

(iii) an accident compensation earnings-related payment; and

(iiib) a payment of earnings compensation under the Compensation for Live Organ Donors Act 2016; and

(iv) Repealed.

(c) does not include—

(i) an amount of exempt income:

(ii) an extra pay:

(iii) a schedular payment:

(iv) an amount of income described in section RD 3(3) and (4):

(v) an employer's superannuation contribution other than a contribution referred to in subsection (9):

(vi) a payment excluded by regulations made under this Act.

(d) Repealed.

Employees' expenditure on account

(2) A payment of expenditure on account of an employee is included in their salary or wages.

…

Accommodation benefits

(8) A benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment) is included in salary or wages.

Cash contributions

(9) An amount of an employer's superannuation cash contribution that an employee chooses to have treated as salary or wages under section RD 68 is included in salary or wages.

RD 6 Certain benefits and payments

When this section applies

(1) This section applies when an employee receives—

(a) a benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment); or

(b) another benefit in kind that is included in their salary or wages; or

(c) 1 or more of the following payments:

(i) a superannuation payment:

(ii) a pension:

(iii) a retiring or other allowance:

(iv) an annuity; or

(d) a benefit under section CE 2(2) and (4) (Value and timing of benefits under share purchase agreements) in relation to which the employer has made an election under section RD 7B.

…

RD 7 Extra pay

Meaning

(1) An extra pay—

(a) means a payment that—

(i) is made to a person in connection with their employment; and

(ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and

(iii) is not overtime pay; and

(iv) is made in 1 lump sum or in 2 or more instalments; and

(b) includes a payment of the kind described in paragraph (a) made—

(i) as a bonus, gratuity, or share of profits; or

(ii) as a redundancy payment; or

(iii) when the person retires from employment; or

(iv) as a result of a retrospective increase in salary or wages, but only to the extent to which it accrues from the start of the increase until the start of the first pay period in which the increase is included in salary or wages; and

(bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax; and

(c) includes an amount of income that a person derives under section CE 9 (Restrictive covenants) or CE 10 (Exit inducements) if the income is derived in connection with an employment relationship between the person and the person who paid the amount; and

(cb) includes an unrepaid PAYE income overpayment that is treated as all or part of an amount of extra pay under section RD 8B(2)(b); and

(d) does not include a payment of exempt income.

YA 1 Definitions

In this Act, unless the context requires otherwise,—

amount—

(a) includes an amount in money's worth:

...

67. Section 11 of the Legislation Act 2019 provides as follows:

> **11 Legislation applies to circumstances as they arise**
>
> Legislation applies to circumstances as they arise.

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.

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 23/04: The interest limitation rules and short-stay accommodation

Introduction | Whakataki

What this Interpretation Statement is about

1. This Interpretation Statement explains how the interest limitation rules apply if you incur loan interest for a property you use to provide short-stay accommodation. It also explains what other income tax rules may be relevant to any interest that is deductible, depending on your circumstances. It covers short-stay accommodation provided:
   - in your holiday home,
   - in your main home,
   - in a separate dwelling on the same land as your main home,
   - in a property used only to provide short-stay accommodation, or
   - on your farm, or lifestyle block (that is not a farm).
2. This Interpretation Statement explains how the rules apply to interest incurred by natural persons or trustees. It does not cover the situation where the interest is incurred by a company. It also does not cover the situation where the short-stay accommodation is used to provide social, emergency, transitional, or support housing.
3. In this Interpretation Statement:
   - "Short-stay accommodation" is accommodation provided to a guest for up to four consecutive weeks.
   - A "short-stay dwelling" is a dwelling in which you provide short-stay accommodation.
   - A "guest" is a person who pays an amount[1] to use a short-stay dwelling.
4. The tax rules apply to land. Under general law, dwellings affixed to land are part of the land. When this Interpretation Statement refers to a short-stay dwelling, this includes the land on which the dwelling is placed. When this Interpretation Statement refers to land, this includes any dwellings on the land.
5. This Interpretation Statement is part of a series of items covering the tax rules that apply to persons who provide short-stay accommodation. The earlier items are available on Inland Revenue's website here. Those earlier items pre-date the interest limitation rules and the residential rental ring-fencing rules (referred to in this Interpretation Statement as the ring-fencing rules). Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

Structure of this Interpretation Statement

6. This Interpretation Statement is structured so that you only need to read the parts that are relevant to your circumstances. First there is an overview of the interest limitation rules, and then the Interpretation Statement is broken up into sections that explain how the interest limitation rules, and other relevant tax rules, apply to each of the short-stay accommodation

1 The amount paid will usually be in money, but also includes money's worth. Money's worth is something which has a monetary value.

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situations specified in [1]. An appendix provides additional detail on some aspects of the interest limitation rules and the other relevant tax rules that may apply.

7. The Interpretation Statement and appendix cross-reference one another to assist you to locate the information relevant to your situation (without the need to read the entire item, as some content may not be relevant to your situation). For example, if your short-stay dwelling is a separate dwelling on the same land as your main home, we suggest you read the relevant section in the Interpretation Statement and then, if you need to, read the relevant cross-referenced content in the appendix that provides additional detail.
8. First, however, we suggest you read the overview of the interest limitation rules in [9] to [22].

Analysis | Tātari

Overview of the interest limitation rules applying to short-stay dwellings

9. The interest limitation rules in subpart DH apply to interest incurred on or after 1 October 2021 to the extent it is for disallowed residential property (DRP). The rules:
   - Deny all interest deductions for DRP acquired on or after 27 March 2021.
   - Progressively deny deductions for grandparented residential interest, which is interest incurred for DRP acquired before 27 March 2021 with a loan drawn down before that date or a loan that refinances such a loan (a grandparented transitional loan). A portion of grandparented residential interest is allowed during the phase-out period (1 October 2021 to 31 March 2025) and from 1 April 2025 interest deductions will be fully denied.

Disallowed residential property

10. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode (ie, a dwelling), and it includes any appurtenances belonging to or enjoyed with the place. It does not matter whether the place is used as a residence or abode.
11. The words "residence" and "abode" are not defined for the purposes of the Act and have their ordinary meaning. "Residence" means a person's home[2] and "abode" means a house or home.[3]
12. An appurtenance is an accessory to some more important thing. In the context of a dwelling, an example of an appurtenance is a standalone garage that is used with a dwelling. An appurtenance also includes the curtilage (garden or yard) of the dwelling.

<u>Excepted residential land</u>

13. DRP does not include land to the extent it is "excepted residential land". Relevantly for this Interpretation Statement, "excepted residential land" includes:
    - a person's main home,
    - the main home of a beneficiary of a trust, if the owner of the home is a trustee, provided no principal settlor of the trust has a different main home (ie, either no principal settlor has a main home, or the place is their main home as well as being the beneficiary's main home), and
    - farmland (including any dwellings on the land).
14. Unless it is excepted residential land (eg, a main home or farmland), land with a short-stay dwelling on it is DRP. This is because it is land that has a place (the dwelling) configured as a residence or abode. The interest limitation rules will apply to interest incurred for the short-stay dwelling unless the "new build land" exemption applies.

The new build land exemption

15. If the new build land exemption applies, the interest limitation rules do not apply and interest incurred for the land will be deductible for a 20-year period, subject to normal deductibility rules. The new build land exemption applies to every owner of the new build land during the exemption period.

2 *Concise Oxford English Dictionary* (12th ed, Oxford University Press, 2011).

3 *Concise Oxford English Dictionary* (12th ed, Oxford University Press, 2011).

16. In general terms, "new build land" is land to the extent to which it has a place configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode.
17. The phrase "self-contained residence or abode" is not defined for the purposes of the Act. Its ordinary and plain meaning requires that a dwelling has the necessary facilities, such as a kitchen, bathroom, toilet, and electricity, to enable it to be used as a residence or abode. A dwelling will not be self-contained if it shares essential facilities with another dwelling.

The rules may apply to part of a piece of land

18. The statutory definitions of DRP and "excepted residential land" and the new build land exemption use the phrase "to the extent to which". This means the interest limitation rules may apply to only part of a piece of land (for example, if part of the land is the owner's main home and part is not, or if part of the land is new build land and part is not).
19. If the interest limitation rules apply to only part of a piece of land, it is necessary to determine the proportion of the land the rules apply to. This is known as apportionment. In many circumstances, a land area apportionment will be appropriate and will achieve a fair and reasonable assessment. In other circumstances, a different apportionment approach might be appropriate – for example, apportionment based on valuation of different parts of the land.

Identifying the interest incurred for DRP

20. Tracing is generally used to identify whether interest is incurred for DRP. This requires identifying whether the loan under which the interest is paid was used for a short-stay dwelling (for example, whether the loan was used to purchase the short-stay dwelling or to pay for repairs or maintenance to the short-stay dwelling). In rare cases, a special rule applies if it is not possible to trace a grandparented transitional loan.

The interest limitation rules are overriding

21. The interest limitation rules override all other deduction rules. If a deduction for interest is denied under the interest limitation rules, a deduction is not allowed under any other rule.
22. However, interest that has been denied deductibility only under the interest limitation rules (ie, it would otherwise have been deductible) may become deductible in the year the DRP is disposed of, if the disposal is taxable – for example, if the disposal is taxed under the bright-line test. Because of this, it may be necessary to keep track of how much interest you would have been allowed to deduct if not for the interest limitation rules.

How the interest limitation rules apply to specific types of short-stay accommodation

23. The following discussion explains how the interest limitation rules and other tax rules apply to different short-stay accommodation scenarios. Please go to the section relevant to you. If you provide short-stay accommodation:
    - **in your holiday home** – go to [24],
    - **in your main home** – go to [71],
    - **in a separate dwelling on the same land as your main home** – go to [84],
    - **in a separate property used only for short-stay accommodation** – go to [154], or
    - **on your farm or lifestyle block** – go to [177].

Short-stay accommodation provided in your holiday home

24. The basis of the following discussion is that your holiday home is the only place configured as a residence or abode on the land.
25. The interest limitation rules apply to interest to the extent to which it is incurred for DRP.
26. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.
27. The land with your holiday home is land with a place configured as a residence or abode. Therefore, it is DRP. The interest limitation rules will apply to the interest incurred for your holiday home unless the holiday home is new build land.
28. In general terms, new build land is land to the extent to which it has a place that is a configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place

was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].

29. If your holiday home is new build land, see from [57]. If your holiday home is not new build land, see from [30].

If your holiday home is not new build land

30. The table below (figure 1) provides an overview of the rules relevant to interest deductibility for your holiday home.

Figure | Hoahoa 1 – Short-stay accommodation provided in your holiday home and the holiday home is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules apply. Interest deductions are not allowed – subject to partial deductibility in the phase-out period[4] if you have a grandparented transitional loan.[5]	If there is private use of the holiday home and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the holiday home could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [46]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the holiday home could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • the MuA rules do not apply to the holiday home, and • the rental activity for the holiday home[6] is loss-making.

The interest limitation rules apply

31. Since your holiday home is not new build land, the interest limitation rules will apply. The way the interest limitation rules apply depends on whether the interest you incurred for the holiday home is grandparented residential interest.

32. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

33. If the interest you incurred for your holiday home:
    - is grandparented residential interest, you will be able to deduct a portion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,
    - is not grandparented residential interest, you will be denied a deduction for the interest.

34. Whether you have grandparented residential interest or not, if the future disposal of your holiday home is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. The way in which it is recognised depends on which land sales provision the disposal is taxed under (see [40] to [43]).

Interest limitation rules override ability to deduct interest under the mixed-use asset rules or standard deductibility rules

35. If you use your holiday home to earn income and use it privately,[7] most deductible expenses need to be apportioned between those uses of the property. The method for this apportionment depends on whether the mixed-use asset rules

4 The phase-out period is 1 October 2021 to 31 March 2025.
5 A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.
6 Or a portfolio of rental properties if you have one.
7 This may include use by you or your family, or use by friends who are not charged full market rent.

(the MuA rules) apply. If the MuA rules apply, they provide a formula for apportionment. If the MuA rules do not apply, you need to apply general apportionment principles (referred to here as the standard deductibility rules). See further from [46].

36. However, the interest limitation rules override the ability to deduct interest that would otherwise be deductible. This means the interest that would be apportioned to the income-earning use of your holiday home, which would otherwise have been allowed as a deduction under either the MuA rules or standard deductibility rules, is denied a deduction under the interest limitation rules.[8]

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

37. Despite the interest limitation rules overriding both the MuA rules and standard deductibility rules, you may still need to apportion the interest you have incurred for your holiday home under the relevant rules (discussed from [46]). This will be the case if you use your holiday home privately as well as to earn income and:
    - The interest is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period.
    - A future disposal of your holiday home could be taxable.
38. This is because any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.

If you have some deductible interest in the phase-out period

39. If you have some deductible interest in the phase-out period because your interest is grandparented residential interest, you will need to apportion your deductible interest under either the MuA rules or standard deductibility rules (see from [46]).

Treatment of previously denied interest if the future disposal of your holiday home is taxable

40. If the future disposal of your holiday home is taxable, interest incurred in prior years that would have been allowed under either the MuA rules or standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.
41. A disposal of your holiday home would be taxable if, for example, you dispose of it within the bright-line period[9] or you acquired it with a purpose or intention of disposing of it.
42. If the disposal of your holiday home is taxable under the bright-line test, the interest previously denied because of the interest limitation rules is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income – whether under the bright-line test or one of the other land sale provisions (s EL 20).
43. If your disposal is taxable under any of the other land sales provisions, the previously denied interest is allowed as a deduction in the income year of disposal but is subject to allocation under the ring-fencing rules.[10] The ring-fencing rules are discussed in the appendix from [A48].

If it is clear the future disposal of your holiday home will not be taxable

44. If you do not have deductible interest expenditure in the phase-out period (or the phase-out period has finished) and it is clear a future disposal of your holiday home will not be taxable, you do not need to apportion your interest under either the MuA rules or standard deductibility rules. This is because the interest is not deductible and will not become deductible on the disposal of the holiday home. It will be clear a future disposal will not be taxable if you have owned the holiday home for longer than the applicable bright-line period and none of the other land sales provisions could apply (for example, you did not acquire the holiday home with a purpose or intention of disposal).

8 Except if it is partially deductible during the phase-out period (see [33]).

9 Generally, for land acquired before 27 March 2021 and for all new build land, the bright-line period is 5 years, and for land acquired on or after 27 March 2021, the bright-line period is 10 years.

10 Subpart EL contains rules for the allocation of deductions for excess residential land expenditure. These rules are commonly referred to as the "residential loss- ringfencing rules".

If it is not clear whether the future disposal of your holiday home will be taxable

45. However, it may not be clear whether the disposal of your holiday home will be taxable until the time of disposal. In this case, you should apply the relevant apportionment calculation under either the MuA rules or standard deductibility rules to your interest for the property for each year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in each income year but was denied under the interest limitation rules. This means you will readily be able to determine the total amount of interest that can be recognised if a future disposal of the land is taxable. The discussion from [46] to [54] will help you determine whether the MuA rules or standard deductibility rules are relevant.

If you need to apportion for private use – MuA rules or standard deductibility rules

46. If you need to apportion the interest you have incurred for your holiday home because you use it privately as well as to earn income and you have some deductible interest during the phase-out period and/or a future disposal of your holiday home could be taxable, you will need to work out which apportionment rules to use.
47. You will need to apportion your interest either under the MuA rules or the standard deductibility rules, depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.
48. If you use your holiday home partly for income-earning purposes and partly for private purposes and it is also not used for at least 62 days in the income year, the MuA rules will apply. This is unless you opt out of the rules, which you can do in two situations (see [52] to [53]).
49. For the MuA rules, private use is when you, or a person associated with you (for example, close relatives such as your children, grandchildren, siblings, or in-laws), use the dwelling. It is irrelevant whether you are paid for that use. Private use also includes use of the dwelling by a guest who pays less than 80% of the market value amount for use of the dwelling.
50. If the MuA rules apply, they apportion your interest (and other expenditure for the property) between income-earning use and private use by using a prescribed formula. This determines the deduction you are allowed. The formula apportions relevant expenditure based on the number of income-earning days relative to total days the property is physically used.
51. If the MuA rules do not apply,[11] your expenses for the property will be apportioned based on the standard deductibility rules. Generally, this would involve time and space-based apportionment, with potential deductibility for days the property is not used privately and is available for rent.[12]
52. The two situations in which you can choose to opt out of the MuA rules (if they would otherwise apply) are where:
    - If the amount of income you derive for the income year from your holiday home is less than $4,000.
    - Your holiday home rental activity for the year is loss-making (that is, the expenses you could deduct for the year under the MuA rules exceed the income) and your income from renting out the dwelling during the income year is less than 2% of the property's value.[13]
53. If you opt out of the MuA rules, the income from your holiday home for that year is treated as exempt income and all interest (and other expenses) incurred for the holiday home will be non-deductible.
54. Comprehensive explanations of how to determine which apportionment rules apply to short-stay dwellings and how those rules are applied are contained in:
    - QB 19/06: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 12.
    - QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.
    - QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

11 Other than because you opted out of the MuA rules.

12 See QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

13 The value to use in determining if you are under the 2% threshold is: the most recent capital value or annual value set by your local authority or, if you purchased the property after the most recent local authority valuation, the purchase price you paid for the property (unless you acquired it from an associated person – in which case the market value at the time you acquired the property).

55. As noted at [5], the above items pre-date the interest limitation rules and the ring-fencing rules. Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

If your holiday home is new build land

56. The table below (figure 2) provides an overview of the rules relevant to interest deductibility for your holiday home.

Figure | Hoahoa 2 – Short-stay accommodation provided in your holiday home and the holiday home is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	If there is private use of the holiday home, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [59]).	If the MuA rules do not apply and the rental activity for the holiday home[14] is loss-making, the amount of total deduction (including interest) allowed in the income year may be limited by the ring-fencing rules (see from [62]).

Interest limitation rules do not apply

57. Since your holiday home is new build land, the interest limitation rules do not apply to interest incurred for your holiday home.

58. Interest will be deductible to the extent it is incurred in relation to income-earning use of your holiday home and is not prohibited because it is expenditure of a private nature. Apportionment for private use is discussed from [59]. If you have only used your holiday home privately, you cannot deduct any interest you incurred for the property.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

59. If you have used your holiday home both privately[15] and for earning income in an income year, you will need to apportion most of your deductible expenses for the property (including interest) between those different uses of the property.[16] Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.

60. You will need to apportion your interest (and most other expenses for the property) either under the mixed-use asset rules (the MuA rules) or based on general apportionment principles, depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.

61. The discussion from [48] to [54] will help you determine whether the MuA rules or standard deductibility rules apply and direct you to further guidance on how to apply the relevant rules.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

62. If the MuA rules do not apply to your holiday home, the ring-fencing rules[17] may apply to limit your total deduction (including interest) for the property in the income year.

63. The ring-fencing rules apply to "residential rental property". "Residential rental property"[18] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land.[19] "Residential land"[20] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in a trust). Therefore, it is highly unlikely that the business premises exclusion could apply.

14 Or a portfolio of rental properties if you have one.
15 This may include use by you or your family, or use by friends who are not charged full market rent.
16 There are some expenses that do not need to be apportioned – for example, fees for advertising the holiday home on holiday rental sites.
17 Subpart EL contains the ring-fencing rules.
18 See section EL 3 for the definition of "residential rental property".
19 The ring-fencing rules will not be relevant if the MuA rules do not apply because you opted out of them, because in this situation your expenses for the property will be non-deductible (see [53]).
20 "Residential land" is defined in section YA 1.

64. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[21]
65. Your holiday home used to provide short-stay accommodation will be residential rental property (provided it is not farmland and not within the business premises exclusion). This is because it is land with a dwelling, and you are allowed a deduction for expenditure relating to the land (because you are using the land to derive income).
66. There is a main home exclusion from the ring-fencing rules.[22] The main home exclusion is available (meaning the ring-fencing rules do not apply for a particular income year) if:
    - more than 50% of the land is used for most of the income year by the owner as their main home; or
    - the land is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
67. When your holiday home is the only place configured as a residence or abode on the land, the main home exclusion rule is unlikely to apply.[23]
68. If the ring-fencing rules apply, the total deduction for expenditure incurred for your holiday home that you can allocate to the income year is limited to the income you derive from your holiday home in the income year.[24]
69. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.
70. The ring-fencing rules are discussed in more detail in the appendix from [A48].

Example | Tauira 1 – Holiday home

On 1 February 2021, Tamati purchased a holiday home for $850,000 using a bank loan of $450,000 and $400,000 of his own money. The code compliance certificate (evidencing the home was added to the land) was issued on 1 June 2015. The most recent capital value for the holiday home is $925,000, set by the local authority in 2022.

For the income year ending 31 March 2023, Tamati incurs interest expenditure of $24,750 under the loan for the holiday home, other expenditure (not relating solely to the use of the holiday home to derive income) of $5,000 for the holiday home, and $2,000 of expenditure that relates solely to the use of the holiday home to derive income and from which no personal benefit is received (eg, advertising costs).

The holiday home is used for 70 days to earn income of $17,500 from (non-associated) guests, used for 100 days by Tamati for his private use, and not used for 195 days.

How the taxation laws apply

Income from land use

Tamati has income of $17,500 from the holiday home.

If Tamati does not opt-out of the MuA rules (as explained below), the income of $17,500 will be assessable income.

If Tamati meets the requirements to opt-out of the MuA rules and chooses to do this, the income of $17,500 will be treated as exempt income.

21 Section EL 12.

22 Section EL 9.

23 It would only be in rare scenarios that it might – for example, if the property is trust property and one of the beneficiaries of the trust used the dwelling as their main home for more than six months of the year and the principal settlors of the trust were deceased.

24 Or, if your holiday home is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

Deductions for interest

The MuA rules (rather than the standard deductibility rules) apply, unless Tamati is able to opt-out of them and chooses to do so.[25] This is because the holiday home is used partly for income-earning purposes and partly for private purposes and is not used for 195 days, which is more than the minimum 62 non-use days required for the MuA rules to apply.

A deduction for interest is allowed under the MuA rules if the deduction is not denied under the interest limitation rules. If Tamati does not opt-out of the MuA rules, he will be allowed to deduct some of his interest expenditure for the holiday home because he has a grandparented transitional loan (discussed below), so it is sensible to consider first the MuA rules and then consider the extent to which the deduction is denied under the interest limitation rules.

If Tamati meets the requirements to opt-out of the MuA rules and chooses to do this, he will not be allowed to deduct any interest (or other expenses) for the holiday home.

The MuA Rules

Since the amount of Tamati's income of $17,500 from the holiday home is less than 2% of its most recent capital value of $925,000 (2% of $925,000 is $18,500), Tamati can elect to opt out of the MuA rules.

If Tamati opts out of the MuA rules:

- His income of $17,500 is treated as exempt income.
- None of his expenditure for the holiday home will be deductible because it is incurred in deriving exempt income so the exempt limitation applies.

If Tamati does not opt-out of the MuA rules, he must apportion the total expenditure he has incurred in providing the short-stay accommodation (other than any fully deductible expenses such as the advertising costs) using the MuA apportionment formula. The formula calculates the amount apportioned to income-earning use and the amount apportioned to private use. Only the amount apportioned to income-earning use is deductible under the MuA rules – subject to the interest limitation rules.

Since a deduction for interest is only allowed under the MuA rules if the deduction is not denied under the interest limitation rules, Tamati separately applies the MuA apportionment formula to his interest expenditure to identify the amount of interest apportioned to income-earning use. He then applies the MuA apportionment formula to his other expenditure that needs to be apportioned.

Applying the MuA apportionment formula to his interest expenditure of $24,750, Tamati calculates the amount apportioned to income-earning use is $10,191.18. Of this amount, he is allowed a deduction only to the extent the deduction is not denied under the interest limitation rules.

Applying the MuA apportionment formula to the $5,000 of other expenditure for the holiday home that does not relate solely to the use of the holiday home to derive income, Tamati calculates that he can deduct $2,058.82 of the $5,000.

The $2,000 expenditure that relates solely to the use of the holiday home to derive income and from which no personal benefit is received (eg, advertising costs) is fully deductible under the MuA rules.

The interest limitation rules

If Tamati does not opt-out of the MuA rules, he needs to consider how the interest limitation rules apply to his interest expenditure of $10,191.18 apportioned to income-earning use under the MuA rules. The is because the interest of $10,191.18 has been incurred for DRP, and the new build land exemption does not apply (because the code compliance certificate, evidencing the holiday home was added to the land, was issued before 27 March 2020).

Tamati's bank loan is a grandparented transitional loan because it was first drawn down before 27 March 2021. Therefore, the interest payable under the loan is grandparented residential interest and deductibility is phased-out between 1 October 2021 and 31 March 2025. The percentage denied for the period 1 April 2022 to 31 March 2023 is 25%.

Therefore, Tamati is denied a deduction of $2,547.80 (25%) of the $10,191.18. He is allowed a deduction of the remaining $7,643.38.

25 QB 19/06 explains when the MuA rules apply.

If Tamati disposes of the holiday home in a later income year and that disposal is taxable, the denied interest deduction would be recognised in that year. If the disposal were taxable:

under the bright-line test, the amount of $2,547.80 denied under the interest limitation rules would be treated as a cost of the holiday home when calculating the amount of Tamati's income from the disposal;

under a provision other than the bright-line test, the amount of $2,547.80 denied under the interest limitation rules would be allowed as a deduction in the year of disposal and allocated under the ring-fencing rules.

Total allowable deduction

If he does not opt-out of the MuA rules, Tamati's total allowable deduction for the holiday home is $11,702.20 (comprised of the $7,643.38 allowable interest deduction, $2,058.82 allowable deduction for other expenses that must be apportioned, and $2,000 of other fully deductible expenses).

The ring-fencing rules

The ring-fencing rules may apply to limit the deduction that is allocated to an income year when a person owns a residential property (or for a portfolio of residential properties) and has expenditure that relates to the property (or portfolio) for which they are allowed a deduction.

However, the ring-fencing rules do not apply to residential land for an income year when it is an asset referred to in s DG 3 – that is, an asset as defined for the MuA rules (ie, an asset that in the income year is used partly privately, partly for income-earning and is vacant for at least 62 days).

Because the holiday home is an asset as defined for the MuA rules, the ring-fencing rules cannot apply.

The MuA quarantine rule

There is a specific rule (the quarantined expenditure rule) in the MuA rules that may limit a person's deduction for an income year if the amount of income derived from the asset is less than 2% of the asset's value. Tamati's income from the holiday home ($17,500) is less than 2% of the holiday home's value (2% of $925,000 = $18,500). However, the quarantined expenditure rule applies to limit the deduction that can be taken only if the allowable deduction for expenditure exceeds the income from the asset. That is not the case here. Tamati's total allowable deduction for the holiday home ($11,702.20) is less than the income from the holiday home ($17,500). Therefore, the quarantine rule does not apply to limit the deduction Tamati can take in the income year.

Example | Tauira 2 – Holiday home

On 1 April 2022, Kate purchased a holiday home for $750,000 using a bank loan of $400,000 and $350,000 of her own money. The code compliance certificate (evidencing the home was added to the land) was issued on 1 December 2020. The most recent capital value for the holiday home is $825,000, set by the local authority in 2022.

For the income year ending 31 March 2023, Kate incurs interest expenditure of $22,000 and other expenditure (not relating solely to the use of the holiday home to derive income) of $3,000 for the holiday home. The holiday home is used for 40 days to earn income of $10,000 from (non-associated) guests, is used for 225 days for private use by Kate's son (following his return to New Zealand after living overseas), used for 50 days for private use by Kate, and not used for 50 days. The holiday home is marketed and available for rent for those 50 vacant days. The holiday home is the only land Kate owns that she derives rental or other income from.

How the taxation laws apply

Income from land use

Kate has assessable income of $10,000 from the holiday home.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply because the new build land exemption applies. This is because compliance certificate, evidencing the home was added to the land, was issued on or after 27 March 2020.

The MuA Rules

The MuA rules do not apply. This is because holiday home is not used for 50 days, which is less than the minimum of 62 non-use days required for the MuA rules to apply.

The standard deductibility rules

Because the MuA rules do not apply, Kate's expenses for the property that relate to both income-earning and private use ($22,000 interest + $3,000 other expenses) need to be apportioned under the standard deductibility rules.

Kate uses QB 19/08 to help her apportion these expenses. As explained in QB 19/08, she also has some expenses that are fully deductible, such as website listing and host fees.

The ring-fencing rules

The ring-fencing rules apply because the holiday home is a residential rental property, and the holiday home is not Kate's main home.

The amount of Kate's deduction for the holiday home is limited to her residential income of $10,000.

If the total of Kate's deductible expenses in relation to the holiday home exceeds $10,000, Kate can only deduct $10,000 of those expenses in the income year. Any excess would be suspended as a deduction for the 2023 income year and carried forward to a later income year in which Kate derives residential income (that is, income from a residential rental property).

Short-stay accommodation provided in your main home

71. The table below (figure 3) provides an overview of the rules relevant to interest deductibility for your main home.

Figure | Hoahoa 3 – Short-stay accommodation provided in your main home – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	Interest and most other expenses will need to be apportioned (so partially deductible). See QB 19/05 for guidance on how to apportion interest and other expenses.	The ring-fencing rules do not apply provided more than 50% of the land has been used as a main home for most of the income year (see from [78]). If the main home exclusion applies and the rental activity is loss-making, the amount of total deduction you can take in the income year (after apportionment) is not limited by the ring-fencing rules.

The interest limitation rules do not apply

72. The interest limitation rules apply to interest to the extent to which it is incurred for DRP. The statutory definition of DRP is discussed in detail in the appendix from [A2].

73. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.

74. DRP does not include land to the extent to which it is "excepted residential land". A person's main home is excepted residential land and therefore is not DRP.

75. A person's main home is the one dwelling they use as their residence. If a person has more than one home, their main home is the place they have the greatest connection with.

76. If you provide short-stay accommodation in your main home (whether by renting a room or the entire home):

- the main home exception applies, and
- the interest limitation rules do not apply to interest incurred for your home.

77. QB 19/05: What are my income tax obligations if I rent out my home or a dwelling on your property as short-stay accommodation? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 3 explains how the other relevant tax rules, including deductions for interest, apply when you provide short-stay accommodation in your main home.

The ring-fencing rules do not apply

78. The ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:
    - you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
    - the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
79. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.
80. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, see the discussion on the ring-fencing rules in the appendix from [A48].

Change in use of main home

81. If your main home ceases to be your main home and you use that dwelling to provide short-stay accommodation, the interest limitation rules apply to interest incurred for that dwelling from the date of the change in use.
82. Equally, if you use a dwelling to provide short-stay accommodation and that dwelling becomes your main home, the interest limitation rules cease to apply to interest incurred for the dwelling from the date of the change in use.
83. The ring-fencing rules may commence or cease applying in the income year of a change of use of the property. This depends on whether more than 50% of the land is used as a main home for most of the income year.

Example | Tauira 3 – Main home

On 1 April 2023, Javan purchases a property with a two-storey house for $900,000 using a bank loan of $550,000 and $350,000 of his own money. There are 3 bedrooms on the top floor and one bedroom on the ground floor. The house has one kitchen, which is on the top floor and one laundry, which is on the ground floor. There are bathrooms and toilet facilities on both floors. Javan uses the house as his main home. He uses the bedroom on the ground floor to provide short-stay accommodation.

For the income year ending 31 March 2024, Javan incurs interest expenditure of $32,500 and has paying guests for 123 nights, deriving income of $9,840.

How the taxation laws apply

Income from land use

Javan cannot use the standard-cost approach (referred to in QB 19/05), as he rented the room out for more than 100 nights in the income year.[26]

Javan therefore has income of $9,840.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply. This is because the main home exclusion applies.

The MuA rules

The MuA rules do not apply. This is because the MuA rules apply to an asset in its complete form. The asset in its complete form is the house. The house (in its complete form) is used on each day in the income year as Javan's main home. There are therefore not the minimum of 62 non-use days required for the MuA rules to apply.

26 If the standard-cost approach is used, some or all of the income will be exempt, and no deductions for actual costs can be claimed.

The standard deductibility rules apply

The standard deductibility rules apply. These are explained in QB 19/05, which Javan uses to help him apportion the interest and any other expenses he has incurred that need to be apportioned.

The ring-fencing rules

The ring-fencing rules do not apply because the main home exclusion to the ring-fencing rules applies. This because more than 50% of the land is used for most of the year as Javan's main home.

Short-stay accommodation provided in a separate dwelling on the same land as your main home

84. Your main home and your separate short-stay dwelling will be on the same land when they are on the same legal title (called a record of title). For example, you may have a sleepout or cottage on the same record of title as your main home.
85. The interest limitation rules apply to interest to the extent to which it is incurred for DRP.
86. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.
87. DRP does not include land to the extent to which it is "excepted residential land".
88. Excepted residential land includes:
    - a person's main home,
    - farmland.
89. A person's main home is the one dwelling they use as their residence. If a person has more than one home, their main home is the place they have the greatest connection with.
90. When your main home and short-stay dwelling are on the same land and that land is farmland, the interest limitation rules do not apply. What is farmland is discussed from [177].
91. When your main home and short-stay dwelling are on the same land and that land is not farmland, the interest limitation rules:
    - do not apply to your main home (because it is excepted residential land); but
    - do apply to your short-stay dwelling, unless your short-stay dwelling is new build land.
92. In general terms, new build land is land to the extent to which it has a place that is configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption, including when a place will be self-contained, is discussed in the appendix from [A8].
93. How the interest limitation rules apply to your short-stay dwelling depends on whether you have one loan for both your main home and the short-stay dwelling or separate loans for each and whether your short-stay dwelling is new build land. If you have:
    - **one loan** for both your main home and short-stay dwelling, and the short-stay dwelling **is not new build land,** see from [94],
    - **one loan** for both your main home and short-stay dwelling, and the short-stay dwelling **is new build land**, see from [111],
    - **separate loans** for your main home and short-stay dwelling, see from [126].

One loan for your main home and short-stay dwelling and the short-stay dwelling is not new build land

94. The table below (figure 4) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 4 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – one loan and the short-stay dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
Apportion the loan interest between your main home and the short-stay dwelling. The interest limitation rules apply to the interest apportioned to the short-stay dwelling. Interest deductions for the interest apportioned to the short-stay dwelling are not allowed – subject to partial deductibility in the phase-out period[27] if you have a grandparented transitional loan.[28]	If there is private use of the short-stay dwelling and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the property could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [101]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[29] is loss-making.

95. If you have one loan for both your main home and your separate short-stay dwelling, you will need to determine how much of the interest incurred in the income year is for your short-stay dwelling and how much is for your main home. This is called "apportionment". It is discussed in the appendix from [A17].

96. Apportionment is necessary because the interest limitation rules:
    - Apply to the interest apportioned to your short-stay dwelling.
    - Do not apply to the interest apportioned to your main home (because the main home exception applies). That said, a deduction for interest apportioned to your main home will generally be denied under the private limitation.[30]

The interest limitation rules apply to interest apportioned to the short-stay dwelling

97. Since your short-stay dwelling is not new build land, the way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.

98. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

99. If the interest incurred and apportioned to your short-stay dwelling:
    - is grandparented residential interest, you will be able to deduct a proportion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,
    - is not grandparented residential interest, you are denied a deduction for the interest.

100. Whether you have grandparented residential interest or not, if the future disposal of the property with your main home and short-stay dwelling on it is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. While it is not common for a property with someone's main home on it to be taxed on disposal, it is possible (see from [A66] in the appendix for examples of when this might be the case).

27 The phase-out period is 1 October 2021 to 31 March 2025.

28 A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

29 Or a portfolio of rental properties if you have one.

30 The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

101. Any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.

102. Therefore, if you have used the short-stay dwelling both privately[31] and to earn income in an income year, you may also need to apportion the interest incurred for your short-stay dwelling between those different uses for the dwelling. This will be the case if:

- the interest you incurred for the short-stay dwelling is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period, or
- a future disposal of the land with your main home and separate short-stay dwelling could be taxable.

103. The method for apportionment between your income-earning use and private use of the short-stay dwelling depends on whether the mixed-use asset rules (the MuA rules) or standard deductibility rules apply. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.

104. In summary:

- The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. This means the interest apportioned to the income-earning use of your short-stay dwelling which would be allowed a deduction under the relevant apportionment and deductibility rules is denied a deduction under the interest limitation rules.
- Despite the interest limitation rules overriding both the MuA rules and the standard deductibility rules, you may still need to apportion the interest you have incurred for your short-stay dwelling under the relevant rules. As noted at [102], this will be the case if the interest is grandparented residential interest or a future disposal of the land could be taxable.
- On a taxable disposal, interest incurred in previous years that would have been allowed under either the MuA rules or the standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.
- It would not be common for property with someone's main home and a short-stay dwelling on it to be taxable on disposal, but there are some situations where this could be the case. This is discussed in the appendix from [A66].
- You do not need to apportion your interest between income-earning and private use of the short-stay dwelling if:
  - you do not have deductible interest expenditure in the phase-out period (because the interest is not grandparented residential interest), or the phase-out period has finished, and
  - it is clear the future disposal of the property will not be taxable.
- If it is not clear whether the future disposal of the property could be a taxable disposal and you have used the short-stay dwelling in an income year both privately and to earn income, you should apply the relevant apportionment calculation under MuA rules or standard deductibility rules to your interest for the dwelling for that year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in the income year but was denied under the interest limitation rules. This means you will readily be able to determine the amount of interest that can be recognised if a future disposal of the land is taxable.
- If the disposal of your land is taxable, interest apportioned to income-earning use under either the MuA rules or the standard deductibility rules in prior income years and denied under the interest limitation rules is recognised in the year of disposal as follows:
  - If the disposal is taxable under the bright-line test, the previously denied interest is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income – whether under the bright-line test or one of the other land sale provisions (s EL 20).
  - If your disposal is taxable under any other provision, the previously denied interest is allowed as a deduction (in the income year of disposal) but is subject to allocation under the ring-fencing rules. The ring-fencing rules are discussed in the appendix from [A48].

31 This may include use by you or your family, or use by friends who are not charged full market rent.

The ring-fencing rules

105. The ring-fencing rules[32] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:
- potentially during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

106. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

107. In addition, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:
- you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
- the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

108. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.

109. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, the ring-fencing rules may be relevant in the situations noted at [105].

110. The ring-fencing rules are discussed in more detail in the appendix from [A48].

One loan for main home and short-stay dwelling and short-stay dwelling is new build land

111. The table below (figure 5) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 5 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – one loan and the short-stay dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
Apportion the loan between your main home and the short-stay dwelling. The interest limitation rules do not apply to the loan interest apportioned to the short-stay dwelling.[33] Interest for the short-stay dwelling is deductible subject to the following columns.	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [116]).	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[34] is loss-making.

32 Subpart EL contains the ring-fencing rules.

33 The interest limitation rules will also not apply to the interest apportioned to your main home. Interest for your main home will only be partly deductible if you have some income-earning use of your home.

34 Or a portfolio of rental properties if you have one.

Interest limitation rules do not apply

112. If you have one loan for both your main home and short-stay dwelling and your short-stay dwelling is new build land, the interest limitation rules do not apply to the interest incurred:
    - for your main home, because the main home exception applies,
    - for your short-stay dwelling, because the new build land exemption applies.

Apportionment of interest between main home and short-stay dwelling

113. You will need to apportion the interest you have incurred to determine the portion incurred for your main home and the portion incurred for your short-stay dwelling.
114. This is because the standard deductibility rules will apply to the interest apportioned to your main home and a deduction will generally be denied for that interest under the private limitation.[35] The interest incurred for your short-stay dwelling will generally be deductible, subject to apportionment under either the mixed-use asset rules (the MuA rules) or standard deductibility rules (see from [116]) and the application of the ring-fencing rules (see from [119]).
115. Apportionment between different parts of your property is discussed in the appendix from [A17].

Apportionment for private use – MuA rules or standard deductibility rules

116. If you have used the short-stay dwelling both privately[36] and for earning income in an income year, you will need to apportion your deductible expenses for the property (including interest) between those different uses of the property. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.
117. You will need to apportion your expenses either under the MuA rules or based on general apportionment principles (the standard deductibility rules), depending on your circumstances.
118. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

119. If the MuA rules do not apply to the interest that is apportioned to your short-stay dwelling, the ring-fencing rules[37] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year.
120. However, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:
    - you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
    - the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
121. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.
122. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available.
123. If the ring-fencing rules apply, the total deduction for expenditure incurred for the short-stay dwelling that you can allocate to the income year is limited to the income you derive from the short-stay dwelling in the income year.[38]
124. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.
125. The ring-fencing rules are discussed in detail in the appendix from [A48].

35 The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

36 This may include use by you or your family, or use by friends who are not charged full market rent.

37 Subpart EL contains the ring-fencing rules.

38 Or, if the property is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

Separate loans for main home and short-stay dwelling

126. If you have separate loans for your main home and for your short-stay dwelling, the interest limitation rules:
    - Do not apply to the interest incurred under the loan for your main home (because the main home exception applies). That said, a deduction for interest apportioned to your main home will generally be denied under the private limitation.[39]
    - Do apply to the interest incurred under the loan for the short-stay dwelling unless the dwelling is new build land.
127. As already noted, in general terms, new build land is land to the extent to which it has a place that is configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].
128. If your short-stay dwelling is new build land, see from [145]. If your short-stay dwelling is not new build land, see from [130].

If your short-stay dwelling is not new build land

129. The table below (figure 6) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 6 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – separate loan for the short-stay dwelling and the dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules apply to the interest on the loan for the short-stay dwelling. Interest deductions for the interest are not allowed – subject to partial deductibility in the phase-out period[40] if you have a grandparented transitional loan.[41]	If there is private use of the short-stay dwelling and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the property could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [134]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[42] is loss-making.

The interest limitation rules apply to interest for the short-stay dwelling

130. Since your short-stay dwelling is not new build land, the way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.
131. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

39 The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

40 The phase-out period is 1 October 2021 to 31 March 2025.

41 A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

42 Or a portfolio of rental properties if you have one.

132. If the interest incurred and apportioned to your short-stay dwelling:
    - is grandparented residential interest, you will be able to deduct a proportion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,
    - is not grandparented residential interest, you are denied a deduction for the interest.
133. Whether you have grandparented residential interest or not, if the future disposal of the property with your main home and short-stay dwelling on it is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. While it is not common for a property with someone's main home on it to be taxed on disposal, it is possible (see from [A66] in the appendix for examples of when this might be the case).

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

134. Any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.
135. Therefore, if you have used the short-stay dwelling both privately[43] and to earn income in an income year, you may also need to apportion the interest incurred for your short-stay dwelling between those different uses for the dwelling. This will be the case if:
    - the interest you incurred for the short-stay dwelling is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period, or
    - a future disposal of the land with your main home and separate short-stay dwelling could be taxable.
136. The method for apportionment between your income-earning use and private use of the short-stay dwelling depends on whether the mixed-use asset rules (the MuA rules) or standard deductibility rules apply. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.
137. In summary:
    - The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. This means the interest apportioned to the income-earning use of your short-stay dwelling which would be allowed a deduction under the relevant apportionment and deductibility rules is denied a deduction under the interest limitation rules.
    - Despite the interest limitation rules overriding both the MuA rules and the standard deductibility rules, you may still need to apportion the interest you have incurred for your short-stay dwelling under the relevant rules. As noted at [135], this will be the case if the interest is grandparented residential interest or a future disposal of the land could be taxable.
    - On a taxable disposal, interest incurred in previous years that would have been allowed under either the MuA rules or the standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.
    - It would not be common for property with someone's main home and a short-stay dwelling on it to be taxable on disposal, but there are some situations where this could be the case. This is discussed in the appendix from [A66].
    - You do not need to apportion your interest between income-earning and private use of the short-stay dwelling if the interest is not grandparented residential interest and it is clear the future disposal of the property will not be taxable.
    - If it is not clear whether the future disposal of the property could be a taxable disposal and you have used the short-stay dwelling in an income year both privately and to earn income, you should apply the relevant apportionment calculation under MuA rules or standard deductibility rules to your interest for the dwelling for that year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in the income year but was denied under the interest limitation rules. This means you will readily be able to determine the amount of interest that can be recognised if a future disposal of the land is taxable.
    - If the disposal of your land is taxable, interest apportioned to income-earning use under either the MuA rules or the standard deductibility rules in prior income years and denied under the interest limitation rules is recognised in the year of disposal as follows:

43 This may include use by you or your family, or use by friends who are not charged full market rent.

- If the disposal is taxable under the bright-line test, the previously denied interest is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income – whether under the bright-line test or one of the other land sale provisions (s EL 20).
- If your disposal is taxable under any other provision, the previously denied interest is allowed as a deduction (in the income year of disposal) but is subject to allocation under the ring-fencing rules. The ring-fencing rules are discussed in the appendix from [A48].

The ring-fencing rules

138. The ring-fencing rules[44] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:
   - potentially during the phase-out period, or
   - if the property is part of a portfolio for which interest is deductible.
139. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.
140. In addition, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:
   - you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
   - the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
141. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.
142. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, the ring-fencing rules may be relevant in the situations noted at [138].
143. The ring-fencing rules are discussed in more detail in the appendix from [A48].

If your short-stay dwelling is new build land

144. The table below (figure 7) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 7 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – separate loan for the short-stay dwelling and the dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply to the interest on the loan for the short-stay dwelling. Interest for the short-stay dwelling is deductible subject to the following columns.	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [146]).	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[45] is loss-making.

44 Subpart EL contains the ring-fencing rules.

45 Or a portfolio of rental properties if you have one.

Interest limitation rules do not apply

145. Since your short-stay dwelling is new build land, the interest limitation rules do not apply to interest incurred under the loan for the dwelling because the new build land exemption applies.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

146. If you have used the short-stay dwelling both privately[46] and for earning income in an income year, you will need to apportion your deductible expenses for the property (including interest) between those different uses of the property. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.
147. You will need to apportion your expenses either under the mixed-use asset rules (the MuA rules) or based on general apportionment principles (the standard deductibility rules), depending on your circumstances.
148. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest incurred for it.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

149. If the MuA rules do not apply to the interest that is apportioned to your short-stay dwelling, the ring-fencing rules[47] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year.
150. The ring-fencing rules apply to "residential rental property". "Residential rental property"[48] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land. "Residential land"[49] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as a business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in a trust). Therefore, it is highly unlikely that the business premises exclusion could apply. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[50]
151. In addition, there is a main home exclusion from the ring-fencing rules.[51] The main home exclusion is available (meaning the ring-fencing rules do not apply for a particular income year) if:
    - more than 50% of the land is used for most of the income year by the owner as their main home, or
    - the land is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
152. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.
153. The ring-fencing rules are discussed in more detail in the appendix from [A48].

46 This may include use by you or your family, or use by friends who are not charged full market rent.
47 Subpart EL contains the ring-fencing rules.
48 See section EL 3 for the definition of "residential rental property".
49 "Residential land" is defined in section YA 1.
50 Section EL 12.
51 Section EL 9.

Example | Tauira 4 – Main home and short-stay dwelling on the same land

On 1 April 2023, Maia purchases a property with a house (the original dwelling), built in the 1960s, for $1m using a bank loan of $600,000 (loan 1) and $400,000 of her own money. The area of the property is 1,000m^2. The house is positioned on the front half of the property.

At the time of purchase, the current rating valuation for the property (issued in 2022) provides the land has a capital value of $980,000, with a land value of $690,000 and improvements (original dwelling) of $290,000.

Shortly after the purchase, Maia takes out an additional bank loan for $300,000 (loan 2) and purchases a pre-built self-contained dwelling (the second dwelling), which is positioned on the back half of the property. The area of the property with the original dwelling (and its appurtenances) is 650m^2 and the area with the second dwelling (and its appurtenances) is 350m^2.

The code compliance certificate for the second dwelling, evidencing it has been added to the land, is issued on 31 March 2024. Following the issuing of the code compliance certificate, the local authority issues an amended rating valuation for the property. The rating valuation provides the land has a value of $875,000 and the improvements (that is, the original dwelling and the second dwelling) have a value of the $600,000.

From 1 April 2024, Maia uses the second dwelling to provide short-stay accommodation.

For the income year ending 31 March 2025, Maia uses the original dwelling as her main home. She incurs interest expenditure of $33,000 for loan 1 and $18,425 for loan 2. She derives income from the second dwelling of $27,500. There is no private use of the second dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Maia has assessable income of $27,500 from the second dwelling.

Deductions for interest

The interest limitation rules

Loan 2

The interest limitation rules do not apply to loan 2. This is because the interest paid under loan 2 is for the second dwelling and the new build land exemption applies to the dwelling. The exemption applies because the code of compliance for the second dwelling, evidencing it has been added to the land, is issued on 31 March 2024 – so after the relevant date of 27 March 2020.[52]

Loan 1

The new build land exemption will also apply to part of the interest paid under loan 1. This is because from 31 March 2024, part of the interest paid under loan 1 is for the part of the land with the second dwelling, and the new build land exemption applies to the second dwelling.[53]

Maia must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using the land area apportionment methodology, she determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

Since loan 1 is for the entire property including the original dwelling, Maia must determine how much of loan 1 is for the land excluding the original dwelling (since the original dwelling is not new build land). The 2022 rating valuation provides that the land value is $690,000 of the total value of the improved land (the land and the original dwelling), which was $980,000.

52 The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

53 While the new build exemption will apply to the second dwelling from 31 March 2024, Maia's interest for the second dwelling will be deductible from 1 April 2024 as that is when she started renting the dwelling out.

Using these figures, Maia calculates that $23,234.70 of the total interest incurred of $33,000 is for the land:

$$\frac{\$690{,}000}{\$980{,}000} \times \$33{,}000 = \$23{,}234.70$$

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). On this basis, Maia calculates that $8,132.15 of the interest attributable to the unimproved land is for new build land:

$$\frac{35}{100} \times \$23{,}234.70 = \$8{,}132.15$$

Therefore, the interest limitation rules do not apply to $8,132.15 of the interest under loan 1, because this is the interest incurred under that loan which is for new build land. The amount of $8,132.15 is deductible, provided a deduction is not denied under the MuA rules or the ring-fencing rules.

The balance of the interest under loan 1 ($24,867.85) is the proportion of interest Maia has paid for the area of the land with her main home (including the main home and its appurtenances). Maia's main home is excepted residential land. Excepted residential land is not DRP and the interest limitation rules therefore do not apply to the $24,867.85. However, Maia cannot deduct any of the interest of $24,876.85 as she has no income-earning use of the area of the land with her main home – it is only used privately.

The MuA rules

The MuA rules do not apply to the interest (or other expenses) incurred in providing the short-stay accommodation because there has been no private use of the second dwelling.

The standard deductibility rules

Because the second dwelling is rented out or available for rent for the whole income year, Maia does not need to apportion the deductible interest of $18,425 under loan 2 and $8,132.15 under loan 1 (or other expenses) further. If Maia had periods of private use of the second dwelling (but the MuA rules did not apply) or periods where the second dwelling was not available for rent, the standard deductibility rules, as explained in QB 19/05 would apply to reduce her allowable interest (and other) deductions accordingly.

The ring-fencing rules

The ring-fencing rules do not apply to the deductible interest for the second dwelling ($18,425 under loan 2 and $8,132.15 under loan 1). This is because the main home exclusion to the ring-fencing rules applies. This is because more than 50% of the total land area (of 1,000m^2) is used for most of the year as Maia's main home (650 m^2 / 1000m^2 = 65%).

Example | Tauira 5 – Main home and short-stay dwelling on the same land

This example follows on from Example 4.

On 1 April 2026, Maia sells her property to Tom for $1.5m. Tom funds the purchase using a bank loan of $650,000 and $850,000 from the sale of his former home. In April 2024, after Maia added the second dwelling to the property, the local authority issued a rating valuation for the property with a capital value of $1.475m.

In the income year ending 31 March 2027, Tom uses the original dwelling as his main home and uses the second dwelling to provide short-stay accommodation. He incurs interest expenditure of $40,000 and derives income from the second dwelling of $27,500. There is no private use of the second dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Tom has assessable income of $27,500 from the second dwelling.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to interest incurred for the second dwelling because the new build land exemption applies to the dwelling. The exemption applies because the code of compliance, evidencing that dwelling has been added to the land, was issued on 31 March 2024 – so after the relevant date of 27 March 2020.[54]

Tom must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using a land area methodology, he determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). On this basis, Tom calculates that $14,000 of the total interest of $40,000 he incurred is apportioned to the second dwelling:

$$\frac{35}{100} \times \$40{,}000 = \$14{,}000$$

Therefore, $14,000 of the interest Tom incurred is deductible, subject to the possible application of the MuA rules and the ring-fencing rules.

The interest limitation rules do not apply to the interest of $26,000 apportioned to the original dwelling. This is because the original dwelling is Tom's main home and so is excepted residential land. The interest limitation rules do not apply to excepted residential land. However, Tom cannot deduct any of the interest of $26,000 as he has no income-earning use of his main home land – it is only used privately.

The MuA rules

The MuA rules do not apply to the interest (or other expenses) incurred in providing the short-stay accommodation because there has been no private use of the second dwelling.

The standard deductibility rules

Because the second dwelling is rented out or available for rent for the whole income year, Tom does not need to apportion the deductible interest of $14,000 (or other expenses) further. If Tom had periods of private use of the second dwelling (but the MuA rules did not apply) or periods where the second dwelling was not available for rent, the standard deductibility rules, as explained in QB 19/05 would apply to reduce his allowable interest (and other) deductions accordingly.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2026-27 income year because the main home exclusion to the ring-fencing rules applies. This is because more than 50% of the total land area (of $1000m^2$) is used for most of the year as Tom's main home ($650m^2$ / $1000m^2$ = 65%).

Example | Tauira 6 – Main home and short-stay dwelling on the same land

This example follows on from Example 5.

On 1 April 2030, Tom sells the property to Chris for $1.6m. Chris funds the purchase using a bank loan of $800,000 (loan 1) and $800,000 from an inheritance. On 1 July 2030, the local authority issues a rating valuation for the property, with a capital value of $1.8m.

In the income year ending 31 March 2031, Chris decides to renovate the second dwelling which has become tired due to its use to provide short-stay accommodation. He undertakes the work himself. He borrows $75,000 from the bank (loan 2) to fund the renovations.

To maintain his rental income (which Chris needs to help repay his mortgage) while he is undertaking the renovation work, Chris uses the second dwelling as his main home and uses the original-dwelling to provide short-stay accommodation.

54 The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

He incurs interest expenditure of $50,000 for loan 1 and $4,875 for loan 2 and derives income from the original dwelling of $42,000. When the original dwelling is not in use by guests, Chris' son uses it free of charge, as he is looking for a rental property after the break-up of his marriage and is moving between friends and family's places in the meantime. The original dwelling is vacant for fewer than 62 days in the income year.

The renovation work on the second dwelling is completed by the end of the income year.

On 1 April 2031, Chris moves back into the original dwelling and uses it as his main home again, and uses the second dwelling to provide short-stay accommodation.

How the taxation laws apply

Income from land use

In the income year ending 31 March 2031, Chris has assessable income of $42,000 from the original dwelling.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to interest incurred for the second dwelling because the new build land exemption applies to the dwelling. The exemption applies because the code of compliance, evidencing the second dwelling was added to the land, was issued on 31 March 2024 – so after the relevant date of 27 March 2020.[55]

Chris must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using a land area methodology, he determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

Loan 1

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). So Chris calculates that $17,500 of the total interest of $50,000 he incurred under loan 1 is apportioned to the second dwelling:

$$\frac{35}{100} \times \$50{,}000 = \$17{,}500$$

However, Chris cannot deduct any of the interest of $17,500 apportioned to the second dwelling, as he has no income-earning use of that dwelling – it is his main home for the income year and it is only used privately.

The remaining $32,500 (65% x $50,000) is apportioned to the original dwelling.

The interest limitation rules apply to the interest of $32,500 apportioned to the original dwelling. This is because:

- The new build land exemption does not apply to the original dwelling (because a code compliance certificate, evidencing the dwelling was added to the land or converted into a residence or abode, has not been issued on or after 27 March 2020).
- The original dwelling is not Chris's main home for any of the income year and it is therefore not excepted residential land.

Loan 2

The new build land exemption applies to the $4,875 of interest incurred under loan 2 for the renovations to the second dwelling. However, Chris cannot deduct any of this $4,875 interest, as he has no income-earning use of the second dwelling – it is his main home for the income year and it is only used privately.

The MuA rules

The MuA rules do not apply to the interest incurred under loan 1 that is apportioned to the original dwelling ($32,500). This is because the original dwelling is vacant for fewer than 62 days in the income year. There are therefore not the minimum of 62 non-use days required for the MuA rules to apply.

55 The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

The standard deductibility rules apply

Chris' son's use of the original dwelling free of charge is considered private use. As the MuA rules do not apply, the standard deductibility rules would apply to reduce Chris' allowable interest deductions (and any other deductions not relating solely to the use of the dwelling to derive income) because of the private use.

The standard deductibility rules are explained in QB 19/05.

The ring-fencing rules

The ring-fencing rules potentially apply to limit the total deduction allocated to the 2030-31 income year.

The ring-fencing rules apply when a person owns residential land and has expenditure that relates to the land for which they are allowed a deduction. The property is residential land, and Chris is allowed deductions for the property as he has used it (partly) for income-earning.

If Chris' total deduction for the property (or for a portfolio of residential properties if he has one) exceeds his income from the property (or portfolio), the amount of deduction allocated to the income year will be limited to the income from the property (or portfolio).

Short-stay dwelling on a separate property that is used only to provide short-stay accommodation

154. This scenario is the provision of short-stay accommodation in a short-stay dwelling when the short-stay dwelling is the only dwelling (residence or abode) on the land (described in a record of title) and the dwelling is used only to provide short-stay accommodation. That is, the short-stay dwelling is not used for any other purpose (such as private use). An example would be an apartment used exclusively to provide short-stay accommodation.
155. The interest limitation rules apply to interest to the extent to which it is incurred for DRP. The statutory definition of DRP is discussed in detail in the appendix from [A2].
156. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.
157. Your short-stay dwelling is DRP because it is land with a place configured as a residence or abode. The interest limitation rules apply to the interest incurred for your short-stay dwelling unless the dwelling is new build land.
158. In general terms, new build land is land to the extent to which it has a place configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].
159. If your short-stay dwelling is not new build land, see from [161]. If your short-stay dwelling is new build land, see from [170].

If the short-stay dwelling is not new build land

160. The table below (figure 8) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 8 – Short-stay accommodation provided in a dwelling on a separate property used only to provide short-stay accommodation and the dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Ring-fencing rules
The interest limitation rules apply. Interest deductions are not allowed – subject to partial deductibility in the phase-out period[56] if you have a grandparented transitional loan.[57] Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules will apply to limit your total deduction for the income year if the rental activity for the property[58] is loss-making.

The interest limitation rules apply

161. Since your short-stay dwelling is not new build land, the interest limitation rules apply. The way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.

162. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

163. If the interest you incurred for the dwelling:

- is grandparented residential interest, you will be able to deduct a portion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025;
- is not grandparented residential interest, you will be denied a deduction for the interest.

164. Whether you have grandparented residential interest or not, if the future disposal of your short-stay dwelling is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. The way in which it is recognised depends on which land sales provision the disposal is taxed under (see [40] to [43]).

165. If the future disposal of our short-stay dwelling could be taxable (for example under the bright-line test), you should keep track of interest you have incurred for the property that you have been denied a deduction for under the interest limitation rules. This means you will readily be able to determine the total amount of interest that can be recognised if a future disposal of the land is taxable.

The ring-fencing rules may apply if the property (or portfolio) is loss-making

166. The ring-fencing rules[59] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:

- potentially during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

167. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

168. The ring-fencing rules are discussed in more detail in the appendix from [A48].

56 The phase-out period is 1 October 2021 to 31 March 2025.

57 A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

58 Or a portfolio of rental properties if you have one.

59 Subpart EL contains the ring-fencing rules.

If the short-stay dwelling is new build land

169. The table below (figure 9) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 9 – Short-stay accommodation provided in a dwelling on a separate property used only to provide short-stay accommodation and the dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	The ring-fencing rules will apply to limit your total deduction (including interest) for the income year if the rental activity for the property[60] is loss-making (see from [171]).

The interest limitation rules do not apply

170. Since your short-stay dwelling is new build land, the interest limitation rules do not apply to interest incurred for the dwelling because the new build land exemption applies.

The ring-fencing rules may apply if the property (or portfolio) is loss-making

171. While the interest limitation rules do not apply to the interest for your short-stay dwelling, the ring-fencing rules may apply to limit the total deduction you can allocate to an income year.
172. The ring-fencing rules apply to "residential rental property". "Residential rental property"[61] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land. "Residential land" [62] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as a business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in a trust). Because your short-stay dwelling is used only to provide short-stay accommodation and is not used as your main home, the business premises exclusion cannot apply. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[63]
173. There is a main home exclusion from the ring-fencing rules. However, because your short-stay dwelling is used only to provide short-stay accommodation (and is not used as your main home), the main home exclusion rule cannot apply.
174. If the ring-fencing rules apply, the total deduction for expenditure incurred for your short-stay dwelling that you can allocate to the income year is limited to the income derived from the dwelling in that income year.[64]
175. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.
176. The ring-fencing rules are discussed in more detail in the appendix from [A48].

60 Or a portfolio of rental properties if you have one.
61 See section EL 3 for the definition of "residential rental property".
62 "Residential land" is defined in section YA 1.
63 Section EL 12.
64 Or, if your short-stay dwelling is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

Example | Tauira 7 – Short-stay dwelling on a separate property used only to provide short-stay accommodation

On 1 April 2022, Akeno purchased an apartment, built in the 1990s, for $625,000, using a bank loan of $300,000 and $325,000 of his own money. He purchased the apartment for the purpose of providing short-stay accommodation. Akeno does not own any other rental properties.

For the income year ending 31 March 2023, Akeno incurs interest expenditure of $18,750 under the loan, other expenditure for the apartment of $4,500, and derives income of $25,100. There is no private use of the apartment, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Akeno has assessable income of $22,100 from the apartment.

Deductions for interest

The interest limitation rules

The interest limitations rules apply to the interest incurred by Akeno. This is because the apartment is DRP, the new build land exemption does not apply (because the apartment was added to the land before 27 March 2020), and the apartment is not excepted residential land because it is not Akeno's main home.

Akeno's interest deductions are fully denied (not phased out), because his loan is not a grandparented transitional loan – it was drawn down after 27 March 2021.

No apportionment required

Because there is no private use of the apartment and it is rented out or available for rent for the whole income year, Akeno does not need to apportion his deductible (non-interest) expenditure under the MuA rules or standard deductibility rules.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2022-23 income year because Akeno's income from the apartment of $25,100 exceeds his deductible expenditure of $4,500 incurred in relation to the apartment, and he does not own any other rental properties (so does not have a rental portfolio). The ring-fencing rules apply to limit the total deduction allocated to a residential rental property (or portfolio of properties) only when expenditure from the property (or portfolio) exceeds the expenditure derived from the property (or portfolio).

Short-stay accommodation provided on your farm or lifestyle block

Is your land farmland?

177. If you provide short-stay accommodation on your farm or lifestyle block, the first matter to consider is whether the land is "farmland".

178. This is because the interest limitation rules apply to interest to the extent to which it is incurred for DRP, and DRP does not include land to the extent to which it is "excepted residential land". Farmland, including any place configured as a residence or abode on the land, is excepted residential land and is not DRP. Consequently, the interest limitation rules do not apply to interest incurred for farmland (including interest incurred for any short-stay dwelling on farmland).

179. "Farmland" is defined in the Act as land that is being worked in the farming or agricultural business of the land's owner or land that, due to its area and nature, is capable of being worked as a farming or agricultural business.[65]

180. The expression "lifestyle block" is not used in the Act. The Collins English Dictionary (online ed) defines the term as meaning "a semi-rural property comprising a house and land for small-scale farming".

181. For the Act, what is relevant is whether land is "farmland" (as defined in the Act) and not whether the land is a "lifestyle block".

65 Section YA 1.

182. Due to their small size, lifestyle blocks are generally unlikely to be used, or capable of being worked, in farming or agricultural businesses, so will not be farmland. If this is the case, the farmland exception from DRP will not apply.[66]

183. In considering whether your short-stay dwelling is on farmland, it is only the legal title (called a record of title) that the dwelling is on that is relevant. If, for example, your short-stay dwelling is on a land that adjoins your farmland, but the farm and the land the dwelling is on are in separate legal titles, you only consider the land in the legal title for the dwelling.

184. If your short-stay dwelling is on farmland, see from [185]. If the property is not farmland, see from [198].

If your land is farmland

185. The table below (figure 10) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 10 – Short-stay accommodation provided on your farmland – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [187]).	The ring-fencing rules will not apply to limit your total deduction (including interest) for the property as it is farmland.

Interest limitation rules do not apply

186. If the land with your short-stay dwelling is farmland the interest limitation rules do not apply to interest incurred for the dwelling. As mentioned, this is because farmland is excepted residential land and the interest limitation rules do not apply to interest incurred for excepted residential land.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

187. Although the interest limitation rules will not apply to the interest incurred for your short-stay dwelling, if you have used the short-stay dwelling both privately[67] and for earning income in an income year, you will need to apportion your deductible expenses for the dwelling (including interest) between those different uses. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.

188. You will need to apportion your expenses either under either the mixed-use asset rules (the MuA rules) or based on general apportionment principles (the standard deductibility rules), depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.

189. If you use the short-stay dwelling partly for income-earning purposes and partly for private purposes, and it is also not used for at least 62 days in the income year, the MuA rules will apply. This is unless you opt out of the rules, which you can do in two situations – see [193] to [194].

190. For the MuA rules, private use is when you or a person associated with you (for example, close relatives such as your children, grandchildren, siblings, or in-laws), use the dwelling. It is irrelevant whether you are paid for that use. Private use also includes use of the dwelling by a guest who pays less than 80% of the market value amount for the use of the dwelling.

191. If the MuA rules apply, they apportion your interest (and other expenditure for the dwelling) between income-earning use and private use by using a prescribed formula. This determines the deduction you are allowed. The formula apportions relevant expenditure based on the number of income-earning days relative to total days the property is physically used.

192. If the MuA rules do not apply,[68] your expenses for the dwelling will be apportioned based on the standard deductibility rules. Generally, this would involve time and space-based apportionment, with potential deductibility for days the dwelling is not used privately and is available for rent.[69]

66 See QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks, which provides guidance on the meaning of farmland, when activities carried out on land will be a farming or agricultural business, and when a lifestyle block will be farmland.

67 This may include use by you or your family, or use by friends who are not charged full market rent.

68 Other than because you opted out of the MuA rules.

69 See QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

193. The two situations in which you can choose to opt out of the MuA rules (if they would otherwise apply) are where:
   - If the amount of income you derive for the income year from your short-stay dwelling is less than $4,000.
   - Your rental activity for the short-stay dwelling for the year is loss-making (that is, the expenses you could deduct for the year under the MuA rules exceed the income) and your income from renting out the dwelling during the income year is less than 2% of the relevant portion of the property's value.[70]

194. If you opt out of the MuA rules, the income from your short-stay dwelling for that year is treated as exempt income and all interest (and other expenses) incurred for the dwelling will be non-deductible.

195. Comprehensive explanations of how to determine which apportionment rules apply to short-stay dwellings and how those rules are applied are contained in:
   - QB 19/06: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 12.
   - QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.
   - QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

196. As noted at [5], the above items pre-date the interest limitation rules and the ring-fencing rules. Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

The ring-fencing rules do not apply

197. The ring-fencing rules do not apply to limit your total deduction (including interest) for the property in the income year, because the land is farmland.

If your land is not farmland

198. If your land is not farmland, the rules that apply depend on your circumstances.

199. If your short-stay dwelling is the only dwelling on the land, and the dwelling is not your main home, the discussion from [24] on short-stay accommodation provided in a holiday home is relevant, treating your short stay-dwelling as the holiday home.

200. If your main home is the only dwelling on the land, and you provide short-stay accommodation in your home, the discussion from [72] on short-stay accommodation provided in your main home is relevant.

201. If your main home is on the land, and you provide short-stay accommodation in a separate dwelling on the land, the discussion from [84] on short-stay accommodation provided on the same land as your main home is relevant.

Example | Tauira 8 – Short-stay dwelling on a lifestyle block

Marama and Dave own a 10-acre block of rural land as tenants in common in equal shares (50:50). Approximately 4 acres of the land is regenerating indigenous forest. The existing cottage on the land was built in the 1920s. Marama and Dave use the cottage as a weekender and a holiday home. They run 20 sheep on the unforested part of the land to assist with controlling grass growth. The only other land Marama and Dave own is their main home, which is in the city.

In June 2022, Marama and Dave borrowed $180,000 to purchase a tiny home to put on the property and provide short-stay accommodation in. The tiny home has a bathroom, potable water, and cooking facilities. The tiny home's wastewater system is connected to a septic tank and drip lines. The potable water is rainwater collected in an external 10,000 litre tank, which is treated by a water filtration and UV system (located inside the tiny home).

Under the district plan of the local authority, Marama and Dave were required to obtain building consent for the tiny home. A code compliance certificate (evidencing the tiny home was added to the property) was issued on 1 February 2023. From 1 April 2023, Marama and Dave commence using the tiny home to provide short-term accommodation.

70 The value to use in determining if you are under the 2% threshold is: the most recent capital value or annual value set by your local authority or, if you purchased the property after the most recent local authority valuation, the purchase price you paid for the property (unless you acquired it from an associated person – in which case the market value at the time you acquired the property). You then need to apportion that value between the land area used for the short-stay dwelling and the rest of the property, and test the 2% threshold against the value of the land used for the short-stay dwelling.

In the income year ending 31 March 2024, Marama and Dave incur interest expenditure of $8,600 and other expenditure of $2,000 relating to the tiny home. They derive income from the tiny home of $16,000. There is no private use of the tiny home, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Marama and Dave each have assessable income of $8,000 from the tiny home (the income of $16,000 is split between them equally as it is derived by them equally as 50:50 owners of the land).

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to the interest incurred for the tiny home because the new build land exemption applies to the tiny home.

The tiny home is new build land because it is configured as a self-contained residence or abode and a code compliance certificate, evidencing that the tiny home was added to the land, was issued on or after 27 March 2020.

Therefore, none of the interest deduction is disallowed by the interest limitation rules.

No apportionment required

Because there is no private use of the tiny home and it is rented out or available for rent for the whole income year, Marama and Dave do not need to apportion their interest or other deductible expenditure under the MuA rules or standard deductibility rules.

Therefore, Marama and Dave can each deduct $4,300 of the interest and $1,000 of the other expenses for the tiny home. These deductible expenses are split between them equally as they are incurred 50:50 by Marama and Dave.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2023-24 income year because Marama and Dave's income from the tiny home ($8,000 each) exceeds their deductible expenditure ($5,300 each) incurred in relation to the tiny home, and they do not own any other rental properties (so do not have a rental portfolio). The ring-fencing rules apply to limit the total deduction allocated to a residential rental property (or portfolio of properties) only when expenditure from the property (or portfolio) exceeds the income derived from the property (or portfolio).

Example | Tauira 9 – Short-stay dwelling on farmland

Stu and Suretha own a 250-hectare block of land as joint tenants. The block is used (together with other land they own) in their farming business. They have an existing loan of $300,000 in relation to the block (existing loan). They borrow a further $250,000 (new loan) to build a dwelling on the land to provide short-stay accommodation in.

In the income year ended 31 March 2023, they incur interest of $17,600 under the existing loan, interest of $15,000 under the new loan, and other expenditure of $2,000 relating to the dwelling. They derive income of $15,000 from using the dwelling to provide short-stay accommodation. There is no private use of the dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Stu and Suretha each have assessable income of $7,500 from the dwelling (the income of $15,000 is split between them equally as it is derived by them equally as joint tenants).

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to the interest incurred under the existing loan or the new loan. This is because the interest limitation rules apply to interest incurred for DRP and DRP does not include excepted residential land.

Farmland, including any place configured as a residence or abode, is excepted residential land. Farmland is (relevantly) land that is being worked in the farming or agricultural business of the land's owner. Stu and Suretha are working the 250-hectare block in their farming business. The block is therefore farmland and excepted residential land.

Therefore, none of the interest deduction for either loan is disallowed by the interest limitation rules.

No apportionment required

Because there is no private use of the dwelling and it is rented out or available for rent for the whole income year, Stu and Suretha do not need to apportion their interest or other deductible expenditure under the MuA rules or standard deductibility rules.

The interest incurred under the existing loan is deducted as an expense of the farming business.

Therefore, Stu and Suretha can each deduct $7,500 of the interest and $1,000 of the other expenses for the dwelling. These deductible expenses are split between them equally as they are incurred by them jointly.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2022-23 income year. This is because the ring-fencing rules apply to residential land. Residential land does not include farmland and the block is farmland.

Example | Tauira 10 – Short-stay dwelling on farmland

Anetelea and Kenese own a 550-hectare block of land as joint tenants. The block is used (together with other land they own) in their farming business. The most recent capital value for the 550-hectare block is $5.5m, set by the local authority in 2022. Anetelea and Kenese's main home is on another block of land.

In 2021, Anetelea and Kenese borrowed $300,000 to build a dwelling on the land to provide short-stay accommodation in (the dwelling loan). The portion of the land used in relation to the short-stay dwelling is one hectare (0.18% of the total land area). When the dwelling is not being used by guests, Anetelea and Kenese's family use the dwelling as a holiday home. The dwelling was completed in May 2022. On completion of the build, Anetelea and Kenese obtained a valuation of $520,000 from a registered valuer for the potion of the land with the dwelling.

In the income year ended 31 March 2023, Anetelea and Kenese incur interest of $18,800 under the loan for the dwelling, other expenditure (not relating solely to the use of the dwelling to derive income) of $3,000 for the dwelling, and $2,000 of expenditure that relates solely to the use of the dwelling to deriving income and from which no personal benefit is received (eg, advertising costs and welcome chocolates for paying guests). The dwelling is used for 130 days to earn income of $22,100 from guests, is used for 30 days by Anetelea and Kenese's family, and not used for 205 days.

How the taxation laws apply

Income from land use

Anetelea and Kenese each have income of $11,050 from the dwelling (the income of $22,100 is split between them equally as it is derived by them equally as joint tenants).

As explained below, Anetelea and Kenese cannot opt-out of MuA rules and consequently, the income of $11,050 is assessable income.

Deductions for interest

The interest limitation rules

The interest limitation rules do apply to the interest incurred for the dwelling. This is because the interest limitation rules apply to interest incurred for DRP and DRP does not include excepted residential land. Farmland, including any place configured as a residence or abode, is excepted residential land. Farmland is (relevantly) land that is being worked in the farming or agricultural business of the land's owner. Anetelea and Kenese are working the 550-hectare block in their farming business. The block is therefore farmland and excepted residential land.

The MuA rules

Rules apply

The MuA rules apply.[71] This is because the dwelling is used partly for income-earning purposes and partly for private purposes and is not used for 205 days, which is more than the minimum 62 non-use days required for the MuA rules to apply.

Opting-out not possible

A person may elect to opt-out of the MuA rules if the income from the asset (in this case the dwelling) is less than $4,000 or if they have an amount of quarantined expenditure.

As Anetelea and Kenese each derive income of $11,050 from the dwelling, opting-out under the income threshold is not available.

Anetelea and Kenese will each have an amount quarantined expenditure if the income they each derive from the dwelling is less than 2% of the most recent capital (or annual value) value of the land.

Since different activities occur on the block (that is, farming and short-stay accommodation) and the block is in a single record of title, the value of the block must be determined in one of two ways for the purposes of applying the 2% threshold (s DG 16(1B)(c)).

The first is multiplying the value of land ($5.5m) by the percentage of area of the land that is used for the dwelling (0.18%). Under this approach, the value of the land is $9,900 (0.18% of $5.5m = $9,900). The income of $11,050 that Anetelea and Kenese each derive from the dwelling is greater than 2% of $9,900.

The second approach is by a valuation of the portion of land with the dwelling. If this approach is used, the valuation must be made by a registered valuer no more than 3 years before the end of the income year (31 March 2023). Anetelea and Kenese have a current registered valuation of $520,000, made less than 3 years before the end of the income year. The income of $11,050 Anetelea and Kenese each derive from the dwelling is greater than 2% of $520,000 ($10,400).

Therefore, Anetelea and Kenese do not have quarantined expenditure and cannot opt-out of the MuA rules on that basis.

Apportionment

The expenses incurred in providing the short-stay accommodation are split between Anetelea and Kenese equally as they are incurred by them jointly. They are therefore each allocated $9,400 of interest, $1,500 of the other expenses not relating solely to the use of the holiday home to derive income, and $1,000 of the expenses that relate solely to the use of the dwelling to deriving income and from which no personal benefit is received.

As explained in QB 19/07, the expenses that relate solely to the use of the dwelling to deriving income and from which no personal benefit is received are fully deductible.

Anetelea and Kenese must each apply the MuA apportionment formula to the other expenses (totalling $10,900) to determine the amount of expenditure they each incur that is apportioned to income-earning use.

Applying the MuA apportionment formula, Anetelea and Kenese calculate the amount of their respective apportionable expenditure that is apportioned to income-earning use is $8,856.25.

Anetelea and Kenese are each allowed a deduction for $9,856.25 ($8,856.25 apportioned under the MuA rules plus $1,000 of fully deductible expenses). They are not allowed a deduction for the $2,043.75 apportioned to private use.

The ring-fencing rules

The ring-fencing rules do not apply. This is because the ring-fencing rules apply to residential land. Residential land does not include farmland and the block is farmland.

71 QB 19/06 explains when the MuA rules apply.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007

Subparts DG, DH and EL, ss CB 6A, CB 16A and the definitions of "farmland" and "residential rental property" in s YA 1.

Other references | Tohutoro anō

QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks, *Tax Information Bulletin* Vol 31, No 1 (February 2019): 39.

https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2018/qb1817-qb-1817-income-tax-bright-line-test-farmland-and-main-home-exclusions-sale-of-lifestyle-block

QB 19/05: What are my income tax obligations if I rent out my home or a dwelling on your property as short-stay accommodation? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 3.

https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/download-qb19-05

QB 19/06: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 12.

https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/download-qb19-06

QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.

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QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/download-qb19-08

QB 19/16: If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed? *Tax Information Bulletin* Vol 32, No 1 (February 2020): 65.

https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/qb-1916-if-property-held-in-a-trust-is-rented-out-by-the-trustees-for-short-stay-accommodation-who-s

Appendix: Additional detail on some aspects of the interest limitation rules and the other rules that may apply

A1. As noted at [6] in the Interpretation Statement, this appendix provides additional detail on some aspects of the interest limitation rules and the other relevant tax rules that may apply, depending on your circumstances. This appendix provides additional detail on:

- The definition of "disallowed residential property" – see from [A2].
- The definition of "excepted residential land" – see from [A6].
- The new build land exemption from the interest limitation rules – see from [A8].
- "To the extent to which" (apportionment) – see from [A17].
- Grandparented transitional loans and grandparented residential interest – see from [A22].
- Grandparented transitional loans that cannot reasonably be traced – see from [A28].
- Grandparented transitional loans and the high water mark rule – see from [A39].
- The ring-fencing rules – see from [A48].
- Situations where the future disposal of a property with someone's main home and a short-stay dwelling on it might be taxable – see from [A66].

Definition of "disallowed residential property"

A2. Key terms used in the interest limitation rules are defined in s DH 5.

A3. The key term "disallowed residential property" (DRP) is defined in s DH 5(2):

> **DH 5 Key terms**
>
> …
>
> *Disallowed residential property*
>
> (2) Disallowed residential property—
>
> (a) means land in New Zealand to the extent to which—
>
> (i) it has a 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:
>
> (ii) the owner has an arrangement that relates to erecting a place there, configured as a residence or abode, whether or not that place is or is to be used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
>
> (iii) it is bare land that, under rules in the relevant operative district plan, may be used for erecting a place there, configured as a residence or abode, whether or not that place is or is to be used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
>
> (b) does not include land to the extent to which it is excepted residential land.

A4. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode, and it includes any appurtenances belonging to or enjoyed with the place. It does not matter whether the place is used as a residence or abode.

A5. Land with a short-stay dwelling on it is DRP because it is land that has a place (the dwelling) configured as a residence or abode. The interest limitation rules will apply to interest incurred for the short-stay dwelling unless:

- the short-stay dwelling is on land that is excepted residential land (for example, farmland), or
- the new build land exemption applies.

Definition of "excepted residential land"

A6. The key term "excepted residential land" is defined in s DH 5(3) and means land to the extent to which it is described in sch 15.

A7. Schedule 15 states:

> **Schedule 15**
>
> **Excepted residential land**
>
> 1. Business premises, except if the business premises—
>   (a) are used or available for use in a business of supplying accommodation; and
>   (b) are not land described in clause 7.
> 2. Farmland, including 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.
> 3. A hospital, convalescent home, nursing home, or hospice.
> 4. A boarding establishment.
> 5. A hotel, motel, inn, hostel, or camping ground.
> 6. A rest home or retirement village.
> 7. For the relevant person (person A), land that has been used predominantly for a place configured as a residence or abode, including any appurtenances belonging to or enjoyed with the place, if that place is the main home for 1 or more of the following people:
>   (a) person A;
>   (b) a beneficiary of a trust, if person A is a trustee of the trust and—
>   (i) a principal settlor of the trust does not have a main home; or
>   (ii) if a principal settlor of the trust does have a main home, the place is their main home.
> 8. Student accommodation.
> 9. For the relevant person, employee accommodation.
> 10. Māori excepted land.

New build land exemption from the interest limitation rules

A8. Section DH 4 contains exemptions from the interest limitation rules, including the new build land exemption.

A9. The new build land exemption provides that the interest limitation rules do not apply to interest incurred by a person to the extent to which it is incurred in relation to new build land and in a 20-year period starting from a specified date.[72]

A10. The exemption applies to every owner of the new build land during the 20-year exemption period.

A11. The phrase "to the extent to which" recognises that in some cases only part of a single parcel of land will be new build land and that apportionment will be required. Apportionment is discussed from [A17].

A12. The term "new build land" is defined in s DH 5(7).

A13. The following sets out the types of new build land and the date the 20-year exemption period starts for each:

- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. This includes land exclusively used by residents of the place and also a reasonable portion of shared areas of land, appurtenant to the place. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.

72 Section DH 4(1).

- Land for which there is an agreement that a place that is configured as a self-contained residence or abode will be added to the land and a code compliance certificate will be issued on or after 27 March 2020 evidencing that the place was added to the land. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.
- Land that has a place that was a hotel or motel, to the extent to which, by a conversion, it becomes places that are configured as self-contained residences or abodes, and the conversion is recorded in the records of a local authority or building consent authority as having been "completed" on or after 27 March 2020. In this case, the 20-year exemption period starts on the date that, in the records of the local authority or building consent authority, the conversion is recorded as having been completed.
- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if the place was removed from the earthquake prone buildings register on or after 27 March 2020, and—
  - a code compliance certificate has been issued on or after 27 March 2020 evidencing that building work to remediate the place is complete:
  - the completion of the building work to remediate the place is recorded in the records of a local authority or building consent authority as having been "completed" on or after 27 March 2020 and as having been verified by a suitably qualified engineer.

  In this case, the 20-year exemption period starts either on the date on which the code compliance certificate is issued or on the date that, in the records of the local authority or building consent authority, the remediation is recorded as having been completed (as applicable).
- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if the place was not previously weather-tight and a code compliance certificate has been issued on or after 27 March 2020 evidencing that at least 75% of the place's cladding has been replaced. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.

A14. However, in the case of a code compliance certificate issued subject to a building consent waiver or modification under clause B2.3.1 of the Building Code under the Building Act 2004, the 20-year exemption period starts from the date the relevant building work is entered into the records of the local authority or building consent authority as "substantially completed".

New build must be a self-contained residence or abode

A15 The definition of new build land requires that the new place (or converted place) is a "self-contained residence or abode". This phrase is not defined in the Act. However, its ordinary and plain meaning requires that a place has the necessary facilities, such as a kitchen, bathroom, toilet, and electricity, to enable it to be used as a residence or abode. A dwelling will not be self-contained if it uses essential facilities that are shared with another dwelling (for example, the main home). A sleepout used to provide short-stay accommodation will not be new build land if it is not self-contained.

A16 Although the interest limitation rules will not apply to your short-stay dwelling to the extent to which it is new build land, the ring-fencing rules may apply. The ring-fencing rules are discussed from [A48].

"To the extent to which" (apportionment)

A17. The phrase "to the extent to which" is used in the Act to indicate that apportionment may be required, depending on the facts.

A18. The phrase is used in various parts of the interest limitation rules. For interest incurred for a dwelling used to provide short-stay accommodation, the phrase is used in the following relevant ways:

- DRP is defined as land in New Zealand "to the extent to which" it has a place (dwelling) configured as residence or abode, including any appurtenances belonging or enjoyed with that place.
- The new build land exemption provides that the interest limitation rules do not apply to interest incurred by a person "to the extent to which" it is incurred for new build land.
- Land is excluded from definition of DRP "to the extent to which" it is excepted residential land.
- Excepted residential land is defined as land "to the extent to which" it is described in sch 15.

A19. The interest limitation rules do not specify the apportionment method that is to be used and therefore the existing principles from case law apply. These principles provide that the onus is on the taxpayer to establish that their preferred method is the one that should be adopted and that it achieves the objective of a fair and reasonable assessment. Whether a particular method is fair and reasonable depends on the facts and circumstances of each case.

A20. To illustrate:

- DRP is land to the extent to which it has a place configured as a residence or abode. However, DRP does not include land to the extent to which it is excepted residential land. Business premises are excepted residential land, unless it is a business of supplying accommodation in a dwelling that is not the person's main home.[73]
- If your business premises (for example, a retail shop) and your short-stay dwelling are on the same land (record of title) and you incur interest for the land, you will be required to apportion the land to determine the proportion of the land that is the business premises and the proportion that is the short-stay dwelling. The interest limitation rules will apply only to the interest apportioned to the short stay-dwelling (unless an exemption such as the new build land exemption applies).
- A percentage of total land area apportionment method is likely to be appropriate. Under this method, if the land area of your short-stay dwelling (including appurtenances) is 60% of the total land area, then 60% of the interest you incur for the land is apportioned to your short-stay dwelling and subject to the interest limitation rules.

A21. In other circumstances, a different apportionment approach might be appropriate to achieve the objective of a fair and reasonable assessment – for example, apportionment based on valuation of different parts of the land.

Grandparented transitional loans and grandparented residential interest

A22. If your short-stay dwelling is DRP and you acquired the dwelling before 27 March 2021 with a grandparented transitional loan, your deductions for grandparented residential interest (that is, interest incurred on the principal of a grandparented transitional loan) are progressively denied in the transitional period from 1 October 2021 to 31 March 2025. From 1 April 2025, you will not be allowed any deductions for interest.

A23. A grandparented transitional loan is a New Zealand denominated loan for DRP first drawn down:

- Before 27 March 2021.
- On or after 27 March 2021, if an estate or interest in the DRP was acquired before 27 March 2021 (for example, under a binding agreement for sale and purchase).
- On or after 27 March 2021, if the acquisition of the DRP resulted from an offer made on or before 23 March 2021 that could not be revoked by the purchaser before 27 March 2021.
- On or after 27 March 2021, if the following three requirements are satisfied:
  - A previous owner of the DRP (the original owner) had a loan under one of the three preceding bullet points.
  - A bright-line rollover provision applies to every transfer of the DRP from the original owner to any intermediate owner to the current owner (the taxpayer).
  - The taxpayer's loan amounts are equal to or less than the amount of the original owner's loan at the time the original owner transferred the DRP.

A24. A grandparented transitional loan does not include any re-drawings or additional borrowings under the same loan facility on or after 27 March 2021.

A25. If you have a grandparented transitional loan for your short-stay dwelling (and the dwelling is DRP) and you take out a new loan to refinance that loan, the new loan will be treated as a grandparented transitional loan. The interest you incur on the new loan, to the extent to which it is for the short-stay dwelling, will be progressively denied from 1 October 2021 to 31 March 2025.

73 Or the main home of a beneficiary of a trust, if the owner of the property is a trustee, provided no principal settlor of the trust has a different main home.

A26. The percentages of the deduction for grandparented residential interest progressively denied in the transitional period are:

Figure | Hoahoa 11 – Transitional period interest denial percentages

Period that grandparented residential interest is incurred	Percentage denied
1 October 2021 to 31 March 2022	25%
1 October 2022 to 31 March 2023	25%
1 October 2023 to 31 March 2024	50%
1 October 2024 to 31 March 2025	75%
On and after 1 April 2025	100%

A27. If you have an amount of grandparented residential interest for your short-stay dwelling, you will need to consider whether the ring-fencing rules apply to limit the amount of your deduction.

Grandparented transitional loan that cannot reasonably be traced

A28. The tracing approach is generally used to identify whether interest you incur is for DRP.

A29. In some rare cases, you may have used a grandparented transitional loan to purchase both a short-stay dwelling (that is DRP) and other property that you use to derive income (for example, a commercial building) and the portion of the loan used for the dwelling cannot be reasonably determined (an untraceable loan). In this situation, a special rule applies to treat a portion of the untraceable loan (the notional loan principal) as having been used to purchase the dwelling. Interest on the notional loan principal is treated as grandparented residential interest, and deductibility of that interest is progressively denied over the transitional period from 1 October 2021 to 31 March 2025. Interest on the remaining portion of the grandparented transitional loan is not subject to the interest limitation rules, and deductibility of that interest is determined under the general (or other applicable) deduction rules.

A30. The special rule only applies when the portion of a grandparented transitional loan used for DRP "cannot reasonably be determined". This will be a question of fact and degree in each case. You must answer this question objectively. This means you determine whether a reasonable person could not, in the circumstances of the case, reasonably determine the portion of the loan that was used for DRP. Whether the necessary information to calculate the portion is available, or can be reasonably obtained, is likely to be a highly relevant factor for the "cannot reasonably be determined" question. If information needs to be obtained from a third party (such as a bank, accountant, or lawyer) and they charge for the information, this would not in itself mean the portion of the loan used for DRP cannot reasonably be determined.

A31. If you have an untraceable loan, you need to apply the following formula to determine the notional loan principal of the loan:

outstanding borrowings – allowed property

A32. In the formula:

- Outstanding borrowings is the amount of the untraceable loan on 26 March 2021 (excluding any amount not used for either DRP or allowed property).
- Allowed property is the total value of your property on 26 March 2021, excluding DRP and ignoring property not used to derive assessable income. However, the value of DRP held on 26 March 2021 to which an exemption applies (for example, the new build exemption) is included in allowed property.

A33. You must apply the following valuation rules to determine the value of your allowed property:

- For land, including new build land but excluding land acquired for a s CB 7 business relating to land and land subject to an undertaking or scheme involving development, division or building to create new build land:
  - the most recent capital value or annual value set by a local authority, or
  - if the land was acquired after the most recent local authority valuation, its acquisition cost or, if acquired from an associated person, its market value.
- For all other property, its tax book value or, if you prepare financial accounts according to relevant accounting standards or legislative standards, the financial accounts' valuation.

A34. If the result of the formula is positive, interest on the positive amount is grandparented residential interest and is progressively denied over the transitional period from 1 October 2021 to 31 March 2025. If the result is negative, it is treated as zero and no amount of interest is treated as grandparented residential interest.

A35. The formula, in effect, treats an untraceable loan as being used to acquire allowed property before acquiring DRP. If the value of your allowed property on 26 March 2021 exceeds the value of your outstanding borrowings on 26 March 2021, none of the interest on the outstanding borrowings will be subject to denial under the interest limitation rules.

A36. If you have an untraceable loan, for tax purposes you will in effect be treated as having two loans – the notional loan principal (treated as being used for DRP) and a remaining loan (treated as being used for allowed property). When you make a repayment reducing the balance of the untraceable loan, you need to apply special repayment rules to allocate the repayment to the reduction of either the notional loan principal or the loan for allowed property.

A37. The general repayment rule is that repayments are applied first against the notional loan principal. When the notional loan principal is reduced to zero, there will be no grandparented residential interest, and the interest limitation rules will no longer apply to the untraceable loan.

A38. The general rule is overridden when the source of the repayment is the disposal of allowed property that you owned on 26 March 2021. In this situation, only the amount (if any) of the repayment that exceeds the 26 March 2021 value of that allowed property is applied in reduction of the notional loan principal. If the repayment is less than or equal to the 26 March 2021 value of the disposed of item of allowed property, the repayment does not reduce the notional loan principal.

Grandparented transitional loan and the high water mark rule

A39. If your grandparented transitional loan for your short-stay dwelling is a variable balance loan (a grandparented transitional variable balance loan), such as a revolving credit facility or an overdraft, you can choose whether to apply the high water mark rule to simplify the calculation of your grandparented residential interest.

A40. The high water mark rule simplifies the calculation of grandparented residential interest for a grandparented transitional variable balance loan by making it unnecessary to trace each individual withdrawal and deposit to that loan between 27 March 2021 and 30 March 2025. Under the high water mark rule, the period from 1 October 2021 to 31 March 2025 is referred to as the affected interest period. Simplification is optimised if a grandparented transitional variable balance loan has only been used for DRP and the balance at any "instant" during the affected interest period does not exceed the initial loan balance.

A41. Under the high water mark rule:

- For a period in the affected interest period the amount of interest that is treated as grandparented residential interest is the total amount of interest for all "instants" in the "period" that are for, or traced to, DRP.
- A period in the affected interest period is a period in which grandparented residential interest is incurred. A period can be any period in the affected interest period (1 October 2021 to 31 March 2025). Since deductions for grandparented residential interest are denied at different specified percentages for the periods 1 October 2021 to 31 March 2022, 1 April 2022 to 31 March 2023, 1 April 2023 to 1 April 2024, and 1 April 2024 to 31 March 2025, a calculation for each of these periods will be required.
- An instant (in a period) is the duration of time that the balance of the loan remains unchanged.
- If the balance of the loan increases or decreases in a period, a new instant occurs, and an interest calculation is required for that instant.

A42. The amount of interest for an instant is calculated on the lesser of the initial loan balance and the affected loan balance.

A43. The initial loan balance is the amount of the grandparented transitional variable balance loan for the DRP on the start date. The start date is generally either:

- the end of 26 March 2021, if the loan was first drawn down before 27 March 2021, or
- the date the loan was first drawn down, if the first draw down is on or after 26 March 2021 and:
  - an estate or interest in the DRP was acquired before 27 March 2021, or
  - the acquisition of the DRP resulted from an offer made on or before 23 March 2021 that could not be revoked before 27 March 2021.

A44. The affected loan balance is the actual balance of the grandparented transitional variable balance loan at any instant. It is calculated using the following formula, which adjusts for further advances and repayments:

initial loan balance + (advances – repayments) – (unrelated advances – unrelated repayments)

A45. In the formula:

- The "initial loan balance" is calculated as described above.
- "Advances" is the total amount of debit entries from the start date to the date of the calculation.
- "Repayments" is the total amount of credit entries from the start date to the date of the calculation.
- "Unrelated advances" is the total amount of debit entries from the start date to the date of the calculation that have been applied to purposes that are not for the DRP that qualifies for grandparenting.
- "Unrelated repayments" are only relevant if your grandparented transitional variable balance loan is a grandparented transitional loan that cannot be traced. An unrelated repayment is a repayment, or portion of a repayment, that is not allocated to the reduction of the notional loan principal.[74]

A46. Although calculating interest for each instant for a grandparented transitional variable balance loan may appear to be complex, in many instances the calculation can be based on the interest charged by your lender. The application and effect of the high water mark rule is as follows:

- If your grandparented transitional variable balance loan has been applied only for DRP that qualifies for grandparenting and not for any other purpose, and the balance on the loan does not exceed the initial loan balance at any time during the affected interest period:
  - adjustments to calculate the affected loan balance will be equal to the debit and credit transactions to the account for the period in the affected interest period, and
  - all interest you incur for the loan for a period in the affected interest period will be grandparented residential interest.
- If your grandparented transitional variable balance loan has been applied for DRP that qualifies for grandparenting and for other purposes, and the affected loan balance during the affected interest period remains below the initial loan balance, the amount of grandparented residential interest is calculated on the affected loan balance. For a period in the affected interest period, interest calculations will be required for every instant. In this situation, it may be easier, as a practical matter, to calculate interest on the portion of the loan applied to other purposes and subtract this from the interest charged by the lender to determine the grandparented residential interest.
- If the affected loan balance exceeds the initial loan balance at any instant, regardless of whether the loan has been solely applied for DRP, the amount of grandparented residential interest is calculated on the initial loan balance.

A47. After you have calculated the amount of grandparented residential interest under the high water mark rule for a period, a deduction for the amount of that interest is then subject to progressive denial from 1 October to 2021 to 31 March 2025 at the percentages for the periods set out in the table at [A26].

74 See [A37] and [A38], which explain how repayments of an untraceable grandparented transitional loan are allocated.

Ring-fencing rules

A48. Although the interest limitation rules do not apply to interest you incur for a short-stay dwelling that is new build land, you will need to determine whether the ring-fencing rules apply in an income year to limit the deduction you can claim for the interest (and other expenditure) you incur for the new build land.

A49. The ring-fencing rules may also be relevant to land that is not new build land, but it is likely this would only be the case:

- during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

A50. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

A51. The ring-fencing rules[75] apply to "residential rental property" which is "residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land". The definition of "residential land" includes land that has a dwelling on it unless the land is farmland or is used predominantly as business premises. It also includes land that has a dwelling on it if the land is used by a person predominantly as a business premises for business of supplying accommodation and the dwelling is not the person's main home.[76]

A52. The ring-fencing rules apply in each income year a person is allowed a deduction for expenditure or loss incurred in relation to a residential rental property or a portfolio of residential rental properties. The default position under the rules is that they apply on a residential portfolio basis. A residential portfolio is one or more residential rental properties that a person holds in a portfolio. However, a person can elect to apply the ring-fencing rules on a property-by-property basis.

A53. The ring-fencing rules do not apply to residential land owned by a person for an income year if more than 50% of the land is used for most of the income year as a main home. The rules also do not apply to residential land to which the mixed-use asset rules (the MuA rules) apply or to residential land that is held on revenue account.[77]

A54. The main home exclusion is available (meaning the ring-fencing rules will not apply) for a particular income year if:

- more than 50% of the land is used for most of the income year by the owner as their main home, or
- the property is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

A55. The main home exclusion from the ring-fencing rules requires the land to be used for "most" of the income year by the owner[78] as a main home. The word "most" is not defined for the Act and has its ordinary meaning in context. The ordinary meaning of "most" is "greatest in amount or degree".

A56. A short-stay dwelling that is new build land is likely to be a residential rental property and subject to the ring-fencing rules unless it is a main home or the MuA rules apply. This is because the dwelling is residential land for which the person who owns the land is allowed a deduction for interest (and other expenditure) relating to the use of the land to derive income.

A57. The ring-fencing rules limit the amount of the deduction in the income year to the amount of residential income derived by the person from the property (or portfolio).

A58. If the default portfolio basis is used, "residential income" means the following amounts:

- Rental income from the portfolio.
- Income under the financial arrangements rules in relation to a loan, denominated in a foreign currency, to the extent to which the loan relates to the portfolio.
- Depreciation recovery income for the portfolio.
- The amount the person would have as net income for the year if their only income was income from the disposal of a residential rental property in the portfolio.
- The amount that the person would have as net income for the year if their only income was from residential land that is outside the rules because it is held on revenue account and falls within the exclusion in s EL 10.

75 A comprehensive explanation of the ring-fencing rules can be found in *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

76 Or the main home of one or more other persons referred to in s CB 16A(2).

77 Subject to the notification requirement in s EL 10(3) for land held on revenue account other than under s CB 7.

78 Or a beneficiary of the trust, if applicable.

A59. If the property-by-property basis is used, "residential income" means the above amounts for only the particular residential rental property. In this case, the last bullet point above will not be relevant.

A60. Deductions for excess expenditure are suspended in the year incurred and carried forward as an excess amount to a later income year in which the person derives residential income and added to the person's deductions for the residential rental property, or portfolio, in that later income year. If in that later income year there is an excess amount, it is carried forward to a later income year in which the person derives residential income. Carry forward continues until excess amounts are used.

A61. The effect of ring-fencing a person's excess amounts to income they derive from a residential property, or portfolio, is that excess amounts cannot be offset against the person's other assessable income.

Disposal of residential rental property

A62. If a person has used the property-by-property basis and the disposal of a residential rental property is taxable, any unused excess amount relating to the property is released (unfenced) on disposal and allowed as a deduction against the person's other income. However, the amount that is unfenced is reduced if, and to the extent, an excess amount has previously been transferred to the property. The transferred amount remains subject to treatment under the ring-fencing rules.

A63. If the disposal of the residential rental property is not taxable, the unused excess amount is carried forward to a later income year in which the person derives residential income from another residential rental property and is transferred to that property.

Disposal of portfolio

A64. If a person has used the portfolio basis and the disposal of each property in the portfolio is taxable, any unused excess amount relating to the portfolio after the disposal of the last property in the portfolio is released (unfenced). However, the amount that is unfenced is reduced if, and to the extent, an excess amount has previously been transferred to the portfolio from the disposal of a property not in the portfolio and the disposal of that property was not taxable. The transferred amount remains subject to treatment under the ring-fencing rules.

A65. If the disposal of any property in the portfolio is not taxable, any unused excess amount that remains after the disposal of the last property in the portfolio is carried forward to a later income year in which the person derives residential income from another residential rental property and is transferred to that property.

Situations where the future disposal of a property with someone's main home and a short-stay dwelling on it might be taxable

A66. If your interest deductions are denied (or partly denied) by the interest limitation rules, then you only need to consider how much of your interest would have been deductible under either the MuA rules or the standard deductibility rules if a future disposal of the land with your main home and short-stay dwelling could be a taxable disposal.

A67. While it would not be common for property with a person's main home and a short-stay dwelling on it to be taxable on disposal, there are some situations where this could be the case, such as:

- Where the relevant residential or main home exclusion from the applicable land sales provision cannot be used for some other reason. For example, the land area requirements in s CB 16[79] are not met, or the land has not been used for most of the bright-line period for the person's main home (relevant for the main home exclusion from the 5-year bright-line test).[80]
- The main home exclusion from the bright-line test has already been used twice in the last two years or there is a regular pattern of transactions that mean the relevant exclusion cannot be used.[81]

79 The residential exclusion from ss CB 6 to CB 11.

80 Section CZ 40.

81 Relevant for the main home exclusions from both the 5-year and 10-year bright-line tests (ss CZ 40(3) and CB 16A(3)).

A68. However, a future taxable disposal is most likely to arise under the 10-year bright-line test, when the main home exclusion to that test does not apply. This is because of the way the main home exclusion from the 10-year bright-line test operates – it is not an "all or nothing" exclusion like the main home exclusion from the 5-year bright-line test. Because this is the most common scenario that property with a person's main home and a short-stay dwelling could be taxable on disposal, the main home exclusion from the 10-year test is explained below.

A69. Under the 10-year bright-line test, an amount derived by a person from disposing of residential land[82] is income of the person if the disposal occurs within 10 years of the date of acquiring the land.[83] For the bright-line test, residential land includes land that has a dwelling on it. The land with your main home and short-stay dwelling is residential land because it has a dwelling on it.

A70. The 10-year bright-line test does not apply to a disposal of residential land if the main home exclusion applies to the land. This exclusion applies if all the days in the bright-line period are "exempted predominant main home days" for one or more main home persons:

- A day will be an "exempted predominant main home day" if the land has been used on that day "predominantly" for a dwelling that is the main home for one or more main home persons.
- Land is used "predominantly" for a dwelling that is the main home if the area of the land used for the dwelling that is the main home is larger than the area of the land used for any other purpose.
- A main home person is the owner of the land. If the owner of the land is a trustee of a trust, a main home person also includes a beneficiary of the trust, provided no principal settlor of the trust has a different main home (ie, either no principal settlor has a main home, or the land is their main home as well as being the beneficiary's main home).
- A day will also be an "exempted predominant main home day" even if it is a day in a period in which the land has not been used predominantly for a dwelling that is a main home by a main home person, provided that period is equal to or shorter than the "exempt home period limit", which is 365 days. The effect of this is that there is a grace period of up to a year where a day in that period will be an "exempted predominant main home day" even though on that day the land is not being used as a main home by a main home person. This ensures that the main home exclusion is not lost when a main home person temporarily ceases using the dwelling as a main home (for example, if the person is overseas on secondment). However, for the grace period to apply it must take place immediately before or after a period where the land is being used as a main home by a main home person. If the period in which the land is not being used as a main home exceeds the 365-day exempt home period limit, the main home exclusion will not apply.

A71. For example, if the 10-year bright-line test is relevant, the main home exclusion from the 10-year bright-line test will apply if you dispose of your land (with both your main home and short-stay dwelling) within 10 years of acquisition and on each day from the acquisition date to the disposal date the home has been your main home, and the area of the land used for the main home is larger than the area of the land used for your short-stay dwelling.[84]

82 The 10-year test generally applies to land acquired on or after 27 March 2021. It does not apply to the extent the land is new build land (a 5-year bright-line period applies in that case).

83 Subject to an exclusion or roll-over relief applying.

84 In the rare situation where the area of the land used for a short-stay dwelling is larger than the area of the land used for the main home dwelling, the main home exclusion will not apply.

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 23/06: GST – goods purchased on deferred payment terms

Question | Pātai

If a person is registered for GST on a payments basis, when can they claim an input tax deduction for goods purchased on deferred payment terms?

Answer | Whakautu

Generally, a person who is registered for GST on a payments basis can claim input tax deductions only when and to the extent that payment has been made. This includes goods purchased under a standard sales agreement or goods purchased on a 'buy now, pay later' basis.

However:

- If a person has entered into a hire purchase agreement for the purchase of goods, they can claim a full input tax deduction when they enter into the agreement.
- If a person has entered into a layby sales agreement for the purchase of goods, they can claim an input tax deduction only when property in the goods is transferred, typically after the final payment has been made.

Summary – for payments basis persons	
Type of agreement	**When an input tax deduction can be claimed**
Standard sales agreement	When and to the extent that payment has been made.
'Buy now, pay later' (BNPL) agreement	Typically, when the agreement is entered into as the BNPL provider pays for the supply in full.
Hire purchase agreement	When the agreement is entered into.
Layby sales agreement	When property in the goods is transferred, typically after final payment has been made.

Explanation | Whakamāramatanga

Introduction

1. A person who is registered for GST on an invoice basis can usually claim a full input tax deduction in the taxable period in which the invoice or taxable supply information is issued. Therefore, they get the timing benefit of an upfront input tax deduction even though payment might not occur until later, in a different taxable period.
2. The Commissioner has been asked whether a person who is registered for GST on a payments basis can also claim a full input tax deduction upfront for goods purchased on deferred payment terms. The answer to this question depends on how the sales agreement is classified.

3. This Question We've Been Asked (QWBA) considers the timing of input tax deductions for persons registered for GST on a payments basis, when they purchase goods under:
   - a standard sales agreement;
   - a 'buy now, pay later' agreement;
   - a hire purchase agreement; and
   - a layby sales agreement.
4. This QWBA focuses on persons who account for GST on a payments basis. However, it may also be useful for persons who account for GST on a hybrid basis. Under a hybrid basis, input tax is deducted on a payments basis and output tax is returned on an invoice basis. Therefore, the input tax treatment under a payments basis is the same as the input tax treatment under a hybrid basis.
5. This QWBA replaces "Payments made by instalments – accounting for GST on payments basis", *Tax Information Bulletin* Vol 6, No 4 (October 1994): 6.
6. Three examples at the end of this item at [44] illustrate the concepts discussed.
7. All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

Payments basis and the time of supply

8. A person's GST accounting basis determines when an input tax deduction can be claimed for the purpose of filing a GST return.
9. Where a payments basis is adopted and the general time of supply rule in s 9(1) applies, or the time of supply rules in s 9(3)(a) or (aa) or (6) apply, an input tax deduction can be claimed only when, and to the extent, a payment has been made in that taxable period (ss 19A and 20(3)(b)(i)). This means that when payments are made by instalments, an input tax deduction can only be claimed for each payment after it has been made.
10. However, in some circumstances a person using a payments basis may be able to claim an input tax deduction before payment takes place. This occurs where goods are purchased under a hire purchase agreement. The time of supply for a hire purchase agreement is when the agreement is entered into and not when instalment payments are made (s 9(3)(b)).
11. Where goods are purchased under a layby sales agreement, a person using a payments basis will not usually be able to claim an input tax deduction until the final payment due under the agreement has been made. The time of supply for a layby sales agreement is when property in the goods is transferred to the purchaser, usually on final payment (s 9(2)(c)). This outcome is obviously less advantageous from a timing perspective.

Deferred payment agreements

12. A person can purchase goods on deferred payment terms in many ways. To apply the GST rules correctly, it is necessary to classify the sales agreement. This classification determines when a person using the payments basis can deduct input tax. The terms and conditions of sales agreements vary so each agreement should be considered individually.

Standard sales agreements

13. A standard sales agreement may permit a purchaser to defer payment. For example, a purchaser buys goods and agrees to pay for them in instalments over an agreed period. Delivery of the goods might occur immediately or once the final instalment payment has been made.
14. Store credit accounts are an example of a standard sales agreement offering deferred payment terms. A purchaser buys goods on store credit and defers paying their account until later in the year. Some stores offer account holders up to 50 days of interest-free credit.

GST treatment

15. If the agreement is not a hire purchase agreement or a layby sales agreement, the general time of supply rule for payments basis persons applies. This means the person can claim an input tax deduction only when and to the extent that payment has been made in that taxable period (ss 9(1) and 20(3)(b)(i)). If payment is by way of instalments, the purchaser can deduct only the portion of input tax that relates to the payment actually made (*Nicholls v CIR* (1999) 19 NZTC 15,233 (CA)). Example | Tauira 1 illustrates this type of agreement.

Buy now, pay later agreements

16. 'Buy now, pay later' (BNPL) agreements are essentially a subset of standard sales agreements. They are addressed separately because of their popularity as a method of purchasing goods on deferred payment terms. Typically, under such agreements, the BNPL provider effectively makes a loan to the purchaser to enable them to purchase goods from the retailer. The retailer receives payment for the goods in full, from the BNPL provider, often via a mobile payment app. The purchaser is also usually required to pay a small percentage of the sale price up front to the BNPL provider. The retailer then provides the purchaser with ownership and possession of the goods. The loan made by the BNPL provider to the purchaser is repaid by the purchaser typically in a series of weekly or fortnightly instalment payments. The BNPL provider assumes all the risks should the purchaser fail to make any payments. The terms are often interest-free, but other charges likely apply. New Zealand's main 'buy now, pay later' providers are Afterpay, Laybuy[1], Klarna and Zip. However, it should be noted that not all BNPL agreements are the same and terms may vary between the different providers.

GST treatment

17. As with standard sales agreements, if the BNPL agreement is not a hire purchase agreement or a layby sales agreement, the general time of supply rule for payments basis persons applies. This means the person can claim an input tax deduction when and to the extent that payment has been made in that taxable period (ss 9(1) and 20(3)(b)(i)). In the context of a BNPL agreement (as defined in [16]), payment typically occurs at the time of purchase when the purchaser provides full consideration to the retailer via the BNPL provider's promise to pay the retailer for the supply, not when the purchaser pays the BNPL provider by weekly or fortnightly instalments. As the BNPL provider pays the retailer in full for the supply, the full input tax deduction is available for a GST-registered person purchasing the goods or services. Example | Tauira 3 *illustrates this type of agreement.*

Hire purchase agreements

Definition of "hire purchase agreement"

18. The definition of "hire purchase agreement" in s 2 of the Act refers to the definition of "hire purchase agreement" in s YA 1 of the Income Tax Act 2007.
19. Paragraph (a)(ii) of the definition of hire purchase agreement is relevant for goods sold on deferred payment terms.[2] It defines a hire purchase agreement as "an agreement for the purchase of goods by instalment payments, however the agreement describes the payments, under which the person who agrees to purchase the goods is given possession of them before the total amount payable has been paid". This type of agreement is known as a conditional sale agreement.
20. In summary, an agreement will be a hire purchase agreement if:
    - it is an agreement for the purchase of goods by instalment payments;
    - the purchaser is given possession of the goods before the total amount payable has been paid;
    - the agreement is at retail; and
    - property in the goods passes absolutely to the purchaser after delivery of the goods.
21. These features are summarised below. For more detail on when an agreement is a hire purchase agreement, see IS 22/02: GST and finance leases", *Tax Information Bulletin* Vol 34, No 5 (June 2022): 262).

Agreement for the purchase of goods by instalment payments

22. A hire purchase agreement is an agreement for the purchase of goods by instalment payments. "Instalment" is not a defined term in the Act, so it is helpful to consider its ordinary meaning. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "instalment" as:

> **instalment** n. **1** a sum of money due as one of several equal payments for something, spread over an agreed period of time.

1 Not to be confused with a layby sales agreement, discussed from [34].

2 Paragraph (a)(i) of the s YA 1 definition of "hire purchase agreement" concerns agreements where goods are let or hired with an option to purchase. This QWBA concerns only the sale of goods on deferred payment terms, so para (a)(i) is not considered. IS 22/02: GST and finance leases", *Tax Information Bulletin* Vol 34, No 5 (June 2022): 262, considers the GST treatment of hire purchase agreements in more detail, including the application of para (a)(i) and para (f). Paragraph (f) of the s YA 1 definition of "hire purchase agreement" is also not discussed in this item.

23. "Several" is defined as:

    several det. & pron. more than two but not many.

24. Based on the definitions in the *Concise Oxford English Dictionary, "instalment payments" could mean at least three equal payments of money. However, the Oxford English Dictionary* (online ed, 2nd edition, Oxford University Press, 1989, accessed 4 April 2023) defines instalment more broadly:

    The arrangement of the payment of a sum of money by fixed portions at fixed times; …

    The payment, or the time appointed for payment, of different portions of a sum of money, which, by agreement of the parties, instead of being payable in the gross, at one time, is to be paid in parts, at certain stated times. …

    Each of several parts into which a sum payable is divided, in order to be paid at different fixed times; a part of a sum due paid in advance of the remainder. …

25. This definition suggests that instalment payments do not need to be for equal amounts. An instalment payment is a payment of a portion of a total amount. This is consistent with the nature of hire purchase agreements. There is usually a deposit upfront, some instalments and, occasionally, a larger 'balloon' payment at the end.
26. In a tax context, Parliament has accepted that two payments will constitute instalments. The definition of an "extra pay" in s RD 7(1) of the Income Tax Act 2007 explains that it means a payment that (among other things) is "made in 1 lump sum or in 2 or more instalments…". Similar provisions referring to payments being made in two or more instalments are ss CZ 3(1), RE 21(3) and RF 13(2) of the Income Tax Act 2007.
27. The view that instalment payments means two or more payments is also supported by case law, including the leading case on this type of hire purchase agreement, *Lee v Butler* [1893] 2 QB 318 (CA). In that case, the taxpayer agreed to make two instalment payments.
28. The ordinary meanings and case law support the view that "instalment payments" as used in the definition of hire purchase agreement mean at least two payments. These payments do not need to be for equal amounts. Therefore, for a sales agreement to be a hire purchase agreement it must require payment in two or more instalments.

    Purchaser is given possession of goods before the total amount payable is paid

29. Under a hire purchase agreement, the purchaser must be given possession of the goods before the total amount payable is paid. Possession is usually provided upfront when the agreement is entered into.

    Property in the goods passes absolutely to the purchaser after delivery of the goods

30. Under a hire purchase agreement, property in the goods remains with the supplier until the goods have been delivered to the purchaser **and** the total amount payable has been paid.

    Agreement is "at retail"

31. Finally, the agreement must be "at retail". The Commissioner considers that a hire purchase agreement is made "at retail" when the purchaser is the ultimate consumer or end-user of the goods.[3]

GST treatment

32. If an agreement is a hire purchase agreement, the time of supply rule in s 9(3)(b) applies. Section 9(3)(b) states that where goods and services are supplied under a hire purchase agreement, the supply is deemed to take place at the time the agreement is entered into.
33. The effect of ss 9(3)(b) and 20(3)(b)(iii) is that a person who is registered for GST on a payments basis can claim an input tax deduction in the taxable period in which they enter into the agreement, before any instalment payments are made. This overrides the general time of supply rule for payments basis persons and provides them with a timing advantage. Example | Tauira 2 *considers a hire purchase agreement.*

Layby sale agreements

34. A layby sale agreement is another way for a person to purchase goods on deferred payment terms. Layby sales agreements are different to hire purchase agreements because the purchaser does not typically get possession of the goods until full payment has been made.

3 See "IS 22/02: GST and finance leases", *Tax Information Bulletin* Vol 34, No 5 (June 2022): 262, from [37].

Definition of "layby sale agreement"

35. Section 5(5) of the Act refers to the definition of "layby sale agreement" in s 36B of the Fair Trading Act 1986. Section 36B defines a layby sale agreement as an agreement (whether described as a layby sale agreement or not) between a supplier and a consumer for the supply of goods on terms (either express or implied) that:
    - the consumer will not take possession until all or a specified portion of the total price has been paid; and
    - the price is to be paid in three or more instalments or two or more instalments if the agreement specifies it is a layby sale agreement (noting that a deposit is considered an instalment).
36. In addition, an agreement will not be a layby sale agreement if the goods supplied have a purchase price of more than $30,000.

GST treatment

37. Under s 5(5), a layby sale agreement will constitute a supply when the goods are delivered and property is transferred to the purchaser.[4]
38. Section 9(2)(c) states that the time of supply for a layby sale agreement is when property in the goods is transferred to the purchaser. This will usually be when the goods are collected or delivered and the final instalment payment has been made.
39. However, if the terms of the layby sale agreement allow property in the goods to be transferred to the purchaser before the final instalment payment (but after a specified portion of the total price of the goods has been paid), this will also trigger the time of supply.
40. Therefore, the purchaser can claim an input tax deduction in the taxable period in which property in the goods is transferred, not when the agreement is entered into or when instalment payments are made. This is the same outcome for payments basis and invoice basis persons and is less advantageous from a GST timing perspective than for goods purchased under a hire purchase agreement. Example | Tauira 3 considers a layby sale agreement.

Input tax deductions

41. The amount of input tax that a person can deduct is limited by s 20(3C). Section 20(3C) permits an input tax deduction to the extent that the goods are used for or are intended to be used in making taxable supplies.
42. Therefore, a purchaser can deduct input tax only to the extent that the goods purchased will be used for or are intended to be used in making taxable supplies.
43. With the exception of layby sales, the goods do not need to be in the purchaser's physical possession before an input tax deduction can be claimed. If there is a delay between the agreement being entered into and the goods being delivered (for example, because of a delay in sourcing the goods or because the goods are being manufactured) an input tax deduction may still be available to the purchaser. Provided the goods are intended to be used to make taxable supplies, s 20(3C) is satisfied. Example | Tauira 1 explains how s 20(3C) applies.

4 Under the proviso to s 5(5), if a layby sale is cancelled under s 36F or 36G of the Fair Trading Act 1986 there will be a supply of services if the seller retains any amount to recoup their cancellation charge on the layby sale or if the seller recovers any amount from the buyer under s 36H(b) and (c) of the Fair Trading Act 1986.

Examples | Tauira

44. The following three examples explain how the GST time of supply rules apply to payments basis persons where goods are purchased on deferred payment terms.

Example | Tauira 1: Standard sale agreement

Connor needs to purchase fertiliser for his dairy farm. His farming activity is registered for GST on a two-monthly payments basis aligned with his 31 March balance date.

On 27 May, Connor enters into an agreement to purchase fertiliser from Fertiliser Ltd. Under the terms of the agreement, Connor agrees to pay $36,000 (including GST) in three instalments on 27 June, 27 July, and 27 August. Fertiliser Ltd offers this deal to Connor interest-free and with no deposit required. Once final payment is made, Fertiliser Ltd will deliver the fertiliser to Connor's farm during the first week of September.

The agreement between Connor and Fertiliser Ltd is a straightforward sales agreement. It is not a hire purchase agreement because full payment occurs before Connor receives possession of the goods. It is also not a layby sale agreement because the price of the goods exceeds the $30,000 threshold.

As Connor is registered for GST on a payments basis, he can deduct input tax only to the extent that payments have been made in the relevant taxable period.

The total amount of GST on the sale of the fertilizer is $4,695.65. When Connor files his GST return for the June–July taxable period, he can claim an input tax deduction of $3,130.43. When he files his GST return for the August–September taxable period, he can claim the remaining $1,565.22 of input tax.

Section 20(3C) is satisfied because the goods are intended to be used to make taxable supplies. The fact Connor does not have physical possession of the goods until September does not prevent him from claiming an input tax deduction in the June–July taxable period.

Example | Tauira 2: Hire purchase agreement

Naretta owns and operates a cattle farm. Her farming activity is registered for GST on a payments basis and has a 31 March balance date. She files two-monthly GST returns.

Naretta needs a new hay baler for her farm. Cash flow is tight, so she decides to purchase the baler from Hay Balers Ltd under a hire purchase agreement. Under the terms of the agreement, Naretta gets immediate possession of the baler and agrees to pay the purchase price of $30,000 (including GST) by way of five instalment payments: a deposit and four further monthly instalment payments. Naretta enters into the agreement on 20 March and gets immediately possession of the baler. The GST component of the purchase price is $3,913.05.

The benefit of entering into a hire purchase agreement is that Naretta can claim an immediate input tax deduction for the full amount of GST of $3,913.05 in her February–March GST return. Had she entered into a straightforward sales agreement, she would be able to claim an input tax deduction only to the extent that she had made a payment in the taxable period.

Example | Tauira 3: Layby sales agreements and buy now, pay later agreements

Lochie owns and operates an apple orchard. His orchard activity is registered for GST on a two-monthly payments basis aligned with his 31 March balance date.

Lochie's ride-on lawnmower has broken down, and he needs to purchase a new one. He finds a replacement model at his local farm equipment store, Farming Stuff Ltd. The new mower is $9,000 (including GST), and Farming Stuff Ltd offers several finance options, including traditional layby and a BNPL option.

If Lochie chooses the layby option (offered interest-free), he must make eight payments over eight weeks before Farming Stuff Ltd will deliver the mower to him. He will be unable to claim an input tax deduction until the mower is transferred to him on final payment.

Alternatively, Lochie could take up the BNPL option. The advantage with this option is that Lochie gets immediate ownership and possession of the mower. As this is a straightforward sales agreement, Lochie can deduct input tax to the extent that payments have been made in the relevant taxable period.

Lochie chooses the BNPL option as he needs the mower immediately. He enters into an agreement with a BNPL provider and uses his mobile app to purchase the mower in-store at Farming Stuff Ltd. The BNPL provider makes the payment in full, to Farming Stuff Ltd on 20 September.

In October, when Lochie files his GST return for the August–September taxable period, he claims an input tax deduction for the entire amount of GST - $1,173.90. This is because payment was made in full by the BNPL provider during this taxable period.

Lochie gets a GST timing advantage by taking the BNPL option over a layby because he can claim a full input tax deduction in his GST return for August–September. However, under a layby sales agreement he could deduct the input tax only after the final payment is made in the October–November taxable period.

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Fair Trading Act 1986, ss 36B, 36F and 36G

Goods and Services Tax Act 1985, ss 2 ("hire purchase agreement"), 5(5), 9(1), (2), (3), (6), 19A, 20(3) and (3C)

Income Tax Act 2007, ss CZ 3(1), RD 7(1), RE 21(3), RF 13(2), YA 1 ("hire purchase agreement")

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