Vol 36 No 4 May 2024

TAX INFORMATION
Bulletin

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Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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NEW LEGISLATION

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

Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024

Overview

The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 was introduced on 18 May 2023. It received its first reading on 18 May 2023, its second reading on 19 March 2024 and its third reading on 26 March 2024. The new Act received Royal assent on 28 March 2024.

It amends the:

- Income Tax Act 2007
- Tax Administration Act 1994
- Goods and Services Tax Act 1985
- KiwiSaver Act 2006
- Child Support Act 1991
- Income Tax Act 2004
- Gaming Duties Act 1971
- Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, and
- Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023.

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Annual rates for 2023–24

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

Section 3 of the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 sets the annual income tax rates that apply for the 2023–24 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 the income tax rates be set by an annual taxing Act.

Effective date

The amendment is effective for the 2023–24 tax year.

Detailed analysis

The annual income tax rates for 2023–24 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 2022–23 tax year.

Policy Items

Restoring interest deductibility

Sections CW 62C, DB 7, DB 8, DG 2, DG 5, DG 10, DG 14, DH 8, Subpart DH, DZ 24, YA 1 and schedule 15

Background

The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property.

For property acquired on or after 27 March 2021, interest deductions were denied in full from 1 October 2021.

The ability to claim interest deductions was being phased out for property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021 as follows:

Period that interest is incurred	Percentage of interest deductions allowed
1 October 2021 to 31 March 2022	75%
1 April 2022 to 31 March 2023	75%
1 April 2023 to 31 March 2024	50%

The ability to claim interest deductions is now being reintroduced on the following basis

Period that interest is incurred	Percentage of interest deductions allowed
1 April 2024 to 31 March 2025	80%
1 April 2025 onwards	100%

The above phasing applies to all taxpayers, whether they acquired their property, or drew down their lending, before or after 27 March 2021.

The rules determining which types of land and taxpayers are subject to the interest limitation rules and providing for specific anti-avoidance continue to be necessary while deductibility is being reintroduced and have, therefore, been retained.

The interest limitation rules will be substantially repealed from 1 April 2025, when all taxpayers are allowed full deductions. However, the current rules that allow taxpayers whose disposals of residential land are subject to tax to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of are being retained.

Effective date

The changes to s DH 8, which allow 80% of interest deductions to be taken during the period 1 April 2024 to 31 March 2025, are effective from 1 April 2024.

The remaining amendments repealing the interest limitation rules will take effect from 1 April 2025.

Detailed analysis

Application

The ability to claim interest deductions for residential investment properties applies to all taxpayers, whether they acquired their properties, or drew down lending, before or after 27 March 2021. The new phasing also applies to interest incurred to acquire an ownership interest in, or become a beneficiary of, an interposed residential property holder (ie, a company that holds residential land).

The interest limitation phasing rules continue to apply based on interest incurred for the period 1 April to 31 March each year. For most taxpayers, this will be the same as their income year. However, for taxpayers with non-standard balance dates, this will require them to calculate the amount of interest denied based on different percentages for different parts of their income year.

Example 1: Non-standard balance dates

Enia has a 30 June balance date. She owns several rental properties acquired before 27 March 2021.

For the 2023–24 income year, which ends on 30 June 2024, Enia would be allowed a deduction for 50% of her interest expenses for the period 1 July 2023 to 31 March 2024 and 80% of her interest expenses for the period 1 April 2024 to 30 June 2024.

Scope of the rules

There are no changes to the types of properties, and taxpayers, that are covered by the interest limitation rules. Until the ability to claim interest deductions is fully phased back in, the rules will continue to apply on the same basis as they have since introduction. This means that land that is used, for example, as a business premises, build-to-rent land, land used for social, emergency, council, or transitional housing, and land held by property developers would continue to be exempt from the rules. The 20-year exemption continues to apply for new build land.

In addition, the interposed entity and other specific anti-avoidance rules continue to apply while the interest limitation rules are being phased out.

The rules, including subpart DH and all consequential provisions, will be substantially repealed from 1 April 2025 once the ability to claim interest deductions is fully phased back in.

Deductions on sale

Where gains on the sale of a disallowed residential property are ultimately subject to tax under the bright-line test or other land sales rules, the interest for which a deduction has been denied can be added to the cost of the property and deducted on sale (subject to loss ring-fencing rules) under current section DH 11. This rule has been retained so that it can apply for future sales of properties that were subject to the interest limitation rules. The rule has been relocated to new section DZ 24.

Example 2: Deductions on sale

Jack and Aria buy a rental property in November 2022 for $700,000. They borrow $400,000 at 4% interest to complete the purchase. In July 2024, they sell the rental property for $710,000. The sale is subject to the bright-line test.

Jack and Aria paid a total of $26,600 interest, that would have been deductible if the interest limitation rules had not applied because the property was used to derive taxable income. Therefore, the interest is potentially deductible in the year of sale.

The property was bought for $700,000 and sold for $710,000 20 months later. In the year of sale, the $710,000 sale price is income under the bright-line test, and the cost of the property may be deducted under section DB 23. Section DH 11(1) provides that the original cost of $700,000 is deemed to be increased by the disallowed interest of $26,600. However, section EL 20 provides that, in the year of sale, the amount of the deduction is limited to income from the sale ($710,000) plus net gains from other taxable land sales. If this is the only property Jack and Aria sold that year, the deduction would therefore be limited to $710,000 (resulting in no net income to be taxed or loss deducted). This would mean only $10,000 of the disallowed interest would be deductible. The excess amount of $16,600 would be carried forward and applied against any taxable land sale gains Jack and Aria have in later years.

Returning the bright-line test to two years

Sections CB 6A, CB 6AB, CB 6AC, CB 6AE, CB 13, CB 14, CB 15B, CB 16A, CB 23B, CZ 26B, CZ 39, CZ 40, DB 23C, DB 29, DH 5, DH 10, DH 11, EL 2, EL 3, EL 20, FB 3A, FC 2, FC 9, FC 9B, FC 9C, FC 9D, FD 1, FD 2, FD 3, FM 15, FO 10, FO 17, GB 52, GB 53, RL 1, YA 1 of the Income Tax Act 2007

Sections 54C, 54D and 54E of the Tax Administration Act 1994

Background

The bright-line test taxes income from the sale of residential land where it is sold within a specified period. "Residential land" is defined as land that has a dwelling on it, land for which the owner has an arrangement to erect a dwelling, or bare land that, because of its area and nature, is capable of having a dwelling erected on it. It does not include land used predominantly as business premises or farmland.

There were previously three different bright-line tests that could apply to the sale of residential land:

- the 10-year bright-line test applied to land acquired on or after 27 March 2021, which was not new build land, that was disposed of within 10 years
- the 5-year new build bright-line test applied to new build land (defined as land that has a self-contained residence or abode that received a code compliance certificate on or after 27 March 2020) acquired on or after 27 March 2021, that was disposed of within five years, and
- the 5-year bright-line test applied to land acquired on or after 29 March 2018 and before 27 March 2021 that was disposed of within five years.

The 10-year bright-line test, 5-year new build bright-line test, and 5-year bright-line have been repealed and replaced by a new 2-year bright-line test from 1 July 2024. The reduction in the bright-line period allows a return to the original policy objective for the bright-line test. This objective is to improve compliance with the other land sale rules in the Income Tax Act 2007 by supplementing the intention test in section CB 6, which makes gains from the sale of land purchased with a purpose or intention of disposal taxable. This ensures that land speculators pay their fair share of tax on gains from property sales.

Given this objective, other policy settings have also returned to those that existed when the original 2-year bright-line test was introduced. In particular, the apportionment rules for the main home exclusion have been removed. This means that the main home exclusion applies if the land has been used predominantly (ie, more than 50% of the land area), for most of the bright-line period (ie, more than 50% of the period), for a dwelling that was the person's main home. The main home exclusion has also been modified so that the period when a dwelling is being constructed on the land is ignored in determining whether the property has been used predominantly as a main home for most of the bright-line period.

Consistent with the objective of simplifying the rules, and with returning to the original intention for the bright-line test, the rollover relief rules have also been extended. The rollover relief rules essentially allow a transfer between specified people to be ignored for the purposes of the bright-line test. The previous rules only applied to a very limited set of transfers. These rules have been extended to apply to all transfers between associated persons, provided they have been associated for at least two years prior to the transfer.

Effective date

The new 2-year bright-line test applies for disposals of residential land where the bright-line end date (generally the date a binding contract to sell is formed) occurs on or after 1 July 2024 (more information on the bright-line end date can be found below).

Detailed analysis

Returning to two years

The previous 10-year bright-line test and 5-year new build bright-line test in section CB 6A, and the 5-year bright-line test in section CZ 39, have been repealed and replaced by a new 2-year bright-line test.

This new test applies if the person's bright-line end date for the land is within two years of the person's bright-line start date.

For standard sales of land, the bright-line start date continues to be the date the transfer of the land is registered to the person under the Land Transfer Act 2017. As was previously the case, the bright-line start date is modified in the following situations:

Type of acquisition	Bright-line start date
Land outside New Zealand	Date on which the instrument is registered under foreign laws
No instrument registered	Date the person acquired an estate or interest in the land
"Off the plans" acquisition	Date the sale and purchase agreement was entered into
Subdivided land	Bright-line start date for the undivided land
Freehold estate converted from a lease with perpetual right of renewal	Date of the grant of the leasehold estate
Joint tenancy converted to a tenancy in common or tenancy in common converted to a joint tenancy	To the extent the person's share in the land is unchanged, the bright-line start date for the land before the conversion
Change of trustee	Bright-line start date for the original trustee

The bright-line end date is the date that a vendor enters into a binding agreement for sale and purchase to dispose of the land, even if some conditions still need to be met (such as obtaining finance, a building report or a Land Information Memorandum). Where land is disposed of with no agreement to dispose of the property, the bright-line end date is the earliest of:

- the date on which a person makes a gift of the land
- the date on which the land is compulsorily acquired under any Act by the Crown, a local authority or a public authority
- if there is a mortgage secured on the land, the date on which the land is disposed of by or for the mortgagee
- the date on which the estate or interest is disposed of (usually the settlement date).

Effective date

The new 2-year bright-line test applies to disposals of residential land where the bright-line end date occurs on or after 1 July 2024. The new 2-year bright-line test applies if the bright-line end date is within two years of the bright-line start date.

Example 1: Application date

Jonathan entered into a sale and purchase agreement to acquire residential land in late 2021 with the transfer being registered on the title on 5 January 2022. He used the land as a rental property. He enters into a sale and purchase agreement to sell the land on 20 June 2024. The current 10-year bright-line test will apply to tax the disposal of the land. The land was acquired after 21 March 2021, and the bright-line end date for the land (being the date the sale and purchase agreement was entered into), was prior to 1 July 2024.

Martin also acquired residential land with a bright-line start date on 5 January 2022, which he used as a rental property. He disposes of the land on 27 July 2024. Because the bright-line end date for the land is after 1 July 2024, the new 2-year bright-line test will apply. But because the bright-line end date is more than two years after the bright-line start date, the disposal will not be taxable under the new 2-year bright-line test.

Main home exclusion

Under the 10-year bright-line test (and the 5-year new build bright-line test), the application of the main home exclusion depended on apportionment. There were two bases of apportionment:

- **Time apportionment:** the main home exclusion only applied for periods when a property was physically used as the owner's main home (subject to a "12-month buffer", where the use can be changed without consequence).
- **Land area apportionment:** apportionment was also required where the land area was used for dual purposes and was not predominantly used as a person's main home.

These apportionment rules have been removed from the bright-line test. Instead, the main home exclusion in section CB 16A now applies if the land has been used predominantly, for most of the bright-line period, for a dwelling that was the person's main home.

The requirement that the land is used predominantly for the person's main home means that most of the area of the land (ie, more than 50%) must have been actually used for the home. The test is based on a person's actual use of the property and not the person's intended use of the property.

The land also must be used for most of the bright-line period as the person's main home. The bright-line period is defined in section YA 1 as the period beginning with the bright-line start date and ending with the bright-line end date for the land. This requires the property to have been used more than 50% of the period as the person's main home. The land does not need to have been used without interruption as their main home. For example, a main home can be rented out for short periods while the owner is on vacation or prior to settlement of the sale of the property, as long as the time is less than the private residential use. The original drafting required that the land be used as a main home for most of the period the person owned the land. However, this requirement was amended at Committee of the Whole House stage to ensure this requirement aligns with the bright-line period, which is more relevant in this context.

This main home exclusion either applies or does not apply; it does not apply on a proportionate basis. As a result, when the property is used less than 50% for the main home of the person, either by land area or time, then the main home exclusion will not apply.

Example 2: Main home exclusion

Kate acquires residential land, with a bright-line start date of 28 March 2023. She occupies the property as her main home for 14 months. She then rents the property out for four months prior to selling it. The bright-line end date for the land is 20 September 2024.

The main home exclusion will apply to Kate so that any gain from the sale of her property will not be subject to tax under the new 2-year bright-line test. This is because Kate occupied the property as her main home for more than 50% of the bright-line period.

Example 3: Land not predominantly used for main home

Aroha owns a residential property with three townhouses located on it. The bright-line start date for the property is 30 January 2024. Aroha uses one flat as her main home. Aroha's flat occupies approximately 40% of the land area. Aroha rents out the other two flats.

Aroha disposes of the property in 2025 with a bright-line end date of 30 November 2025. Because Aroha did not use the property predominantly as her main home (ie, 60% of the land area was occupied by rented townhouses), the main home exclusion will not apply.

The main home exclusion continues to be subject to limitations so that it cannot be applied by a person more than twice in two years, or where a person (or group of persons) has engaged in a regular pattern of acquiring and disposing of residential land.

Construction periods

The new main home exclusion ignores the period during which the person's main home is constructed when determining whether the residential land was used predominantly as the person's main home for most of the bright-line period.

The ordinary meaning of "construction" would apply, which would encompass work to build or erect the main home, including the design phase. In many cases, construction would be considered complete once the code compliance certificate has been issued under the Building Act 2004. However, the exact length of the construction period would depend on the facts and circumstances of each case.

Example 4: Construction period

Raj owns a bare section of residential land with a bright-line start date of 17 May 2023. The section remains vacant for three months while Raj decides what to do with the property. Raj then enters into agreements to have a home constructed on the property. The home occupies most of the section. It takes 13 months for the home to be planned, consented, constructed and a code compliance certificate to be issued. Raj then lives in the property for six months before a change of job requires him to move to another city and he sells the property. The bright-line end date for the property is 1 January 2025.

The 13 months during which the home was being constructed on the property is ignored when considering whether the property was used as Raj's main home for most of the bright-line period. Looking at the remaining period, Raj occupied the property for six months, and the property was vacant for three months. Therefore, the main home exclusion will apply because Raj used the property predominantly as his main home for most of the remaining period.

Rollover relief

Rollover relief under the bright-line test ensures that 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 bright-line start date. When the recipient disposes of the residential land, this cost and bright-line start date determines whether the disposal is taxed under the bright-line test and the amount of the gain that is taxable.

The bright-line test, as introduced in 2015, included limited relief for certain transfers: relationship property, inherited property, and company amalgamations. In 2022, in the context of the 10-year bright-line test, additional rollover relief rules were introduced for a limited number of legal transfers of residential land when there is no underlying change in economic ownership.

From 1 July 2024, new section FD 1 extends the rollover relief rules to apply for:

- all transfers between persons that are associated under any of sections YB 2 to YB 13, provided they have been associated for at least two years prior to the transfer, or
- a transfer to a trustee of a newly established trust if all the beneficiaries are:
  - persons that have been associated with the transferor for at least two years (other than infants that are less than two years old and persons that are associated due to a recent marriage or adoption), or
  - charities.

This recognises that transfers between associated persons do not represent the types of speculative transactions that the new 2-year bright-line test is intended to capture.

The new rollover rule applies to transfers between:

- two companies with 50% or more common ownership (section YB 2)
- a company and a person other than a company if the person has a 25% or more voting interest in the company (section YB 3)
- two relatives within two degrees of blood relationship (section YB 4)
- a person and a trustee of a trust if a relative of the person is a beneficiary of the trust (section YB 5)
- a trustee of a trust and a person who has benefited or is eligible to benefit under the trust (section YB 6)
- a trustee of a trust and a trustee of another trust if the same person is a settlor of both trusts (section YB 7)
- a trustee of a trust and a settlor of the trust (section YB 8)
- a settlor of a trust and a person who has benefited or is eligible to benefit under the trust (section YB 9)
- a trustee of a trust and a person who has a power of appointment or removal of the trustee (section YB 11)
- a partnership and a partner in the partnership (section YB 12)
- a look-through company and a person who has a look-through interest for the look-through company and who is a director or employee for the look-through company (section YB 13).

Where rollover relief applies, the transferor is treated as transferring the land for an amount that equals the cost of the land to the transferor. This means that no tax consequences arise for the transferor if the transfer was made within the relevant bright-line period. The transferee takes on the transferor's bright-line start date and cost base. In addition, any period of time where the land was used as a main home by the transferor will also be attributed to the transferee and can be taken into account when the transferee sells the land.

Example 5: Rollover relief

Jocelyn owns residential land with a bright-line start date of 4 June 2024. The land has a cost of $750,000. In December 2024, Jocelyn gets advice from her lawyer that it would be beneficial to transfer the land to her family trust. She has been a settlor, trustee and beneficiary of the family trust since it was established in 2020.

As a settlor and beneficiary of the family trust, Jocelyn is associated with the family trust. Jocelyn has been associated with the trust for more than two years. Therefore, a transfer of the residential land to the family trust will qualify for rollover relief.

Jocelyn will be treated as having transferred the land to the family trust for its cost ($750,000), such that no tax consequences will arise for her under the bright-line test. The trust will be treated as having acquired the land on 4 June 2024 for $750,000.

To ensure that the new rollover provisions cannot be used to avoid the application of the bright-line test in situations where it was intended the test should apply, there is also a limitation on the number of times rollover relief can be applied to a property. Rollover relief can only be claimed for a property under the associated person provision once in any two-year period.

Example 6: Limitation on rollover relief

Following the transfer from Jocelyn in Example X above, in June 2025 the trustees of the trust resolve to transfer the residential land to Jocelyn's sister, who plans to renovate and sell it. Jocelyn's sister has also been a beneficiary of the trust since it was established.

As a beneficiary of the family trust, Jocelyn's sister is associated with the family trust. Jocelyn's sister has been associated with the trust for more than two years. However, because the land has been transferred in a transaction that was subject to rollover relief within the last two years, the associated person rollover relief provision cannot be used again. Therefore, this transaction would be subject to the bright-line test.

The previous rollover relief rules for family trusts and changes in capacity in section CB 6AB have been repealed. The rollover relief rules for Māori authority trusts and Treaty of Waitangi settlements (currently located in sections CB 6AC and CB 6AE) have been rewritten and relocated to new subpart FD (as sections FD 2 and FD 3) with the new associated person rollover relief rule.

The other current rollover relief rules, including those for relationship property settlements in section FB 3A and for transfers on death in section FC 9, have also been retained.

Consequential changes

As a result of the repeal of five-year bright-line test in sections CZ 39 and CZ 40, consequential changes have been made throughout the Income Tax Act 2007 and the Tax Administration Act 1994 to remove references to those provisions. There have also been consequential amendments to change references to a 10-year bright-line period to a 2-year bright-line period.

Removing building depreciation

Sections DB 65B, EE 31, EE 35, EE 37, EE 48, EE 60, EE 61, EE 64, EE 67, EZ 13, EZ 14, YA 1 and Schedule 39 of the Income Tax Act 2007

These amendments set depreciation rates for all buildings with an estimated useful life of 50 years or more at 0% for the 2024-25 and later income years.

Background

- In 2010, with effect from the 2011–12 income year, the ability to claim depreciation deductions for long-lived buildings was removed. Building depreciation was reintroduced in 2020 for non-residential buildings with effect from the 2020–21 income year. These amendments remove the ability to claim depreciation deductions for non-residential buildings for the 2024–25 and later income years.
- The amendments largely return building depreciation settings to when they were last set at 0%. Buildings remain depreciable property so that any depreciation deductions claimed for periods when depreciation was set at a positive rate are factored into depreciation recovery income calculations. The 0% rate applies to buildings with an estimated useful life of 50 years or more. The estimated useful life of a building is determined on a whole-of-life rather than remaining-life basis. The Commissioner of Inland Revenue (the Commissioner) is unable to set special depreciation rates for these buildings.
- A new transitional provision for commercial fit-out has been made available for buildings owners who previously made use of a transitional provision introduced when building depreciation was last set to 0%. These building owners were previously provided with the ability to separate an amount representing the cost of commercial fit-out from the building's adjusted tax value, under former section DB 65, so the fit-out could continue to be depreciated. New section DB 65 allows these owners to continue to do this. The main change from former provision is that depreciation deductions for fit-out will be calculated using a straight-line rate of 1.5% (rather than the 2% rate used in the former provision).
- The amendments also require that deductions taken under former section DB 65 and new section DB 65B to be included when calculating depreciation recovery income for buildings sold from 1 April 2024.

Detailed analysis

Annual rate for buildings with long estimated useful lives

The Act amends sections EE 31, EE 61, EZ 13, and EZ 14 to provide that buildings with an estimated useful life of 50 years or more would have an annual depreciation rate of 0% for tax purposes. This 0% rate is a statutory rate and would override the rates set by determination.

An item's estimated useful life is the estimated useful life for that type of item, as set out in a determination issued by the Commissioner. When determining an item's estimated useful life, a "whole of life" approach is taken. For example, if a person purchases a secondhand item with an estimated useful life of 50 years, its estimated useful life will still be 50 years, regardless of how old the item actually is.

Buildings are still depreciable property, but with a 0% annual depreciation rate. This means that the other depreciation provisions, such as those providing for depreciation recovery still apply.

No special rates for buildings

Special depreciation rates are granted in situations where a specific item's economic depreciation rate is either faster or slower than the rate set by the Commissioner. Section EE 35(2) has been amended so that special depreciation rates are not able to be set for buildings. The Commissioner would continue to be able to set provisional depreciation rates for buildings with an estimated useful life of less than 50 years.

Definition of a building

Commercial fit-out has been excluded from the definition of "building". This is so that the value of items of commercial fit-out do not form part of the value of a building for the purposes of the tax depreciation rules and allows commercial fit-out to continue to be depreciated.

The amendments repeal the definitions of "residential building" and "non–residential building" contained in section YA 1 as they are no longer necessary.

The Commissioner's view on the "meaning of "building" is set out in Interpretation Statement IS 22/04 *Claiming depreciation on buildings*.

Commercial fit-out

While the depreciation rate for long-life buildings is 0%, the depreciation rate for items used in, but not part of, these buildings has not changed, and they would continue to be depreciated separately from the building itself. This includes commercial fit-out which is expressly excluded from the definition of a building.

When the depreciation rate for commercial buildings was set to 0% in 2010, former section DB 65 was introduced to allow building owners who had not previously recorded commercial fit-out separately, to treat up to 15% of the building's tax book value at the end of the 2010–11 income year as fit-out. Taxpayers who opted to use this rule could then depreciate their fit-out at the previous straight-line building depreciation rate of 2%. This rule was repealed when building depreciation was reinstated in 2020.

The amendments reintroduce this rule as new section DB 65B. The rule is only available for buildings acquired in or before the 2010–11 income year. The rule is not available for buildings acquired after the 2010–11 income year where it has been more common to depreciate fit-out as a separate item. (Taxpayers that acquired a building in the 2020-21 to 2023-24 income years and chose to depreciate fit-out as part of the building, can make an application under section 113 of the Tax Administration Act 1994 requesting that the Commissioner amend their assessments, so that fit-out acquired with the building can be depreciated separately. Taxpayers will need to have market valuations to determine the value to be attributed to the items of fit-out).

New section DB 65B sets the annual deduction at 1.5% of the "starting pool". This is equivalent to the straight-line rate for buildings in the 2023–24 income year, and the straight-line rate that currently is being applied to this fit-out. It is proposed that the "starting pool" value would be the same amount as that used for former section DB 65, being 15% of the building's adjusted tax book value for the 2010–11 income year, less the adjusted tax value as at the end of the 2010–11 income year of all items of commercial fit-out that were acquired after the building was acquired and depreciated separately. For this purpose, "building" is defined in section YA 1 as including commercial fit-out acquired as part of the building that has not been depreciated separately.

New section DB 65B(5) provides a formula for determining the remaining value (similar to the adjusted tax value of a depreciable asset) of the fit-out. This is necessary because proposed new section DB 65B sits outside the ordinary depreciation rules. Where the remaining value allocated to the fit-out is less than 1.5% of the starting pool, section DB 65B(4) clarifies that the deduction for that year would be limited to the remaining value.

The remaining value of the fit-out would be calculated by deducting the following amounts from the starting pool:

- the total amount of all deductions allowed under former section DB 65
- the total amount of all deductions allowed under new section DB 65B, and
- an amount representing the imputed deductions that would have been allowed under section DB 65B if it had existed for the 2020–21 to 2023–24 income years. This is calculated using the formula: (1.5% x starting pool) x 4. This amount is a proxy for the depreciation deductions relating to the fit-out that have been taken as part of depreciating the whole building during this period.

Example 1: Commercial building owned since 2009 – section DB 65 deductions

Company ABC acquired a warehouse on 1 April 1999 for $1,000,000. Items of commercial fit-out within the building were not separately identified and depreciated at the time the building was acquired. Twelve months later a refurbishment of the warehouse was completed. The refurbishment was itemised, and depreciation was applied to the various items of commercial fit-out.

At the end of the 2010–11 income year the adjusted tax book value of the warehouse is $640,000 and the adjusted tax book value of the associated commercial fit-out is $64,000.

The starting pool value is:

(15% × 640,000) – 64,000 = $32,000

Therefore, the annual deduction for the 2024-25 income year is:

$32,000 × 1.5% × 12/12 = $480

The remaining value of the fit-out at the end of the 2024-25 income year is calculated by deducting the following amounts from the starting pool value:

- the deductions made under former section DB 65
- the imputed deductions for the years 2020–21 to 2023–24
- deductions made under new section DB 65B.

Company ABC claimed the annual deduction for each of the years 2011–12 to 2019–20 under former section DB 65 amounting to:

$640 × 9 = $5,760

If section DB 65B had existed from 2020 and Company ABC continued to claim deductions for fit-out at the building rate, its total deductions for the 2020–21 to 2023–24 income years (imputed deductions) would amount to:

$32,000 × 0.015 × 4 = $1,920

Therefore, the remaining value of the fit-out at the end of the 2024–25 income year is:

$32,000 – $5,760 – $1,920 - $480 = $23,840

When the annual deduction is more than the remaining value allocated to the fit-out for a given income year, Company ABC can take a final deduction amounting to the remaining value of the fit-out.

Fit-out deductions to be included when calculating depreciation recovery income

Depreciation recovery income arises if the amount received for the sale of the building (or treated as received when the use changes) is greater than the adjusted tax value of the building. However, the amount of depreciation recovery income cannot be more than the total amount of depreciation loss that was available to the person for the building.

Deductions under former section DB 65 are already taken into account in determining the adjusted tax value of a building under section EE 60(1). This section has been amended to also take into account deductions taken under new section DB 65B.

In addition, the amendments require deductions taken under former section DB 65 and new section DB 65B to be included as part of the building's depreciation loss. This change would apply to all buildings sold in or after the 2024–25 income year.

Example 2: Depreciation recovery income

Company ABC sells the building for $1,010,000 million on 1 April 2025. The adjusted tax value of the building when it is sold is:

> 2010–11 adjusted tax value – building depreciation claimed for the 2020–21 to 2023–24 income years – s DB 65 deductions – s DB 65B deductions = $640,000 – $5,760 – $60,000 – $480 = $573,760

The amount of depreciation recovery income is the lesser of:

- $436,240 being the difference between the sale price and the adjusted tax value when the building is sold, and
- $426,240 being the depreciation deductions on the building ($420,000) plus the deductions taken under section DB 65 ($5,760) and section DB 65B ($480).

The amount of depreciation recovery income is therefore $426,240.

Grandparented structures

Grandparented structures are specific types of buildings that, prior to an Interpretation Statement issued by Inland Revenue in 2010 (IS 10/02: *Meaning of "building" in the depreciation provisions*), were considered to be structures not buildings. In 2010, special rules were enacted to allow grandparented structures acquired on or before 30 July 2009 to continue to be depreciated as structures rather than buildings.

These rules were inadvertently repealed as part of the reintroduction of building depreciation in 2020. The amendments reinstate these rules with retrospective effect from 1 April 2020. This includes:

- reintroducing the definition of "grandparented structure" in section YA 1
- excluding "grandparented structures" from the definition of "building", and
- amending section EE 37(3) so that improvements to grandparented structures made after 30 July 2009 are treated as separate depreciable property.

Special excluded depreciable property

"Excluded depreciable property" is defined in section EE 64. This is property for which an economic rate cannot be set. For these items the person must use the historic rates of depreciation. The annual rate for excluded depreciable property is the rate published by the Commissioner for the 1992–93 income year. The Commissioner has no power to change the rate.

To ensure that buildings that are excluded depreciable property are depreciated at the 0% rate and not the applicable 1992–93 rate, the definition of "excluded depreciable property" in section EE 64 has been amended to exclude "special excluded depreciable property", and the definition of "special excluded depreciable property" has been reinstated in section EE 67. "Special excluded depreciable property" has been defined as all buildings that are not items listed in schedule 39. Schedule 39, which lists buildings that would not be expected to be long-life buildings and should not be subject to the 0% rate, has also been reintroduced.

OECD Pillar 2: Global anti-base erosion (GloBE) tax rules

Overview

The Global Anti-Base Erosion (GloBE) rules – sometimes referred to as the 'global minimum tax' – are designed so that multinational enterprises (MNEs) with annual revenues above €750 million pay a minimum 15% effective tax rate on their mobile income in every country where that income is earned.

The GloBE rules are intended to apply to every in-scope MNE in the world, no matter where it has its headquarters, operations or sales. The design of the rules means this intention can be achieved even if many, or indeed most, countries do not adopt the rules, provided a critical mass of countries implement them (that is, enough adopt the rules that domestic MNEs cannot escape the tax by earning income only in countries that do not adopt them). The rules do this by allowing countries that adopt them to tax mobile income arising in other countries if that income is not subject to a 15% effective tax rate. This creates an incentive for countries to adopt the rules or increase their taxes on mobile income.

The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act (the Amendment Act) gives legislative effect in New Zealand to the GloBE rules through amendments to the Income Tax Act 2007 (the ITA) and Tax Administration Act 1994 (TAA). The term used in the ITA to describe New Zealand's GloBE rules is the 'applied global anti-base erosion rules' (applied GloBE rules), and the term used for tax imposed under the applied GloBE rules is 'multinational top-up tax'.

The applied GloBE rules consist of an Income Inclusion Rule (IIR) – including a domestic IIR (DIIR) – and an Undertaxed Profits Rule (UTPR).

The IIR and UTPR components of the applied GloBE rules apply for fiscal years beginning on or after 1 January 2025. The DIIR component of the rules applies for fiscal years beginning on or after 1 January 2026.

Abbreviations

BEPS Base Erosion and Profit Shifting

CE Constituent Entity

DIIR Domestic Income Inclusion Rule

DTA Deferred tax asset

DTL Deferred tax liability

ETR Effective Tax Rate

GIR GloBE Information Return

GloBE Global Anti-Base Erosion

IF Inclusive Framework

IFRS International Financial Reporting Standards

IIR Income Inclusion Rule

IPE Intermediate Parent Entity

JV Joint Venture

LTCE Low-Taxed Constituent Entity

MNE Multinational Enterprise

OECD Organisation for Economic Co-operation and Development

PE Permanent Establishment

POPE Partially Owned Parent Entity

QDMTT Qualified Domestic Minimum Top-up Tax

SBIE Substance-Based Income Exclusion

UPE Ultimate Parent Entity

UTPR Undertaxed Profits Rule

Glossary

Applied GloBE rules: The GloBE rules as introduced in New Zealand.

Constituent Entity: a member of an in-scope MNE group.

GloBE rules: Two interlocking rules (IIR and UTPR) that together form the primary mechanism of Pillar Two.

Model Rules: A 10-chapter document setting out model legislation for governments to base domestic legislation on to enact the GloBE rules.

Multinational Top-Up Tax: Top-up tax imposed under the Applied GloBE rules.

Pillar Two: One half of a 2-pillar solution formulated by the OECD-sponsored Inclusive Framework to address tax challenges arising from the digitalisation of the economy.

Applied GloBE Rules

Sections 6, 7, 21, 44, 48, 51 to 54, 59(4), (5), (11) and (12), 63 and 77, and schedule 1

Summary of changes

The applied GloBE rules give legislative effect in New Zealand to the OECD Pillar Two GloBE rules and deal with consequential amendments as they relate to the interaction between the GloBE rules and New Zealand tax law.

Whether an MNE is required to file and (potentially) pay multinational top-up tax is determined by applying the OECD published Model Rules as modified by schedule 25B to the Income Tax Act 2007 (ITA), the Commentary, and the Agreed Administrative Guidance,[1] which define what type of MNEs are in scope and what are the operative rules. The OECD, through the Inclusive Framework, will continue to publish Agreed Administrative Guidance, which will become part of New Zealand law.

The applied GloBE rules have implications for both MNEs headquartered inside New Zealand and those outside New Zealand.

For an MNE **headquartered *in* New Zealand**, or with a constituent entity (including a branch) located in New Zealand, the applied GloBE rules require the MNE to:

- **Determine whether it is in scope for the GloBE rules**, i.e. if it has an international presence and over €750 million in consolidated revenues in any two of the preceding four years (see section HP 1(1) of the ITA and Chapter 1 of the Model Rules).
- **Determine whether any de minimis or safe harbour applies** in each country where it operates (see Chapters 5 and 8 of the Model Rules and the OECD document "Safe Harbours and Penalty Relief" for the transitional safe harbours that apply to fiscal years ending on or before 30 June 2028).
- **Calculate its effective tax rate (ETR)** in each country where it operates and a safe harbour does not apply (see Chapters 3 to 7 and 9 of the Model Rules).
- **Calculate mobile income** by calculating the GloBE income in each country and reducing it by the SBIE. The SBIE is a carve-out based on tangible assets and payroll costs in a country (see Chapter 5 of the Model Rules).
- **Calculate the top-up tax** if the ETR in a country is less than 15%, the top-up tax will bring the ETR on the MNE's mobile income in that country up to 15% (see Chapter 5 of the Model Rules).
- **Pay multinational top-up tax to Inland Revenue for:**
  - Foreign operations under the **Income Inclusion Rule (IIR)**,[2] which applies when a New Zealand MNE earns the undertaxed income in another country (see Chapter 2 of the Model Rules).
  - New Zealand operations under the **Domestic Income Inclusion Rule (DIIR)**, which applies when a New Zealand-headquartered MNE has undertaxed mobile income in New Zealand (see proposed schedule 25B of the ITA and Chapter 2 of the Model Rules).

MNEs headquartered *outside* New Zealand could also be subject to a multinational top-up tax liability if they have an

[1] Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) - OECD

[2] The IIR applies on a top-down basis, giving the ultimate parent entity country, or an intermediate parent entity country, the right to collect GloBE top-up tax for underlying foreign operations, unless the tax is collected in the foreign country under a Qualified Domestic Minimum Top-Up Tax.

intermediate parent located in New Zealand or a liability under the **Undertaxed Profits Rule (UTPR)**[3] (see proposed schedule 25B of the ITA and Chapter 2 of the Model Rules).

Various consequential amendments have been made to the ITA to deal with how the GloBE rules interact with New Zealand tax law:

- the applied GloBE rules apply notwithstanding the terms of a tax treaty, unless those terms expressly refer to the GloBE rules (see section BH 1(4C))
- imputation credits are not available for top-up tax paid under the IIR and UTPR but are available for tax paid under the DIIR (see sections OB 7BB and OP 11BA), and
- foreign tax credits are available under subpart LJ and LK for top-up taxes paid under another country's QDMTT or DIIR but not for top-up taxes paid under another country's IIR or UTPR (see section LJ 3).

Background

The GloBE rules were released in December 2021 as the Model Rules and provide a template that jurisdictions can translate into domestic law.

The release of the Model Rules was followed by the OECD's release of:

- detailed commentary (the Commentary) to the rules in March 2022;
- three further tranches of Agreed Administrative Guidance in February, July and December 2023, as well as a document on Safe Harbours and Penalty Relief in December 2022. In some instances, the Commentary and Agreed Administrative Guidance modify provisions in the Model Rules

If a country adopts the GloBE rules, it must adopt the Model Rules, Commentary and Agreed Administrative Guidance. Where a country's legislation departs from the Model Rules, there is a risk its GloBE rules will not be "qualifying", and other participating jurisdictions will continue to apply GloBE top-up tax to the country's in-scope MNEs under the UTPR. To address this risk in New Zealand, the GloBE rules have been incorporated into New Zealand legislation by reference to the Model Rules, Commentary and Agreed Administrative Guidance. In the limited areas where the rules need to be adapted, for example, to reflect concepts in New Zealand law like imputation credits and foreign tax credits, the adaptations respect intended outcomes.

Key features

The key features of the applied GloBE rules include:

- Incorporating the Model Rules, Commentary and Agreed Administrative Guidance into the ITA. This is done by reference to the rules, rather than by repeating or translating them in New Zealand law.
- Changes to the ITA necessary to support the interpretation and implementation of the GloBE rules in New Zealand.
- Consequential changes to the ITA necessary to ensure the applied GloBE rules are "qualifying".
- A regulation-making power enabling the Governor-General to make Orders in Council providing for the non-application of changes to the Commentary or Agreed Administrative Guidance (including future tranches of agreed administrative guidance).
- Provisions in the TA dealing with filing returns and penalties.

Effective date

The IIR and UTPR apply for fiscal years beginning on or after 1 January 2025, and the DIIR applies for fiscal years beginning on or after 1 January 2026.

The DIIR is effective a year later than the IIR and UTPR because of the Transitional UTPR Safe Harbour[4] by virtue of which no New Zealand MNE will be subject to another country's UTPR on New Zealand source mobile income until the fiscal year beginning 1 January 2026 at the earliest.

[3] The UTPR is a back-up rule that applies when no parent is subject to the IIR. It allocates top-up tax to countries in proportion to the group's payroll costs and tangible asset values in each country that adopts the GloBE rules. This ensures that if the country where an MNE has its headquarters does not implement GloBE rules, the MNE will still have to pay top-up tax.

[4] See July 2023 Administrative Guidance for more information

Detailed analysis

The applied GloBE rules affect:

- New Zealand-headquartered MNEs and their CEs located in New Zealand (including branches) with over €750 million in global consolidated revenues in at least two of the four immediately preceding fiscal years, and
- New Zealand located CEs of foreign-headquartered MNEs above the €750 million threshold that have New Zealand operations or a New Zealand intermediate parent entity if a top-up tax is due to New Zealand under the UTPR or IIR in accordance with the GloBE rules.

Multinational top-up tax is an ancillary tax

Section BF 1(bb) of the ITA provides that multinational top-up tax is an "ancillary tax", not income tax. As such, a separate administrative regime has been introduced to deal with multinational top-up tax (see Item: "Amendments to the Tax Administration Act 1994" below for further detail). This also means it does not fall in scope of the provisional tax regime.

Multinational top-up tax overrides our double tax agreements

The OECD has stated that the IIR and UTPR are both compatible with OECD model-based tax treaties, such as New Zealand's. To avoid any uncertainty on this point, section BH 1(4C) provides that the GloBE rules adopted by New Zealand apply notwithstanding the terms of a tax treaty, unless those terms expressly refer to the GloBE rules.

Multinational top-up tax is payable by in-scope MNEs

Section HP 1 is the charging provision for the multinational top-up tax. The tax is imposed on CEs of in-scope MNE groups. In relation to the IIR, the tax is generally imposed on the MNE group's UPE. However, all members of the group are jointly and severally liable for the tax. In relation to the UTPR, the liability is placed on all members of the MNE group.

Section HP 1(4) provides that a CE (entity B) that leaves an MNE group is relieved from liability for multinational top-up tax for the fiscal year if:

- The assessment of another entity in the group (entity A) is made after entity B leaves; and
- The amount assessed is more than an earlier assessment of entity A's top-up tax liability for the fiscal year; and
- The Commissioner considers that relieving entity B from liability will not prejudice the recovery of the top-up tax payable for the year; and
- The Commissioner notifies both entity A and entity B that the requirement of c) is met.

This section aims to remove the burden of a GloBE tax liability from entities which no longer belong to the MNE group, without compromising Inland Revenue's ability to collect the appropriate amount of top-up tax from the MNE.

Section HP 2 provides that top-up tax is payable by 20 months after the end of the first fiscal year in which the MNE becomes in-scope of the New Zealand rules. Thereafter, top-up tax is payable by 16 months after the end of an MNE's fiscal year.

The applied GloBE rules

Sections HP 3 and HP 5 provide for the application of the GloBE rules in New Zealand (i.e., the applied GloBE rules) by reference to the OECD Model Rules, Commentary and Agreed Administrative Guidance. For New Zealand law purposes, the GloBE rules are modified by schedule 25B. The applied GloBE rules apply for a fiscal year, and in accordance with the commentary and guidance on the interpretation or administration of the GloBE rules published by the OECD before the start of the fiscal year.

Consequently, where there is an inconsistency between the Model Rules and the Commentary or Agreed Administrative Guidance, it is the Commentary and Agreed Administrative Guidance that take precedence. For the avoidance of doubt, section HP 3(4) makes this explicit.

For example, the Model Rules provide that Article 7.4.1 only applies to investment entities. The Commentary provides that Article 7.4.1 applies to investment entities and insurance investment entities. The outcome is that Article 7.4.1 applies to investment entities and insurance investment entities, and this outcome is ensured by section HP 3(4).

Section 226G of the Tax Administration Act 1994 provides that the Governor-General, by Order in Council made on the recommendation of the Minister of Revenue, shall make regulations providing for the non-application of a change to the Commentary or the Agreed Administrative Guidance (including future tranches).

The Model Rules

This Tax Information Bulletin item provides an overview of the Model Rules and how they will be implemented in New Zealand. The Model Rules, Commentary and Agreed Administrative Guidance are available at the OECD website.[5]

Chapter 1: Scope

This Chapter of the Model Rules discusses which types of entities are in scope for the Rules. The GloBE rules apply to MNEs that have consolidated annual revenues of at least €750 million in at least two of the last four fiscal years. The fiscal year is the period covered by the MNE group's consolidated financial statements.

Special rules exist to address situations when:

- an MNE does not prepare consolidated financial statements
- an MNE does not have four years of consolidated financial statements
- one of the four preceding fiscal years is for a period other than 12 months, or
- an MNE has undergone a merger or demerger.

MNE groups

The UPE of an MNE group is the entity that owns – directly or indirectly – a controlling interest in any other entity but is not controlled – directly or indirectly – by another entity. The UPE is important because the IIR is applied at the UPE level in the first instance (if the UPE's jurisdiction has a qualified IIR), and the UPE's consolidated financial statements determine what entities are within the group.

An 'MNE group' is a group with at least one entity or permanent establishment (PE) that is not located in the jurisdiction of the UPE. Regardless of size, a group that is located entirely within one jurisdiction with no offshore subsidiaries or PEs is therefore outside the scope of the GloBE rules (though some countries have chosen to subject them to the rules). A member of an MNE group is referred to as a CE of the group.

Excluded entities

The following entities are excluded from the GloBE rules:

- Governmental entities.
- International organisations.
- Non-profit organisations.
- Pension funds.
- Investment funds that are UPEs.
- Real estate investment vehicles that are UPEs.

An entity owned by an excluded entity can also qualify as an excluded entity if it meets certain criteria relating to its ownership, assets and income. Exclusion does not affect the inclusion of an entity's revenue for purposes of the revenue threshold.

Chapters 2-5: Key operative rules

The GloBE rules apply a minimum tax on excess profits in each jurisdiction that are taxed below the minimum 15% rate. The key operative rules cover the steps required to determine whether top-up tax is payable and where this must be paid.

The first step is to determine the profit in a jurisdiction. This is calculated by simply adding together the GloBE income and GloBE losses of all the CEs in the jurisdiction.

If the result is positive, the ETR must be calculated for that jurisdiction. The only exceptions to this are when the jurisdiction qualifies for a GloBE safe harbour (provided for in Chapter 8 of the Model Rules, and specified in guidance published in December 2022 and July 2023) or the de minimis exclusion (in Article 5.5 of the Model Rules). The latter will be when the average GloBE revenue (that is, gross income before expenses) and GloBE income (that is, net income) in the jurisdiction for the current and two prior years are below €10 million and €1 million respectively.

[5] https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm

The Effective Tax Rate

This section explains the different components of the ETR calculation in Chapters 3 to 5 of the Model Rules. It sets out the main features of the rules and notes special rules that apply in particular circumstances.

The ETR for a jurisdiction is the total tax divided by the total profit in that jurisdiction. There are detailed rules prescribing what taxes can be included in this calculation, which are referred to as 'covered taxes', and how to calculate the profit in the jurisdiction, which is referred to as 'GloBE income'.

In-scope MNEs must calculate their ETRs for each jurisdiction annually. Calculating the ETR for a jurisdiction broadly involves four steps:

- First, the MNE must identify its CEs located in the jurisdiction. The Model Rules set out how to work out which jurisdiction an entity is located in.
- Second, the MNE must work out the 'GloBE income' or profit of each CE in the jurisdiction. This starts with an entity's accounting profit. Adjustments are then made to the accounting profit to reflect the agreed GloBE base. Some adjustments are mandatory, while others are elective. There are also rules for allocating profit between jurisdictions.
- Third, the MNE must determine the covered taxes of the CEs in the jurisdiction. This requires consideration of the types of taxes that count as 'covered taxes' and which year those taxes are allocated to. The starting point for calculating the amount of covered taxes is the accounting current tax expense. Adjustments are then made to the current tax expense, including an adjustment based on deferred tax, to address timing differences between accounting and tax. There are also rules for allocating covered taxes between jurisdictions.
- Lastly, the ETR is derived by aggregating covered taxes and GloBE income and losses of the constituent entities in a jurisdiction. The total taxes are divided by the total net GloBE income to get the ETR for the jurisdiction.

These steps are discussed in more detail below.

Step 1: Identify the constituent entities in a jurisdiction

The GloBE rules calculate the ETR for a jurisdiction as a whole. This ensures that an MNE with a high ETR in a jurisdiction does not become liable for a top-up tax because it has an LTCE there. The GloBE rules allow blending of income with different tax rates within a jurisdiction.

Chapter 10 of the Model Rules determines where an entity is located. Most CEs are located in the jurisdiction where they are tax resident. Where a CE is not tax resident in a jurisdiction, it is located in the jurisdiction where it was created, for example, where it was incorporated.

Specific rules locate tax transparent entities, like partnerships and PEs for the ETR calculations and charging provisions.

Step 2: Calculate the GloBE income for each CE

The starting point is the entity's financial accounting profit. This is then subject to adjustments to reconcile the most important and common differences between accounting and tax definitions of profit. These adjustments are intended to bring the GloBE base more into line with a measure of taxable profit so that the ETR provides a reasonable measure of the level of effective taxation in that jurisdiction.

There are also rules to allocate certain types of income between jurisdictions.

Accounting profit

The calculation of a CE's GloBE income starts from its financial accounting income. The general rule is that this income should be calculated according to the accounting standard of its UPE and therefore reflects the amount that feeds into the UPE's consolidated financial statements before consolidation adjustments.

This is subject to a requirement that the UPE prepares its accounts under an acceptable accounting standard, or that it adjusts any material differences in its accounting treatment of an item that could result in the MNE obtaining an unfair competitive advantage when compared with the IFRS treatment. NZ IFRS is an acceptable accounting standard for the GloBE rules.

The Model Rules recognise there are situations when it may not be practicable to accurately calculate the entity's accounting profit under the UPE's accounting standard.

Adjustments to accounting profit

Once the MNE has computed the financial accounting income of the constituent entity, the next step is to make the mandatory adjustments.

These adjustments generally reflect significant differences between accounting and tax measures of profit that do not reverse out over time. Separate rules address timing differences in the recognition of income and expenses for accounting and tax, which are covered further below.

Certain elective adjustments are also available to the MNE group. These include an election to offset a net realised gain on local tangible assets against a net realised loss on local tangible assets in the four preceding years and spread any remaining net realised gain equally over the current year and four preceding years.

The election to spread back a net realised gain on local tangible assets should be useful in New Zealand, where capital gains are often not taxed (though gains on sales of shares in companies more than 10 percent owned are already excluded from the GloBE base). The election will allow untaxed gains to be matched against prior year untaxed losses. It will also allow tax imposed at greater than the 15% rate in the spread-back years to reduce or eliminate any GloBE liability that would otherwise arise from the untaxed gain.

Special rule for incentive tax credits

A special rule prescribes the treatment of government incentives delivered as credits via the tax system. This rule is intended to apply to incentives to engage in certain activities, such as research and development.

When an incentive tax credit is designed so that it must be paid in cash or cash equivalents within four years, it is treated as GloBE income for the GloBE rules instead of as a reduction to covered taxes.

New Zealand's research and development tax credit is designed so that it must be wholly or partially refunded within four years. The portion that must be refunded within four years is the amount calculated under section LA 5(4B)(a) of the ITA and referred to as the 'maximum limit of the person's refundability cap' for the year in which the associated research and development expenditure is incurred. Officials' view is that under the Model Rules this amount can be treated as GloBE income and any remaining credit must be treated as a reduction to covered taxes (even if it gives rise to a tax reduction or other benefit within the four-year period).

The mandatory adjustments and remaining elective adjustments are described in Chapter 3 of the Model Rules.

Special rules for acquisitions and disposals

Articles 6.2 and 6.3 of the Model Rules provide special rules for calculating GloBE income (and covered taxes) when a CE joins or leaves a group and when there are transfers of assets or liabilities.

Special rules for Ultimate Parent Entities that are subject to a tax neutrality regime

There are also special rules in Chapter 7 of the Model Rules for calculating the GloBE income of a UPE that is subject to a tax neutrality regime, that is, a regime that achieves a single level of taxation on business income.

Article 7.2 applies to a UPE that is subject to a deductible distribution tax regime. This Article will be relevant to a New Zealand co-operative UPE. It allows such a UPE to reduce its GloBE income (but not below zero) by the amount that is distributed as a deductible dividend within 12 months of the end of a fiscal year if the dividend recipient is:

- subject to tax on the dividend at a nominal rate that equals or exceeds 15% within 12 months of the end of the group's fiscal year
- a natural person who is a tax resident in the UPE country, or has a fixed establishment in the UPE country, and holds an ownership interest in the UPE of 5 percent or less, or
- resident in the UPE country and is a governmental entity, international organisation, non-profit organisation or pension fund that is not a pension services entity.

Allocating income between jurisdictions

The GloBE rules are designed to ensure that MNEs pay tax at a rate of 15% on their profits in each jurisdiction (after taking into account a substance-based carve-out). This means tax imposed at a high rate on profits in one jurisdiction cannot be used to credit low-taxed profits in another jurisdiction. Consequently, allocating profits appropriately between jurisdictions is integral to the GloBE rules.

The Model Rules achieve this through:

- valuing cross-border intragroup transactions in accordance with the arm's length principle, when this is different to the transfer price used for accounting
- requiring financial accounting profits to be allocated between a PE and its head office based on the attribution of income and expenses to the PE for tax purposes, and
- allocating the income of a tax transparent CE (when not attributable to a PE) to its owners to the extent the owners also treat the entity as tax transparent (that is, tax the income) or are not members of the MNE group.

Special allocation rules apply to a PE of an entity subject to a worldwide tax system, such as New Zealand's. A GloBE Loss of the PE is treated as an expense of its head office (and not of the PE) for GloBE purposes to the extent that it is treated as an expense of the head office for local tax purposes, provided it is not set off against income that is subject to tax in both the head office country and PE country. GloBE Income subsequently arising in the PE is treated as GloBE Income of the head office up to the amount of the GloBE Loss that previously was treated as an expense of the head office. This rule allows better co-ordination of a domestic worldwide tax system with the jurisdictional approach adopted by the GloBE rules.

Example 1: Allocating GloBE Loss of a PE

A PE CE located in Jurisdiction B has a GloBE Loss of $100 for fiscal year 1. Its head office, located in Jurisdiction A, has GloBE income of $100 for the fiscal year before taking into account any allocations from the PE.

The PE's GloBE Loss is included as an expense of the head office for local tax purposes. As a result, the loss is allocated to Jurisdiction A for GloBE purposes, reducing the head office's GloBE Income for fiscal year 1 to nil. The GloBE loss in Jurisdiction B is also reduced to nil.

In fiscal year 2, the PE has GloBE income of $150 and its head office has GloBE income of $100 before cross-border allocations. The PE's GloBE Income is allocated to the head office up to the amount of the $100 GloBE Loss that previously was allocated to the head office. After this allocation, the head office has GloBE income of $200 in Jurisdiction A and the PE has GloBE income of $50 in Jurisdiction B.

Step 3: Determine the taxes paid by constituent entities

Covered taxes

Covered taxes are generally limited to taxes on net income in the Model Rules. This limitation reflects that the GloBE rules are intended to ensure a minimum level of tax is paid on the profit in each jurisdiction. It follows taxes should only be included in covered taxes when they are levied on a measure of income.

This means corporate income taxes will generally be covered taxes. However, when an income tax is refundable or creditable to the beneficial owner of a dividend distributed by a constituent entity (for example, by way of imputation), it will only qualify as a covered tax if the credit is provided:

- under a foreign tax credit regime by a jurisdiction other than the jurisdiction that imposed the income tax
- to a beneficial owner of the dividend that is subject to tax on the dividend, at a rate that equals or exceeds the minimum rate, in the jurisdiction that imposed the corporate income tax
- to an individual beneficial owner of the dividend who is tax resident in the jurisdiction that imposed the income tax and who is subject to tax on the dividend, or
- to a governmental entity, international organisation, resident non-profit organisation, resident pension fund, resident investment entity that is not a group entity, or a resident life insurance company to the extent the dividends are received in connection with a pension fund business and subject to tax in a similar manner as a dividend received by a pension fund.

The Model Rules refer to an income tax that is charged under a qualifying imputation system as a Qualified Imputation Tax. New Zealand's corporate income tax meets the definition of a Qualified Imputation Tax and is therefore a covered tax. Australia's corporate income tax is similarly a covered tax.

Withholding taxes and other taxes that are imposed in lieu of a corporate income tax are also covered taxes. Taxes on payroll or sales will not be counted. New Zealand's goods and services tax is not a covered tax, as it is not charged on a measure of income.

Calculating covered taxes for the relevant year

Having established which taxes qualify, the next step is to determine the amount of those taxes in the relevant year. The Model Rules look first to the current tax expense recorded in the financial statements to determine the amount of covered taxes that have been paid.

This amount is adjusted – for example, to exclude any tax paid in respect of income excluded from GloBE income and to exclude current tax accrued in relation to an uncertain tax position and to add any covered taxes that have been treated as an "above the line" expense in the accounts.

An adjustment is also required when an amount of covered tax is refunded or credited to a group entity and the refund or credit is not treated as a reduction to the current tax expense in the financial accounts. An example of this in a New Zealand context is a tax credit for a supplementary dividend, which is typically accounted for directly in equity instead of as a reduction to the current tax expense. An adjustment is required for GloBE purposes to reduce the current tax expense by the amount of this credit.

The remaining adjustments are described in Chapter 4 of the Model Rules.

Refundable tax credits

As discussed above, the treatment of incentive tax credits in the Model Rules depends on their refundability. Tax credits designed in such a way that they must be refunded within four years are referred to as Qualified Refundable Tax Credits and are treated as GloBE income. Refundable tax credits that do not satisfy this refundability requirement are referred to as Non-Qualified Refundable Tax Credits and are treated as a reduction to covered taxes.

This means an adjustment must be made to increase covered taxes when a Qualified Refundable Tax Credit is accounted for as a tax credit or to reduce covered taxes when a Non-Qualified Refundable Tax Credit is accounted for as income.

Timing differences

The Model Rules also include rules that apply when the period in which profits are taxed is different to the period in which they are recognised in GloBE income. This difference typically arises from differences between when income and expenses are recognised for accounting and tax purposes. For example, capital assets are often depreciated at different rates for financial reporting as compared to tax purposes.

Without rules to address these differences, an MNE could suffer a top-up tax because it appears to be low-taxed, when in fact the income has been taxed in a later period from the one in which it has been recognised for the ETR calculation. While this deferral can be of significant benefit if it is long term, the Model Rules have been designed generally (but not always) so that timing benefits do not give rise to the imposition of tax

The Model Rules address this issue using an approach based on deferred tax accounting. Deferred tax accounting is an accounting concept that seeks to match taxes to the period in which the income or expenses are recognised for accounting purposes. It does this by shifting the tax expense from the year the tax is paid to the years in which the income or expenditure is recognised in the financial statements.

In the Model Rules, this means covered taxes are adjusted by the CE's deferred tax income or expense in the period.

Example 2: Timing differences

A CE accrues a current tax expense of $10 for fiscal year 1 and a deferred tax expense of $5 due to a temporary difference between accounting and tax. The deferred tax expense of $5 is added to the current tax expense of $10 to give $15 of covered taxes for Fiscal Year 1.

The temporary difference reverses in Fiscal Year 2, resulting in an increase to the current expense for that year of $5 and a decrease to the deferred tax expense of $5, that is, the deferred tax liability of $5 unwinds. The decrease in the deferred tax expense in Fiscal Year 2 offsets the increase in the current tax expense. So, if there was a current tax expense for Fiscal Year 2 of $10, the decrease in the deferred tax expense in that year would be deducted from this to give covered taxes of $5.

Recognising the deferred tax expense in each year effectively brings forward the $5 of tax relating to the temporary difference to the year when the deferred tax liability is first recognised (rather than the year when the tax is actually paid).

Some modifications to an entity's deferred tax accounting used in its financial statements ensure the outcomes are appropriate for the GloBE rules.

Revaluing deferred taxes

The Model Rules require the deferred tax expense for financial reporting purposes to be valued at the lower of the minimum rate and the applicable tax rate. This ensures there is no top-up for the timing difference without enabling additional upfront credits for deferred tax liabilities to shelter exempt income in that year.

Example 3: Revaluing deferred taxes

A CE has a temporary difference between accounting and tax of $100 for the Fiscal Year due to immediately expensing an asset under the tax rules where it is resident. The local tax rate is 28%. Therefore, the CE recognises a deferred tax liability of $28 for accounting purposes, which increases the deferred tax expense by $28.

This deferred tax expense must be recast to the minimum rate for GloBE purposes ($100 temporary difference x 15% = $15), which means covered taxes can only be increased by $15 due to deferred tax. This is sufficient to shelter the $100 of additional accounting income from top up tax, without allowing any other income to be sheltered.

The Model Rules also exclude certain types of deferred tax movements. These include deferred tax movements for income or expenses excluded from GloBE income and deferred tax from uncertain tax positions.

The recapture

A recapture rule applies for deferred tax liabilities (DTLs) which have not been unwound within five years of the Fiscal Year in which the DTL was originally recognised.

Under this rule, the MNE group is required to recompute its ETR in the year the DTL was originally recognised. This ETR is recalculated without the DTL. If the revised ETR results in a top-up, this top-up is added to the top-up in the current year.

Many types of timing difference are exempt from the recapture rule. These include those for:

- Accelerated depreciation on tangible assets.
- Fair value accounting.
- Research and development expenses.

These timing differences do not need to be recaptured even if it takes longer than five years for the DTL to unwind.

Losses

The timing difference rules also address tax losses. These rules are also based on deferred tax accounting, which means covered taxes are reduced (potentially to a negative number) in the year the local tax loss arises and a deferred tax asset (DTA) is recognised. Covered taxes are then increased in the year the loss is used and the DTA unwinds. This is done by taking account of the deferred tax expense accrued in the financial accounts, which could be a positive or negative figure. Where the local tax rate is above 15%, this deferred tax must be revalued on the basis of a 15% rate. Where the local rate is below 15%, this deferred tax may be revalued on the basis of a 15% rate if the loss DTA is attributable to a GloBE Loss.

Example 4: Losses

A constituent entity has a tax loss and GloBE loss of $100 in Fiscal Year 1. The local tax rate is 15% so the constituent entity recognises a loss DTA in this year of $15 ($100 tax loss x 15%).

In Fiscal Year 2, the constituent entity earns $100 of net income for local tax purposes (before tax losses brought forward) and $100 of GloBE income. For accounting purposes, there is no current tax expense in Fiscal Year 2 because the tax loss brought forward of $100 reduces taxable income to zero, but a deferred tax expense of $15 is recognised because the loss DTA is written off when the tax loss is used. The deferred tax expense increases covered taxes by $15 in Fiscal Year 2. As a result, there would be no top-up tax in Fiscal Year 2 (or Fiscal Year 1).

As the DTA is based on the tax loss available under the tax rules of the local jurisdiction, further rules ensure the appropriate relief is given.

For example, the DTA could be based on an economic loss that would also be recognised in the GloBE income or loss. These losses are recognised in the Model Rules to prevent top-up taxes being applied in a later (profit) year when the MNE has not made an economic profit over time. The loss could also be created by a timing difference between the accounts and the local tax system, in which case the accounting will recognise both a DTA and a DTL.

However, the local tax loss could also be caused by certain features of that jurisdiction's tax rules – for instance, if the jurisdiction exempted certain types of income from tax or provided tax deductions in excess of the cost incurred ('super deductions').

These local tax concessions are not intended to be recognised in the GloBE base and should ordinarily reduce the ETR when there is net GloBE income in the jurisdiction. However, without further rules, they would be incorporated in the GloBE base if they produced a local tax loss and the related DTA could be used for GloBE purposes.

Consequently, a special rule identifies the amount of loss relief that would have been available in the jurisdiction if the DTA was based on the GloBE base rather than the local tax rules. Any excess losses are deemed to be losses arising from permanent differences and give rise to an additional top-up for that year under Article 4.1.5 of the Model Rules.

This ensures that MNEs receive appropriate relief in the GloBE rules for economic losses and for those created through timing differences, while preventing excessive relief when the loss arises from a permanent difference.

Example 5: Losses and permanent differences

An MNE has one CE in a jurisdiction that has a tax rate of 15%. This CE has a GloBE loss for the fiscal year of $100 but a local tax loss of $200 because $100 of income earned is exempt for local tax purposes. The CE recognises a DTA of $30 ($200 tax loss x 15% tax rate) in the fiscal year.

Absent an adjustment, this DTA would increase covered taxes by $30 for GloBE purposes (when the tax loss is used in the future), sheltering $200 of GloBE income. This would not be appropriate because the CE has only suffered an economic loss of $100. The Model Rules address this issue by charging additional top-up tax of $15 in the fiscal year (that is, in the year there is $100 of exempt income for local tax purposes).

Where additional top-up tax arises under Article 4.1.5, an MNE can elect to apply the Carry-forward of Excess Negative Tax Expense administrative procedure included in the Agreed Administrative Guidance published in February 2023 relating to Article 4.1.5. Under this procedure, the MNE avoids the immediate cash impost by carrying forward the Excess Negative Tax Expenses to future periods.

An election also allows an MNE to create a DTA for the GloBE rules based on the GloBE loss in the jurisdiction multiplied by the minimum rate. This may be useful for MNEs with operations in zero tax countries, where the MNE would get no benefit under a system based on deferred tax.

Assigning taxes to a jurisdiction

As with the rules allocating income between jurisdictions, the Model Rules contain rules allocating certain covered taxes. These generally seek to assign the tax to the jurisdiction to which the income is allocated so that all the taxes paid on this income are taken into account.

For example, taxes paid by a (head office) entity on the profits of its PEs are assigned to the jurisdiction where the PE is located. Similarly, controlled foreign company (CFC) charges are 'pushed down' to the CFC so that the tax and income are aligned. There are similar rules to assign taxes for transparent entities, hybrid entities and reverse hybrids.

There is a limit on the extent to which CFC tax charges and taxes on hybrid entities can be pushed down when the tax is imposed on passive income. In these cases, the tax can only be pushed down to achieve the minimum rate on that income. Any tax that is not pushed down is included in the covered tax calculation for the owner that was subject to the tax charge.

Withholding taxes are generally assigned to the CE that recognises the income in its financial accounts rather than the entity that deducts the tax on payment. There is an exception for withholding taxes on dividends paid to other CEs, and this also applies to net basis taxes on dividend income. Both these taxes are assigned to the entity that paid the taxable distribution. The logic is that these taxes are an additional tax on the profit of the distributing entity.

Step 4: Calculate the ETR

Finally, the ETR for a jurisdiction is calculated by dividing the total covered taxes for a jurisdiction (the aggregate of covered taxes in Step 3 for each CE) by the total GloBE income in that jurisdiction (the aggregate of the GloBE income or loss in Step 2 for each CE).

Example 6: The ETR calculation

An MNE has two CEs in Jurisdiction A. CE 1 has covered taxes of $6 million and GloBE income of $80 million for the current fiscal year, and CE 2 has covered taxes of $4 million and GloBE income of $20 million. The MNE's ETR for Jurisdiction A is 10% (covered taxes of $10 million/GloBE income of $100 million).

On a standalone basis, CE 1's ETR is 7.5% ($6 million/$80 million) and CE 2's ETR is 20% ($4 million/$20 million). CE 1's low ETR is due to tax concessions in Jurisdiction A that apply to its business activity. The GloBE rules permit outcomes within a jurisdiction to be blended, which means CE 2's excess taxes (that is, taxes in excess of 15%) increase the ETR for Jurisdiction A, but do not increase the ETR in any other jurisdiction.

When an MNE has GloBE income and negative covered taxes (that is, prima facie, a negative ETR), the Carry-forward of Excess Negative Tax Expense administrative procedure must be applied. Under this procedure, the MNE must carry forward the Excess Negative Tax Expenses to future periods, resulting in an ETR for the current year of 0%. Further guidance on this procedure is available in the Agreed Administrative Guidance.

Further special rules for calculating ETRs

There are special rules for calculating the ETR of stateless entities, JVs and minority-owned CEs. Generally, separate calculations must be made for these entities, rather than their income and covered taxes being included in the jurisdictional blending with other CEs

Calculating the top-up tax

When the ETR in a country is below the 15% minimum rate, the next step is to determine how much top-up tax is owed for each entity in the country.

To do this, an MNE must work out the top-up tax percentage, which is the difference between the minimum rate and the ETR in the jurisdiction. That top-up tax percentage is applied to the MNE's GloBE income in the jurisdiction, after deducting the SBIE, to calculate the jurisdictional top-up tax. Then, the jurisdictional top-up tax is allocated between the CEs located in the low tax jurisdiction.

This section explains these rules for calculating the top-up tax and allocating it between LTCEs. They are in Chapter 5 of the Model Rules.

The steps

There are several steps in the top-up tax calculation in the Model Rules:

- Compute the top-up tax percentage.
- Calculate the SBIE.
- Deduct the SBIE from the net GloBE income in the jurisdiction to determine the excess income.
- Calculate the top-up tax in the jurisdiction by:
  - multiplying the excess income by the top-up tax percentage
  - adding any additional top-up tax calculated for earlier years and for current year permanent differences when there is a GloBE loss in a jurisdiction
  - subtract any QDMTT tax paid in the jurisdiction.
- Allocate the top-up tax for the jurisdiction between the CEs in that jurisdiction (noting that identifying who has to pay the top up tax allocated to the CEs is dealt with in Article 2).

These steps are explained in more detail in the remainder of this section.

Compute the top-up tax percentage

The top-up tax percentage must be calculated when the ETR is below the 15% minimum rate. It is calculated simply by subtracting the ETR from the minimum rate and represents the additional tax rate that needs to be charged on the low-taxed profits to bring the tax on those profits up to the minimum.

Example 7: The top-up tax percentage

Assume the same facts as in example 6 above. The MNE has two constituent entities in Jurisdiction A and its ETR for Jurisdiction A is 10% (covered taxes of $10 million / GloBE income of $100 million).

The top-up tax percentage for Jurisdiction A is calculated by subtracting the ETR of 10% from the GloBE tax rate of 15%. This results in a top-up tax percentage for Jurisdiction A of 5%.

Calculate the SBIE

The top-up tax percentage is applied to the net GloBE income in the jurisdiction that exceeds the SBIE. This approach ensures the SBIE does not increase the ETR in the jurisdiction.

The SBIE is a formulaic carve-out that excludes from top-up tax a reasonable return to the level of substance in the jurisdiction. This is based on a percentage of the MNE's payroll costs and tangible assets in the jurisdiction, on the grounds that employment costs and tangible assets tend to be relatively immobile factors of production and are therefore reasonable proxies for substantive economic activities.

The percentage

The SBIE, or "carve-out", will be 5 percent of the carrying value of the payroll costs and tangible assets in the jurisdiction. An increased amount applies in the transition period, which begins on 1 January 2023 and lasts for 10 years.

In this transition period, the carve-out for payroll costs is 10 percent in the first year, and then it is reduced by 0.2 percent per year for the next five fiscal years and 0.8 percent per year for the remaining four fiscal years. The carve-out for tangible assets is 8 percent in the first year, and then it is reduced by 0.2 percent per year for the next five fiscal years and 0.4 percent per year for the remaining four fiscal years.

Payroll costs

The payroll carve-out for a jurisdiction is based on costs for a CE located in the jurisdiction for employees and for independent contractors that perform activities for the MNE in that jurisdiction.

For this purpose, independent contractors include only natural persons and may include natural persons who are employed by a staffing or employment company but whose daily activities are performed under the direction and control of the MNE. Independent contractors do not include employees of a corporate contractor providing goods or services to constituent entities in the jurisdiction.

The payroll costs include employee benefits that provide a direct personal benefit to the employee, like health insurance and pension contributions, as well as wages and salary costs. Payroll taxes and social security contributions borne by the employer are also included.

Tangible assets

The tangible asset carve-out is based on the average of the opening and closing carrying value (net of accumulated depreciation) of tangible assets in the financial statements. The tangible assets that qualify include property, plant and equipment, natural resources (including land not held for sale, lease or investment), as well as licences for the use of immovable property or exploitation of natural resources. The asset must be located in the jurisdiction of the CE that owns it.

Assets that are leased also qualify as tangible assets for the lessee, which provides consistency between owned and leased assets. Where an asset is leased from another group member, the asset will only be included in the jurisdiction of the lessee.

Special rules to determine how the carve-out is allocated for PEs and for transparent entities are included in Article 5.3.6 and Article 7.4.6 respectively.

Example 8: Calculating the SBIE

Assume the same facts as example 7 above. CE 1's payroll costs for activities performed in Jurisdiction A is $30 million for the current fiscal year, and its tangible assets located in Jurisdiction A have an average accounting carrying value for the current fiscal year of $170 million. CE 2 has no payroll costs or tangible assets.

The SBIE for Jurisdiction A is calculated as follows* ((payroll costs of $30 million x 5 percent) + (tangible assets of $170 million x 5 percent)) = $10 million. Therefore $10 million would be deducted from the MNE's GloBE income for Jurisdiction A when calculating the income subject to top-up tax.

* Assume the carve-out percentages have reduced to 5 percent in the year of the example.

Compute the top-up tax in the jurisdiction

The top-up tax for the jurisdiction is calculated by deducting the SBIE from the net GloBE income in the jurisdiction and then multiplying the result by the top-up tax percentage. The result is then adjusted by adding any Additional Top Up tax and subtracting any QDMTT.

Example 9: Computing the top-up tax

Assuming the same facts as in example 8 above, the MNE's top-up tax for Jurisdiction A for the current fiscal year equals $4.5 million:

(net GloBE income of $100 million – the SBIE of $10 million) x the top-up tax percentage of 5%

If an adjustment is made that results in a decrease to the liability for covered taxes in a prior year (for example, when a tax return is reassessed resulting in a reduction to the tax liability for a prior year), the GloBE rules require the ETR in the earlier year to be recalculated unless the decrease is less than €1 million, in which case it can be included in the current year. This includes when the recapture rule is applied to deferred tax liabilities that have not unwound within five years. When these recalculations result in an ETR falling below the minimum rate, the Additional Top-up Tax for that year is added to the current year's top-up tax and charged in the current fiscal year.

Example 10: Decrease in covered taxes for a prior year

Assume the same facts as in example 9 above. CE 2's Jurisdiction A income tax return for a prior year has been reassessed, resulting in a reduction in its local tax liability for that prior year of $1.2 million but no change in its GloBE income for that year. The Jurisdiction A ETR and top-up tax is recalculated for this prior year resulting in additional GloBE top-up tax for the year of $1 million.*

This additional top-up tax of $1 million is added to the $4.5 million top-up tax for the current fiscal year, resulting in total top-up tax for the current fiscal year of $5.5 million. The GloBE return for the prior fiscal year is not reassessed.

* The reduction in the prior year local tax liability is assumed not to result in a Dollar-for-Dollar increase in top-up tax because of the impact of the SBIE in the prior year.

QDMTT

If the country where the income is earned has a QDMTT, the jurisdictional top-up tax will be reduced, generally to zero or near zero, by the QDMTT. In addition, most QDMTTs are expected to qualify for the QDMTT "safe harbour" approved in the July 2023 Agreed Administrative Guidance.

A QDMTT is a minimum tax implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and Commentary such that it increases the MNE group's domestic liability on domestic excess profits to the minimum rate. The definition also prohibits the provision of benefits to the MNE group related to the GloBE rules.

Under the QDMTT, the jurisdictional top-up tax calculation is based on 100% ownership interest, irrespective of the actual ownership interests held by the parent entity of the MNE group in the constituent entities located in the QDMTT jurisdiction. In some situations, imposing the whole amount of the jurisdictional top-up tax under a QDMTT will result in a greater tax charge than the tax charge that would otherwise have been imposed under the IIR, as the IIR is reduced to take into account minority ownership interests.

A QDMTT excludes from the covered tax calculation:

- taxes paid or incurred by a CE owner under a CFC tax regime allocable to a domestic constituent entity, and
- taxes paid or incurred by a main entity allocable to a PE located in the jurisdiction.

This means taxes paid under the New Zealand CFC regime or by New Zealand head offices for their permanent establishments will not be creditable against a foreign QDMTT. Instead, taxes paid under a foreign QDMTT will give rise to a foreign tax credit in New Zealand under subparts LJ and LK of the Income Tax Act 2007.

Allocation of a jurisdiction's top-up tax to constituent entities

The final step in calculating the top-up tax is to allocate the jurisdictional top-up tax to the individual CEs in the low tax jurisdiction. This paves the way for the final step in the GloBE tax process, which is for the tax allocated to the low tax entities to then be allocated under Article 2 of the Model Rules to the entities required to pay tax under the IIR and UTPR.

This allocation between the LTCEs is necessary to deal with situations when some of the top-up tax is charged to an entity that is not the UPE. For example, if the UPE is not subject to a qualified IIR, the top-up tax may be collected through a combination of the IIR applied at different levels of the group structure and the UTPR (as described in the next section). Allocating the top-up tax to individual CEs ensures the different charging rules can be coordinated.

It is also necessary because the IIR is intended to collect top-up tax from a parent entity based on its interest in a LTCE. This means that where a parent applying the IIR does not wholly own a LTCE, it will only bear the cost of its proportional share of top-up tax. Allocating top-up tax to LTCEs is an important step in achieving this outcome.

The GloBE rules generally allocate the top-up tax for a jurisdiction between the CEs located in the jurisdiction based on their proportion of the jurisdictional GloBE income.

Example 11: Allocating top-up tax to CEs

Assuming the same facts as in example 9 above, the total top-up tax for Jurisdiction A for the current fiscal year of $5.5 million is allocated to each CE located in Jurisdiction A based on its proportion of the net GloBE income for Jurisdiction A.

CE 1 is allocated $4.4 million ((CE 1 GloBE income of $80 million / jurisdictional GloBE income of $100 million) x top-up tax of $5.5 million).

CE 2 is allocated $1.1 million ((CE 2 GloBE income of $20 million / jurisdictional GloBE income of $100 million) x top-up tax of $5.5 million).

This allocation reflects relative levels of GloBE income, rather than relative ETRs.

Special rules deal with situations when top-up taxes are payable and there is no GloBE income in the jurisdiction. This could, for example, happen when all the top-up tax for the year relates to a recalculation of the ETR from an earlier year.

Imposition of top-up tax

As outlined above, the IIR and the UTPR both allocate the liability to pay top-up tax on LTCEs between the MNE's entities. The QDMTT (Qualified Domestic Minimum Top-up Tax) can be contrasted with the IIR and UTPR, as a QDMTT applies exclusively to domestic CEs, whereas the IIR (other than the DIIR) and UTPR apply to foreign CEs.

The IIR and the UTPR work together and are also coordinated to ensure the right amount of top-up tax is collected when multiple IIRs or UTPRs are applied at the same time in different jurisdictions. Therefore, both rules start from the same top-up tax calculation explained above, which allocates top-up tax amongst LTCEs.

This part of the TIB guidance material sets out the ordering rules that prescribe how the IIR and UTPR operate together and how top-up tax is imposed on an MNE's entities. The rules are in Chapter 2 of the Model Rules.

IIR ordering rules

The IIR takes the top-up tax calculated for a LTCE and then imposes this tax on a parent entity in the LTCE's group.

When a parent applies the IIR, the amount of top-up tax it is charged is based on the amount of top-up tax calculated for the relevant LTCE multiplied by the parent's allocable share of the LTCE's income.

The allocable share is a measure of the parent's rights to the profit of the LTCE and is calculated based on accounting principles. The test works by determining the proportion of the LTCE's GloBE income attributable to the parent (that is, after adjustment for interests held by other owners).

The top-down approach

There will often be MNE structures where more than one group entity has an interest in an LTCE. The GloBE rules establish:

- which entities in the group apply the IIR, and
- if more than one group entity applies the IIR for the same LTCE, what adjustments are made to avoid over-taxation.

Which entities apply the IIR

The basic structure is a top-down approach. This means the UPE jurisdiction will usually have the first right to charge the top-up tax for low tax jurisdictions (other than the UPE jurisdiction itself, unless it is in a country that has adopted a QDMTT or domestic IIR).

If the UPE is not subject to a qualified IIR, intermediate parent entities located in other jurisdictions and held directly by it (second tier entities) will apply the IIR to LTCEs in other jurisdictions to the extent of their direct and indirect interest in those LTCEs.

To the extent that the above steps do not result in the imposition of the full amount of top-up tax calculated under chapter 5 of the GloBE rules, third tier intermediate parent entities may have an IIR liability, and so on. Intermediate parent entities are entities that are controlled by the UPE and have an ownership interest in the LTCE, but investment entities are excluded.

Unless the split ownership rules apply (see below), an intermediate parent entity (lower IPE) will not apply its IIR if:

- the UPE is subject to a qualified IIR,[6] or
- another intermediate parent entity (higher IPE) that owns, directly or indirectly, a 'controlling interest'[7] in the lower IPE is subject to a qualified IIR.

If the higher IPE does not have a controlling interest in the lower IPE, the lower IPE's IIR will not be switched off. As explained below, the lower IPE will charge its IIR, but the higher IPE must reduce its share of the top-up tax by the tax charged by the lower IPE.

Adjustments if more than one group entity applies the IIR

If more than one parent entity in a group applies the IIR for an LTCE, parent entities applying the IIR must reduce their own top-up tax liability by any top-up tax allocated to a parent entity further down the group structure. This prevents double allocation of the same top-up tax amount.

Example 12: Multiple intermediate parents

The amount of top-up tax calculated for an MNE's low-taxed constituent entity (LTCE) is $100. The LTCE is 100 percent directly owned by Parent B. Parent A owns 20 percent of Parent B – it does not have a controlling interest.

Both Parent A and Parent B are in jurisdictions with a qualified IIR. The UPE of the group is not in a jurisdiction with a qualified IIR.

Since Parent A does not have a controlling interest in Parent B, both parents apply the IIR. However, since Parent B's IIR will charge the full $100 of top-up tax, Parent A's share of the top-up tax is reduced from $20 to nil. The full amount of top-up tax is charged to Parent B under the IIR.

Exception: the split ownership rules

The split ownership rules are an exception to the IIR's general top-down approach. Under the GloBE rules, an intermediate parent entity that is more than 20 percent owned by minority investors outside the MNE group is called a partially owned parent entity (POPE). The POPE definition is satisfied even if minority investors *indirectly* own more than 20 percent of the ownership interests in the parent entity. A parent entity owned by a POPE will therefore usually also be a POPE.

POPEs have priority rights to apply the IIR, notwithstanding the general top-down approach. The reason for this is that when there are substantial minority interests, some amount of the top-up tax would not be collected at all if the IIR were only applied by parent entities higher up the ownership structure.

[6] The exception to this is when there is a partially owned parent entity (POPE) lower down the group structure. A POPE is a parent entity where at least 20% of its shares are held by minority shareholders.

[7] 'Controlling interest' is defined in the GloBE rules. Broadly, the GloBE definition means an ownership interest such that the parent is required to consolidate the subsidiary's financials on a line-by-line basis in accordance with an acceptable financial accounting standard (or would have been required to, had it prepared consolidated financial statements). It does not mean an ownership interest over 50%.

Example 13: POPEs

The amount of top-up tax calculated for an MNE's LTCE is $100. The UPE indirectly owns the LTCE through A Co. The UPE owns 60 percent of A Co, and A Co owns 100 percent of the LTCE.

Under the GloBE rules, A Co (and not the UPE) would apply the IIR and pay $100 of top-up tax. By charging all the top-up tax to A Co, the top-up tax is effectively borne 60 percent by the UPE (and thus its shareholders) and 40 percent by the minority shareholders.

If this were not the case and only the UPE applied the IIR, the UPE would only be charged $60 of the top-up tax based on its allocable share. The remaining $40 would not be collected under either the UTPR or the IIR.

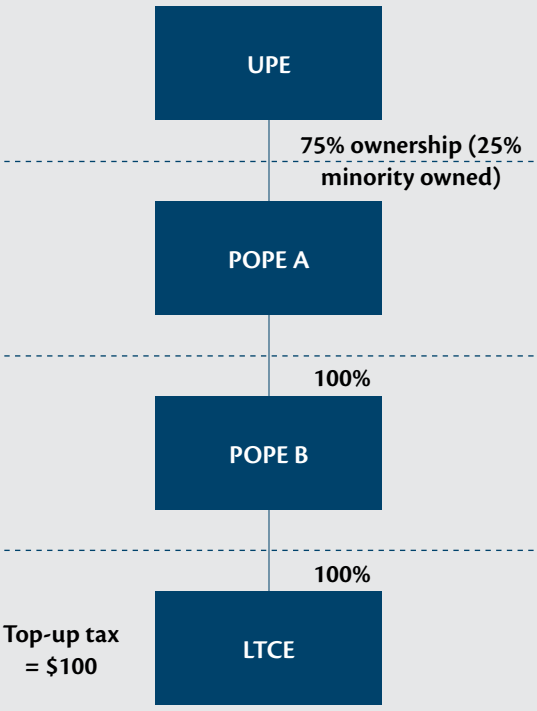
The ordering rules for POPEs require a lower-tier POPE to switch off its IIR only if it is wholly owned by a higher POPE that is subject to the IIR.

Example 14: POPE rules and corresponding tax reductions

The amount of top-up tax calculated for an MNE's LTCE is $100. The UPE indirectly owns the LTCE through a chain of POPEs. The UPE directly owns 75 percent of POPE A, with the remaining 25 percent held by minority investors outside the MNE group. POPE A directly owns POPE B (ownership percentage varies under the two examples below). POPE B directly owns 100 percent of the LTCE.

POPE A owns 100 percent of POPE B

If POPE B is 100 percent owned by POPE A, POPE A would apply the IIR and be charged $100 of top-up tax. POPE B would not be required to apply the IIR.



POPE A owns 90 percent of POPE B, with the remaining 10 percent owned by outside investors

If POPE B is only 90 percent owned by POPE A, both POPEs would apply the IIR.

POPE B would be charged $100 of top-up tax. POPE A would also apply the IIR, but its top-up tax liability would be reduced to zero by the amount of tax charged to POPE B.

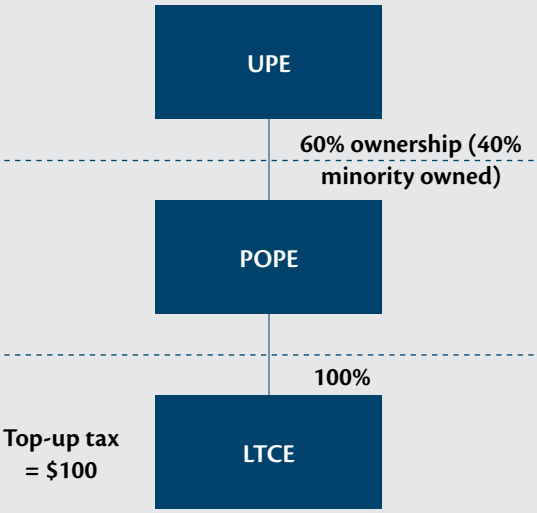
As set out above, if a parent entity further down the group structure has applied the IIR, the liability of any parent further up the group applying the IIR must be reduced. The amount of the reduction is the top-up tax paid by the lower parent under an IIR multiplied by the higher parent's ownership interests in the low-taxed entity held indirectly through that lower parent. So, for example, if the lower parent pays top-up tax of $100 for a low-taxed entity and the higher parent indirectly holds a 60 percent ownership interest in that same low-taxed entity through the lower parent, then the amount of the reduction is $100 x 60% = $60.

Example 15: Reduction for top-up tax charged to lower parent

The amount of top-up tax calculated for an MNE's LTCE is $100.

The UPE indirectly owns the LTCE through a POPE

Assume the POPE directly owns 100 percent of the LTCE, and the UPE directly owns 60 percent of the POPE, with the remaining 40 percent held by minority investors outside the group.

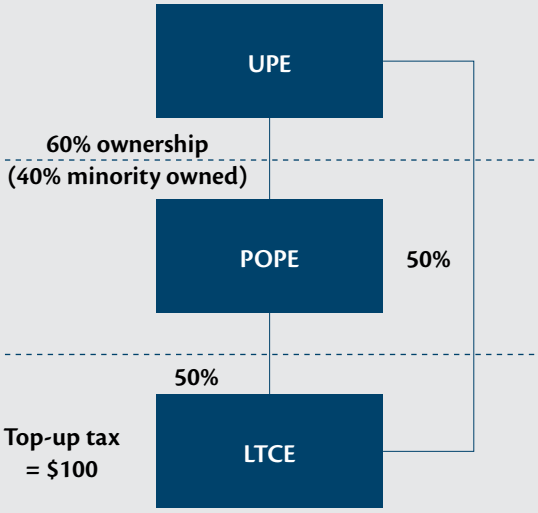


Both the UPE and the POPE apply the IIR:

- The POPE's allocable share of the top-up tax is $100.
- The UPE's allocable share is initially $60, but this is reduced by the top-up tax paid by the POPE multiplied by the UPE's ownership interest in the LTCE held indirectly through the POPE. This reduction equals $60 ($100 x 60% = $60), meaning the UPE has zero allocable share. This is appropriate because the top-up tax has already been fully charged to the POPE.

The UPE owns the LTCE both directly and indirectly through a POPE

Assume the POPE owns 50 percent of the LTCE, and the UPE owns the other 50 percent. As above, the UPE also directly owns 60 percent of the POPE with the remaining 40 percent held by minority investors outside the group.



Again, both the UPE and the POPE apply the IIR:

- The POPE's allocable share of the top-up tax is $50.
- The UPE's allocable share is initially $80, being $50 from its direct interest in the LTCE plus $30 from its indirect interest through the POPE (60% x $50 = $30). The UPE reduces its top-up tax liability by $30 to $50, as the $30 from its indirect interest through the POPE has already been charged to the POPE.
- The result is that the full $100 of top-up tax is collected.

The UTPR

Like the IIR, the UTPR allocates top-up tax. The UTPR primarily functions as a backstop to the IIR.[8] It aims to ensure that top-up tax for an LTCE is paid even if its parent entities are located in jurisdictions without a qualified IIR. This eliminates the incentive for an MNE to headquarter in a country without an IIR.

The UTPR applies if some of the interests in an LTCE are not held by parent entities that are subject to a qualified IIR. However, any top-up tax collected under the UTPR is reduced by the amount that is charged under an IIR.

Example 16: Interaction between IIR and UTPR

The amount of top-up tax calculated for an MNE's LTCE is $100. The MNE's UPE indirectly owns 100 percent of the LTCE through two companies – A Co (which owns 60 percent) and B Co (which owns 40 percent). A Co is in a jurisdiction with a qualified IIR. B Co and the UPE are not.

Applying the IIR, A Co's allocable share of the top-up tax is $60. The remaining $40 of top-up tax is allocated to the MNE's constituent entities under the UTPR.

How the UTPR allocates top-up tax to different jurisdictions

Unlike the IIR, which allocates top-up tax to entities by allocable share or ownership, the UTPR allocates top-up tax to *jurisdictions* based on where the group's tangible assets and employees are located.

The UTPR uses an allocation key to allocate the top-up tax between the different jurisdictions in which the MNE has CEs. The top-up tax is only allocated to jurisdictions that have implemented a qualified UTPR (a 'UTPR jurisdiction').

The allocation is calculated at a jurisdictional level. Top-up tax allocated to New Zealand is a liability of every New Zealand constituent entity in the MNE group, under section HP 1. The group is entitled to determine which entity or entities pay the tax. The top-up tax is allocated based on the proportion of the tangible assets and number of employees in each UTPR jurisdiction. There are equal weights for the asset and employee factors.

Example 17: UTPR allocation

An MNE consists of one company in Jurisdiction P with PEs in Jurisdictions A, B, C, D and E.

The value of tangible assets and number of employees owned by the MNE located in each jurisdiction are:

- Jurisdiction A: $400 million tangible assets, 500 employees
- Jurisdiction B: $400 million tangible assets, 300 employees
- Jurisdiction C: $100 million tangible assets, 200 employees
- Jurisdiction D: $100 million tangible assets, no employees
- Jurisdiction E: No tangible assets or employees.

The MNE's total value of tangible assets in all UTPR jurisdictions is $1 billion, and the total number of employees in all UTPR jurisdictions is 1,000.

Jurisdiction P has not adopted the GloBE rules. Jurisdictions A, B, C, D and E have all adopted the GloBE rules and implemented the UTPR. The PE in Jurisdiction A is low tax, having a top-up tax amount under Article 5 of $100,000.

The share of Jurisdiction A's top-up tax allocated to Jurisdictions A, B, C and D under the UTPR is calculated as follows:

- Jurisdiction A: 50% x (400m/1b) + 50% x (500/1,000) = 45%
- Jurisdiction B: 50% x (400m/1b) + 50% x (300/1,000) = 35%
- Jurisdiction C: 50% x (100m/1b) + 50% x (200/1,000) = 15%
- Jurisdiction D: 50% x (100m/1b) + 50% x 0 = 5%
- Jurisdiction E will not be allocated any top-up tax, even though it is a UTPR jurisdiction, as it has no tangible assets or employees.

[8] It also ensures that any LTCEs in the UPE's jurisdiction are subject to top-up taxation.

The data for this allocation can be taken from the MNE's Country-by-Country report, provided the report is prepared in accordance with the GloBE rules' definitions for Number of Employees and Tangible Assets. This will minimise the additional compliance burdens on MNEs and improve coordination by basing the calculation on existing, readily available and objective data.

Chapter 6: Mergers or acquisitions

Chapter 6 contains special rules dealing with corporate restructurings (including mergers, acquisitions, and demergers) and transfers of assets or liabilities. The chapter also addresses the application of the GloBE Rules to certain holding structures such as JV investments and Multi-Parented MNE Groups.

Chapter 7: Tax neutrality or existing distribution tax regimes

There are special rules in Chapter 7 of the Model Rules for calculating the GloBE income of a UPE that is subject to a tax neutrality regime, that is, a regime that achieves a single level of taxation on business income. Article 7.1 applies to a UPE that is a flow-through entity, and Article 7.2 applies to a UPE that is subject to a deductible distribution tax regime.

Chapter 8: Administration

Chapter 8 of the Model Rules sets some of the administration rules for the regime.

The GIR

Article 8.1 covers the GIR, which is discussed in more detail in the Item: "Amendments to the Tax Administration Act 1994" below.

Safe Harbours

Article 8.2 provides for safe harbours. When a jurisdiction meets the conditions of a safe harbour in respect of an MNE, the MNE's top-up tax for the jurisdiction is zero for the fiscal year.

Agreed Administrative Guidance provides for three safe harbours:

- A transitional CbCR safe harbour, set out in Guidance published in December 2022 and further supplemented by Guidance published in December 2023
- A QDMTT safe harbour, set out in Guidance published in July 2023
- A transitional UPTR safe harbour, also set out in Guidance published in July 2023.

Transitional CbC Report safe harbour

The transitional Country-by-Country (CbC) Report safe harbour is designed as a short-term measure that excludes an MNE's operations in certain lower-risk jurisdictions from the scope of the GloBE rules in the initial years.

The safe harbour allows an MNE not to undertake full GloBE calculations in a jurisdiction where it can demonstrate, using a Qualified CbC Report and Qualified Financial Statement, that it meets one of the following tests.

De minimis test

The de minimis test is met where the MNE group reports total revenue of less than €10 million and profit (loss) before income tax of less than €1 million in the jurisdiction in its Qualified CbC Report for the fiscal year.

A Qualified CbC Report is a CbC Report prepared and filed using Qualified Financial Statements.

Qualified Financial Statements include:

- the accounts used to prepare the consolidated financial statements of the UPE, or
- financial statements of each constituent entity, provided they are prepared in accordance with either an acceptable financial accounting standard or, in some cases, an authorised financial accounting standard.

Simplified ETR test

The simplified ETR test is met where the MNE group has a simplified ETR that is equal to or greater than the transition rate in the jurisdiction for the fiscal year.

The simplified ETR is calculated by dividing the jurisdiction's simplified covered taxes by its profit (loss) before income tax as reported on the MNE group's Qualified CbC Report.

The simplified covered tax is a jurisdiction's income tax expense as reported on the MNE group's Qualified Financial Statements, after eliminating any taxes that are not covered taxes and uncertain tax positions reported in the MNE group's Qualified CbC Report.

The transition rate is 15% for fiscal years beginning in 2023 or 2024, 16% for fiscal years beginning in 2025 and 17% for those beginning in 2026.

Routine profits test

The routine profits test applies where the MNE group's profit (loss) before income tax in the jurisdiction under the CbC Report is equal to or less than the SBIE amount for constituent entities located in that jurisdiction, as calculated under the GloBE rules.

Note: the routine profits test uses revenue and profit (loss) before income tax from an MNE's Qualified CbC Report, but MNEs are required to perform a full SBIE calculation to meet the routine profits test.

Rules for using the transitional safe harbour

If an MNE group has not applied the transitional CbC Report safe harbour in a jurisdiction in a fiscal year in which the MNE group is subject to the GloBE Rules, the MNE group cannot qualify for this safe harbour for the jurisdiction in a subsequent year. This is the "once out, always out" rule.

An MNE that qualifies for the transitional CbC Report safe harbour on a jurisdictional basis is still subject to the GloBE Rules and the safe harbour does not discharge the MNE group from complying with group-wide requirements. For example, an MNE group would still need to prepare and file its GIR during the transitional period.

Special rules apply to certain entities and groups, including UPEs subject to deductible dividend regimes.

If the conditions of the transitional CbC Report safe harbour are not met, then the general rules apply, and any potential liability to top-up tax must be computed under the ordinary GloBE Rules.

QDMTT safe harbour

The QDMTT safe harbour allows an MNE not to calculate its top up tax for a jurisdiction twice, ie once under a QDMTT and again for purposes of an IIR or UTPR. It is more in the nature of an ordering rule, since a QDMTT is a tax whose overall design and outcomes are consistent with those provided for under the GloBE rules. In order to qualify for this safe harbour, the QDMTT must meet certain requirements set out in Guidance.

Transitional UTPR safe harbour

This safe harbour means no tax will be collected under a UTPR with respect to profits in a UPE jurisdiction until fiscal years beginning on or after 1 January 2026.

Chapter 9: Transition

Chapter 9 of the Model Rules sets out transitional rules. Some of these rules apply to all MNEs as they address transition issues arising because the GloBE rules are new. Other transitional rules apply to entities and groups when they first come within the scope of the GloBE rules (for example, through organic growth or a merger), even if that occurs after the GloBE rules have been in place for some time.

An MNE's transition year is determined on a jurisdictional basis. For a jurisdiction, the first fiscal year that the MNE comes within the scope of the GloBE rules is a "transition year" unless the MNE qualifies for a transitional safe harbour, in which case it would be the first fiscal year in which the relevant tested jurisdiction no longer qualifies for or applies the transitional safe harbour. An MNE may therefore have different transition years for different jurisdictions.

The transitional rules described in this chapter of the Model Rules:

- Allow higher percentages to be used in calculating the SBIE in the first 10 years of the GloBE rules (this rule does not apply the transition year concept).
- Allow for a longer filing deadline in an MNE's transition year.
- Address the treatment of losses and other timing differences.
- Provide temporary relief from the UTPR for an MNE in the initial phase of its international activity.

SBIE

As described above, the percentages used in the SBIE are higher for the first 10 years of the GloBE rules.

Longer filing deadline in transition year

An MNE is normally required to file its GloBE return and other notifications within 15 months after the end of its accounting period. In an MNE's transition year, this deadline is extended to 18 months.

Losses and timing differences

Once an MNE becomes subject to the GloBE rules, it will have to calculate its ETR in each jurisdiction where it operates. Losses and accounting-tax timing differences may occur before an MNE's transition year that affect its ETR calculation in its transition year and later years.

For example, if an MNE's pre-transition year losses were not recognised at all, the MNE could have an inappropriately low ETR in a year when those losses are used to reduce local taxable income.

To prevent this, when there are losses and other timing differences arising before a transition year, the MNE will generally be treated as though it were already subject to the GloBE rules at the time the losses or timing differences arose. This is done by recognising existing deferred tax accounting attributes (including DTAs from earlier losses) in the ETR calculation described in Chapter 5. Consistent with that treatment, the amount of DTA and DTL recorded for the purpose of Article 9.1.1 is equal to the DTA or DTL accrued in the financial accounts if the tax rate used to determine the DTA or DTL is below the minimum rate. Otherwise, such DTA or DTL must be revalued on the basis of a 15% rate.

A DTA that is attributable to a GloBE Loss, and that has been recorded at a rate lower than the minimum rate, may be taken into account at a 15% rate.

More detail is available on this in the Commentary on Article 9.1.1 and Agreed Administrative Guidance published in February 2023 relating to Article 9.1.1.

The treatment of losses under the GloBE rules is described above and in Chapter 5 of the Model Rules.

DTAs generated after 30 November 2021 from items that are excluded from the GloBE base must be disregarded for GloBE purposes. In addition, the GloBE tax basis in assets acquired in an intragroup transaction after 30 November 2021 must be based on historical carrying values, and related DTAs and DTLs must similarly be determined based on historical carrying values. This is to prevent inappropriate tax planning transactions.

MNEs in the initial phase of international activity

There is temporary relief from the UTPR for MNEs in the initial phase of international activity. An MNE is in its "initial phase of international activity" if it has CEs in no more than six jurisdictions and has less than €50 million of tangible assets (by book value) outside of the jurisdiction in which it has the most tangible assets (again, by book value). The relief applies on an annual basis.

Because it does not apply for the IIR, this relief is only relevant for groups that are headquartered in a country that does not have an IIR, and even then, the relief will be somewhat undercut if the group has a lower tier parent company in a country with an IIR.

The temporary relief expires after the MNE has been within the scope of the GloBE rules for five years. This five-year period is not suspended if, for example, the MNE's revenues decline so that it falls outside the scope of the rules during those five years.

Example 18: Five-year limit to initial phase relief

A multinational group (NewGroup) crosses the €750 million consolidated annual revenue threshold for the first time in its fiscal year ended 31 December 2030. Its consolidated annual revenues for the following four fiscal years are as follows:

- 2031: €780 million
- 2032: €600 million
- 2033: €640 million

2034: €720 million

As explained above, the GloBE rules apply to MNEs that have consolidated annual revenues of at least €750 million in at least two of the last four fiscal years. The first year in which the GloBE rules apply to NewGroup is therefore 2032.

Assuming NewGroup meets the other requirements for the initial phase relief from the UTPR, it will qualify for the relief in 2032, and the last year for which it can obtain the relief is the 2036 year. It does not matter that NewGroup's annual revenues fell below the €750 million threshold from 2032 to 2034.

Chapter 10: Definitions

Chapter 10 of the Model Rules sets out the key definitions and the rules for determining where an entity is located for applying the key operative rules.

Consequential amendments to the ITA

Foreign tax credit rules

Amended section LJ 3 works in conjunction with section LJ 1(1) to provide that GloBE top-up tax paid under another country's IIR or UTPR is not creditable for non-GloBE income tax purposes. This is because the top-up tax is determined after taking into account income tax imposed on the income attributable to a country, whether that tax is imposed by the country itself or another country (for example, under a worldwide or CFC tax regime). Allowing a credit for an IIR or UTPR would create circularity in the top-up tax calculation and unwind the tax. Similarly, amended section DB 1(1)(b) denies a deduction for these taxes.

By contrast, foreign tax credits are available for GloBE top-up tax paid under another country's QDMTT or DIIR. QDMTTs and DIIRs are charged on domestic profits *before* taxes are charged on these profits in another country. So allowing a credit for another country's QDMTT or DIIR is necessary to prevent double taxation where the relevant income is also in New Zealand's tax net. For example, the credit can be used against a New Zealand CFC tax liability or a head-office tax liability for a New Zealand MNE's PEs. Section DB 1(1)(b) denies a deduction for other countries' QDMTTs and DIIRs, which is consistent with the general non-deductibility of income taxes.

Imputation credits

New sections OB 7BB and OP 11BA and the proposed amendments to tables O1 and O19 provide that multinational top-up tax paid under New Zealand's DIIR gives rise to an imputation credit. This is because New Zealand's imputation system allows a credit for New Zealand tax paid at the company level to prevent double taxation when corporate income is distributed to shareholders and taxed again at their level.

Sections OB 7BB and OP 11BA do not give an imputation credit for top-up tax paid under the IIR or UTPR. This is because the Model Rules state that if the payment of GloBE top-up tax under a country's IIR or UTPR gives rise to a benefit, the IIR or UTPR will not be qualifying, and other participating countries will continue to apply top-up tax to the country's in-scope MNEs under their UTPR. The non-creditability is the same as if the top-up tax had been paid in a foreign country under its QDMTT, or if the foreign country had imposed sufficient tax in the first place that it was not a low tax jurisdiction.

Schedule to the ITA adapting the OECD Model Rules to New Zealand tax law

New Zealand's Domestic Income Inclusion Rule (DIIR)

Section 123 of the Amendment Act provides for the insertion of Article 2.1.7 in Schedule 25B from 1 January 2026. This Article imposes an IIR liability on a New Zealand headquartered in-scope MNE for a year in which it has an ETR on its New Zealand profits of less than 15%.

The DIIR means New Zealand-headquartered MNEs will not have to pay any part of the GloBE top-up tax on undertaxed New Zealand income to other countries under the UTPR

A DIIR is similar to a QDMTT but there are also some differences. For example, if a New Zealand UPE has both a New Zealand ETR below 15%, and a direct subsidiary with a minority interest, the DIIR will only apply to the portion of the jurisdictional top up tax that is allocated to that direct subsidiary and attributable to the New Zealand MNE's ownership. Under a QDMTT, the top-up tax would need to be paid on the basis of 100% ownership.

Proposed Article 2.1.8 is also included to provide for initial phase relief. The DIIR does not apply during the initial phase of an MNEs international activity under the transitional rules in Chapter 9. That is because any undertaxed New Zealand profits are not subject to any other country's UTPR during the period.

New Zealand's UTPR

New Zealand's UTPR does not operate as a denial of an income tax deduction, but is instead a separate tax liability independent of income tax.

The UTPR liability is capped to the lesser of the group's taxable deductions and available tax losses for the tax year corresponding to the fiscal year, in order to meet the "equivalent adjustment" requirements in the Model Rules. When the UTPR liability exceeds these amounts, it is carried forward to the next fiscal year.

The UTPR top-up tax liability is a joint and several liability of all New Zealand entities in an MNE group.

Further information

This Tax Information Bulletin guidance material on the Model Rules has focused on providing a general overview of the OECD Model Rules. The Model Rules, Commentary, Agreed Administrative Guidance and some illustrative examples can all be found on the OECD's website at

https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm

Amendments to the Tax Administration Act 1994

Sections 66(2), (3) and (5), 68, 69, 70(2), 71(2), 71D, 72, 73B, and 74 to 76

Summary of proposed amendments

Amendments to the TAA provide an administrative regime that deals with the applied GloBE rules and the multinational top-up tax.

As the multinational top-up tax is an "ancillary tax" under the Income Tax Act 2007 (ITA), it does not fall within the scope of income tax. This means a specific administration regime is required, which nevertheless generally follows income tax procedures. Its features include:

- MNEs must register with Inland Revenue within six months of the end of the first income year they are in-scope of the Applied GloBE rules.
- New Zealand-headquartered in-scope MNEs must submit a GIR to Inland Revenue in the prescribed electronic format. Portions of this return will be exchanged by the Commissioner with tax authorities in other countries In some circumstances, a GIR also needs to be submitted to Inland Revenue by in-scope MNEs that are headquartered in a foreign country.
- All in-scope MNEs with a New Zealand CE must file an annual top-up tax return. This is a separate tax return that states the amount of multinational top-up tax payable. It must be filed even if the amount owing is zero. The first top-up tax return is due to Inland Revenue two months after the GIR is due (in subsequent years, this will be one month).
- In-scope MNEs must pay multinational top-up tax to the Commissioner by the due date. The due date is the same as the due date for the annual top-up tax return.

The amendments also introduce new penalties for late registration and incomplete and/or late filing of the GIR.

The GloBE rules are closely linked to the Country-by-Country (CbC) Reporting rules – in particular, the same taxpayers are in scope and the GloBE transitional safe harbours rely on CbC Reports. As part of the implementation of systems to receive and exchange GIRs, legislation also now requires CbC Reports be submitted in the required electronic format, and new penalties are introduced for incomplete and/or late filing.

Background

Chapter 8 of the Model Rules provides for a coordinated and standardised approach to reporting, designed to reduce the compliance burden for in-scope MNEs and facilitate the effective administration of the GloBE rules. It also provides for the design of safe harbours that deem a GloBE top-up tax liability for a jurisdiction to be zero when the conditions provided under the GloBE Implementation Framework are met for the relevant fiscal year.

The Model Rules place an obligation on each CE to file a GIR in the country where it is tax resident, which is based on a global standardised format developed as part of the GloBE Implementation Framework.

The GIR provides information on the tax calculations made by an MNE group and contains the information a tax administration needs to evaluate the correctness of a CE's self-assessed GloBE tax liability and to perform an appropriate risk assessment.

A CE's obligation to file a GIR will be relieved if its UPE, or a designated filing entity in the group, files the GIR with a tax administration, and the Competent Authority in the filing jurisdiction has an agreement in effect to automatically exchange the GIR with the Competent Authority of the jurisdiction of the CE.

Chapter 9 of the Model Rules provides transitional timeframes for filing the GIR. For the first year an in-scope MNE has a GIR filing obligation, its GIR will be due 18 months after the end of its fiscal year instead of 15 months.

Local tax return filing and penalty rules are left to the determination of the implementing jurisdiction. In New Zealand, the compliance regime for the GIR and the multinational top-up tax return are in the TAA.

Key features

The key features of the amendments are:

- All in-scope MNEs must register with Inland Revenue within six months of the end of the first income year they are in-scope of the applied GloBE rules.
- All in-scope MNEs with a CE located in New Zealand are required to submit a GIR to Inland Revenue.
- The obligation to submit a GIR does not apply to MNEs with a foreign UPE that have
  - filed the GIR on a timely basis in another country which has an information exchange agreement with New Zealand
  - Notified the Commissioner which group entity has made that filing and with which other country.
- All in-scope MNEs must file an annual top-up tax return.
- Multinational top-up tax must be paid to the Commissioner by the due date.
- New penalties apply for late registration and late, and/or incomplete, filing of the GIR and CbC Report.

Detailed analysis

Registration

New section 78H provides that MNEs are required to notify Inland Revenue that they are within the scope of the GloBE rules. MNEs have six months from the end of the first fiscal year they are in scope of the rules to complete this registration. This process applies to both New Zealand-headquartered MNEs and foreign MNEs with CE located in New Zealand (including PEs).

As part of this registration process, MNEs must inform Inland Revenue of the identity and location of the entity that will be filing the GIR. This will provide Inland Revenue with notice of where the GIR will be received from (whether that is directly or through information exchange channels) and a point of contact if the forms are not received for some reason.

If MNEs cease to be in scope of the applied GloBE rules, they must notify the Commissioner within six months of the end of the first fiscal year that the rules do not apply.

The GIR

New section 78I of the TAA provides that a constituent entity located in New Zealand must provide to the Commissioner, in the prescribed electronic format, the information set out in Articles 8.1.4(a) to (e) of the Model Rules (that is, the GIR). This does not apply where the GIR is submitted on time by the CE's UPE, or a designated filing entity of the CE's MNE group, to a foreign competent authority that is obliged to exchange that information with the Commissioner. However, where the UPE is located in New Zealand, the GIR must be filed locally.

Foreign-headquartered MNEs proposing to file the GIR in another country must notify the Commissioner.

For the first income year in which a CE is required to provide a GIR, the GIR must be filed within 18 months of the end of the fiscal year. For subsequent years, the GIR must be filed 15 months after the end of the fiscal year.

The GIR must be filed in a standard template developed by the OECD. Article 8.1.4 of the GloBE Model Rules lists the information to be included in the GIR but notes that this will be further specified, expanded or restricted, including through the development of simplified reporting procedures. The information required includes:

- Identification of the CEs, including their tax identification numbers (if they exist), the jurisdiction in which they are located, and their status under the GloBE Rules.
- Information on the overall corporate structure of the MNE group, including the controlling interests in the CEs held by other CEs.
- The information necessary to compute:
  - the ETR for each jurisdiction and the top-up tax of each CE under Chapter 5
  - the top-up tax of a member of the JV Group under Chapter 6
  - the allocation of top-up tax under the IIR and the UTPR top-up tax amount to each jurisdiction under Chapter 2.
- A record of the elections made in accordance with the relevant provisions of the GloBE Rules.
- Other information that is agreed as part of the GloBE Implementation Framework and is necessary to carry out the administration of the GloBE Rules.

The GIR was published by the OECD in July 2023, and is available on the OECD website at the same link as the other GloBE materials.[9]

Change to CbC reporting process

As part of the introduction of GloBE information reporting for Pillar Two, the CbC reporting process has been modernised by moving to electronic filing using the XML format under the amendments to section 78G. This brings New Zealand into line with other jurisdictions, which require CbC reporting electronically in XML format.

The New Zealand Multinational top-up tax return

New section 78J requires a multinational top-up tax return to be filed on an annual basis by any CEs located in New Zealand, whether or not they have a UTPR liability. The multinational top-up tax return includes a CE's self-assessment of any top-up tax in a form prescribed by the Commissioner.

The due date for the multinational top-up tax return is one month after the GIR due date. This allows foreign groups to arrange filing of the multinational top-up tax return. For the first year the constituent entity is required to file the multinational top-up tax return, the filing deadline is two months after the due date for the GIR.

Paying the tax

As the multinational top-up tax liability is a separate tax type, payment of the tax is due separately from any income tax liability of the MNE and has its own payment date.

Payment of multinational top-up tax is due on the same day that the multinational top-up tax return is due with Inland Revenue. Payments under the GloBE rules are not subject to provisional tax.

The standard rules in Parts 7 (Interest) and 9 (Penalties) of the TAA apply to GloBE payments that are paid after the due date.

Example 19: Reporting dates

World is my Oyster Limited (WOL) is the New Zealand-resident UPE of an MNE that produces specialist oyster fishing equipment. It has operations in 15 countries and meets the requirements to be subject to the GloBE rules.

WOL has a June balance date, and the first fiscal year it will be required to report under the GloBE rules will be the year ended 30 June 2025. WOL has a New Zealand tax agent and an extension of time to file its New Zealand income tax return.

WOL's reporting and payment dates for the initial 30 June 2025 year will be as follows:

New Zealand income tax return – due 31 March 2026.

GIR – due 31 December 2026 (18 months after balance date – normally this will be due 15 months after balance date on 30 September).

New Zealand multinational top-up tax return and payment – due 28 February 2027 (20 months after balance date – normally this will be due 16 months after balance date on 31 October).

New penalties

Late and/or incomplete GIR

For information to be exchanged with other tax authorities on a timely basis, it is important that Inland Revenue receives a complete GIR on time and in the correct format. This will give time for the information to be checked before it is provided to other jurisdictions. Documents not filed electronically in the XML format will not be treated as filed for this purpose.

New section 139ABB provides for a penalty for failing to comply with the GIR requirements under new section 78I. The penalty applies to:

- New Zealand-headquartered MNEs.
- Foreign-headquartered MNEs with operations in New Zealand that do not file a GIR in a country with which New Zealand has an exchange of information agreement.
- MNEs that do not file their GIR on time in their UPE or designated filing entity country.

[9] Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) - OECD

The amount of the penalty is specified by the Commissioner, and does not exceed $100,000.

Late and/or incomplete New Zealand multinational top-up tax return

Amended section 139A provides for a penalty if a CE fails to comply with the requirement to provide an annual multinational top-up tax return to the Commissioner in accordance with new section 78J. In this case, the amount of the penalty is $500.

Late and/or incomplete CbC Report

As with the GIR, it is important that Inland Revenue receives a complete CbC Report on time and in the correct format. The amendments to section 78G of the TAA ensure that documents not filed electronically in the XML format not be treated as filed for this purpose.

New section 139AAB introduces a penalty for a large multinational group with a New Zealand resident UPE that fails to comply with the requirements under section 78G. The amount of the penalty is an amount specified by the Commissioner, which must not exceed $100,000.

Late registration

Under new section 78H of the TAA, New Zealand-headquartered and foreign-headquartered MNEs are required to notify Inland Revenue that they are in scope of the applied GloBE rules within six months from the end of the first fiscal year they are in scope of the rules. If the MNE fails to comply with this requirement, it will be liable to pay a penalty under section 139ABB for an amount specified by the Commissioner, not exceeding $100,000.

Empowering assessment provisions for penalties

The new GloBE penalties require provisions empowering the Commissioner to assess the penalties. New sections 94BB, 94BC, and 94BCB of the TAA provide for these assessment powers. The taxpayer retains the usual right to challenge an assessment and be relieved of liability for a penalty if it is found to be excessive or incorrectly charged.

Shortfall penalties: Unacceptable tax position

The unacceptable tax position shortfall penalty in section 141B of the TAA does not apply to multinational top-up tax until fiscal years starting on or after 1 January 2027. All other shortfall penalties apply from commencement.

Binding rulings

New subsection 91C(1)(ed) of the TAA gives the Commissioner the power to make binding rulings in respect of the applied GloBE rules, including commentary and administrative guidance. The Commissioner already has this power in relation to various other kinds of taxes in order to provide certainty on tax positions.

Increasing the trustee tax rate to 39%

Overview

The *Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024* (the Act) was enacted on 28 March 2024.

The Act amends the Income Tax Act 2007 (the ITA) to increase the trustee tax rate from 33% to 39% for the 2024–25 and later income years to address the under-taxation of trust income.

The new legislation also introduces:

- Measures to mitigate over-taxation, including:
  - retaining the 33% rate where trustee income for the income year does not exceed $10,000 (after deductible expenses);
  - targeted rules for deceased estates and trusts settled for disabled people; and
  - exclusions for energy consumer trusts and legacy superannuation funds.
- A measure to buttress the 39% trustee tax rate by taxing beneficiary income derived by certain close companies at the 39% trustee tax rate.

Unless otherwise specified, the focus of this Special Report is on "complying trusts".[10]

Current law

The annual income of a trust is taxed either to the trustees or to the beneficiaries of the trust.[11] Trustees of a trust are treated as a single taxable person and their trustee income is calculated separately from their personal income.[12]

Beneficiary income

Definition: Beneficiary income is all income earned by a trust in an income year that is vested absolutely in a beneficiary during the income year, or paid or allocated to a beneficiary before the later of:

- 6 months following the end of the income year, or
- the earlier of:
  - the date the trust files its tax return, or
  - the date the trust is required to file its tax return.[13]

Income does not need to be paid to a beneficiary to be beneficiary income; the income can be allocated to a beneficiary. Provided the income is vested absolutely in the beneficiary, the income is beneficiary income and is taxed at the beneficiary's personal tax rate unless it is subject to the minor beneficiary rule. Income being "vested absolutely" is broadly equivalent to the trustees allocating the income irreversibly to a beneficiary, i.e. they cannot change their mind about the allocation.

Definition: The **minor beneficiary rule** applies to beneficiary income derived by a minor (a New Zealand resident natural person under 16 years old) from property settled on a trust by:

- a relative or legal guardian, or
- an associated person of a relative or legal guardian, unless a specific exception applies.

If the total beneficiary income derived by the minor from a trust is greater than $1,000 in an income year, the income is taxed at the trustee tax rate.[14]

The purpose of the minor beneficiary rule is to limit the tax benefits that could otherwise be achieved by distributing the income of a trust to a minor beneficiary (likely to be on the lowest marginal tax rate).

[10] A complying trust is a trust where tax has always been paid in New Zealand on the worldwide income derived by the trustee and the tax obligations relating to the trustee's income tax liability have been satisfied. A complying trust is defined in section HC 10 of the ITA.

[11] Section HC 5 of the ITA.

[12] Sections HC 2 and YA 5 of the ITA.

[13] Section HC 6 of the ITA.

[14] Sections HC 35 to HC 37 of the ITA.

This rule addresses the concern that a minor is not economically independent from the parents or guardians who control the trust. This rule helps ensure that a family with a trust cannot gain a tax advantage over a family without one by using the income of a trust to meet the family's expenses. This is because families would be able to use a trust to meet the expenses of children from income taxed at the marginal tax rates of the children, instead of meeting those expenses from their own after-tax income.

Table 1: Types of beneficiary income

Types of beneficiary income	Examples
Income distributed or paid to a beneficiary.	Cash transferred to the beneficiary.
Income allocated to a beneficiary by crediting the beneficiary's current account (i.e., the cash is still with the trust but can be called upon by the beneficiary).	Trustees allocating an amount to a beneficiary by making a journal entry in the trust's accounts to the beneficiary's current account.
Income that is allocated to a beneficiary for them to possess at a future date or event.	Trustees settle an amount of income on a sub-trust for a beneficiary.

Trustee income

Definition: Trustee income is all income derived by the trustees of a trust in an income year that is not beneficiary income.[15]

Once income has been taxed as trustee income, subsequent distributions of that income to the beneficiaries are tax-free.[16] That is, trustee income is subject to a final tax imposed in the year the income is derived by the trust.

Trustee's net income

Although beneficiary income is first derived by a trustee, and secondly by a beneficiary (once it has been vested in or paid to the beneficiary), it is only taxed once in the case of a complying trust (i.e. to the beneficiary).[17] Beneficiary income is included in the beneficiary's income for the purposes of calculating their net income.[18]

Beneficiary income is not included in the trustee's income the purposes of calculating the trustee's net income. However, when determining the deductions a trustee is allowed in an income year, beneficiary income is treated as trustee income. Beneficiaries are denied a deduction for any expenditure or loss incurred by the trustee in deriving the beneficiary income.[19]

This means that the trustee's net income is determined based on only trustee income (excluding any beneficiary income) less any deductions incurred in deriving *both* trustee and beneficiary income.

Trustee's net income = **Trustee income** *less* **deductions** (from deriving both trustee and beneficiary income)

Corpus

Definition: Corpus is property settled on a trust.[20]

Corpus is used to provide benefits to the beneficiaries and can be used to derive income and capital gains. Distributions of any amounts other than beneficiary income, including corpus, capital gains, or trustee income from prior years, are exempt from tax to the receiving beneficiary.[21]

[15] Section HC 7 of the ITA.

[16] This is only the case for complying trusts (sections CW 53 and HC 20 of the ITA). Distributions of accumulated trustee income from foreign trusts are taxed at the beneficiary's personal tax rate (sections CV 13 and HC 15 of the ITA). Distributions of accumulated trustee income or capital gains from non-complying trusts are taxed at a 45% tax rate (sections CX 59, HC 15 and Schedule 1, Part A, Clause 4 of the ITA).

[17] This is only the case for complying trusts. A taxable distribution from a foreign or non-complying trust to a beneficiary may be taxed twice (e.g. first to the trustee as trustee income and again to the beneficiary).

[18] Section CV 13(a) of the ITA.

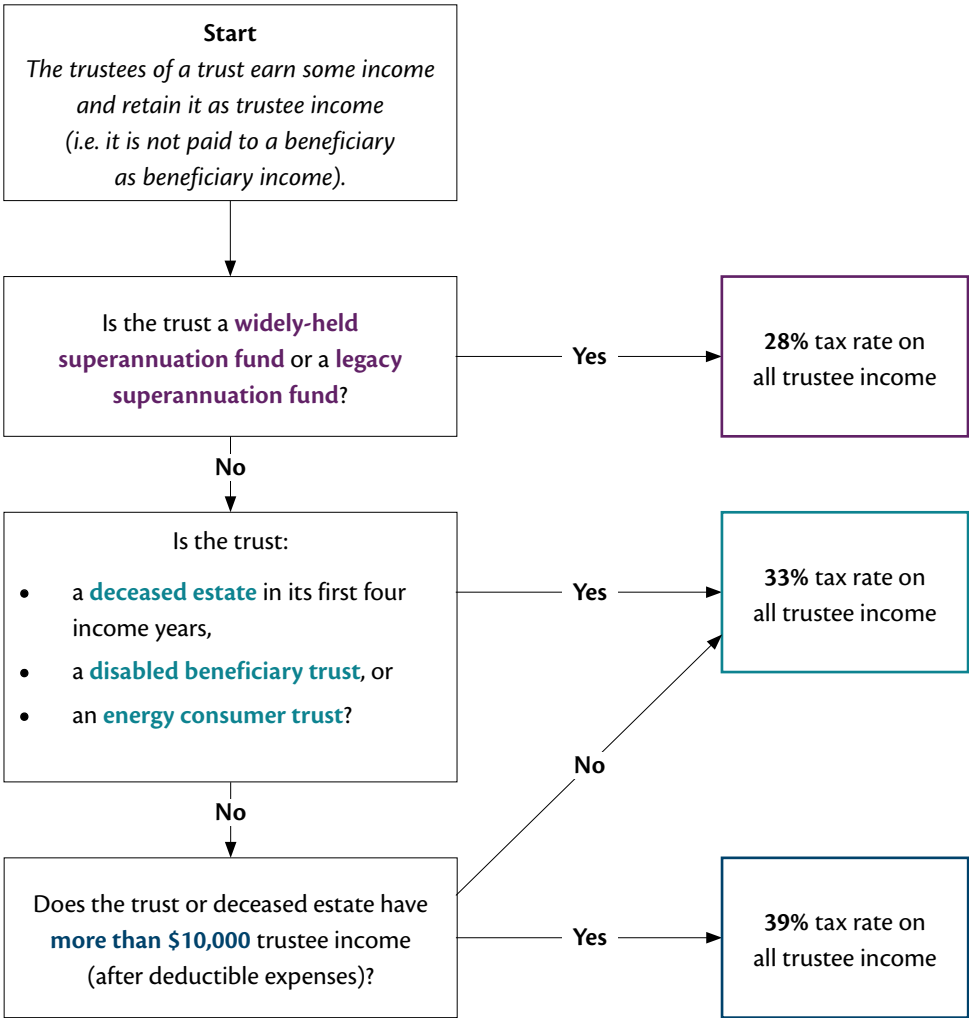
[19] Section DV 9 of the ITA.

[20] Section HC 4 of the ITA.

[21] This is only the case for complying trusts (sections CW 53 and HC 20 of the ITA). Distributions of accumulated trustee income from foreign trusts are taxed at the beneficiary's personal tax rate (sections CV 13 and HC 15 of the ITA). Distributions of accumulated trustee income or capital gains from non-complying trusts are taxed at a 45% tax rate (sections CX 59, HC 15 and Schedule 1, Part A, Clause 4 of the ITA).

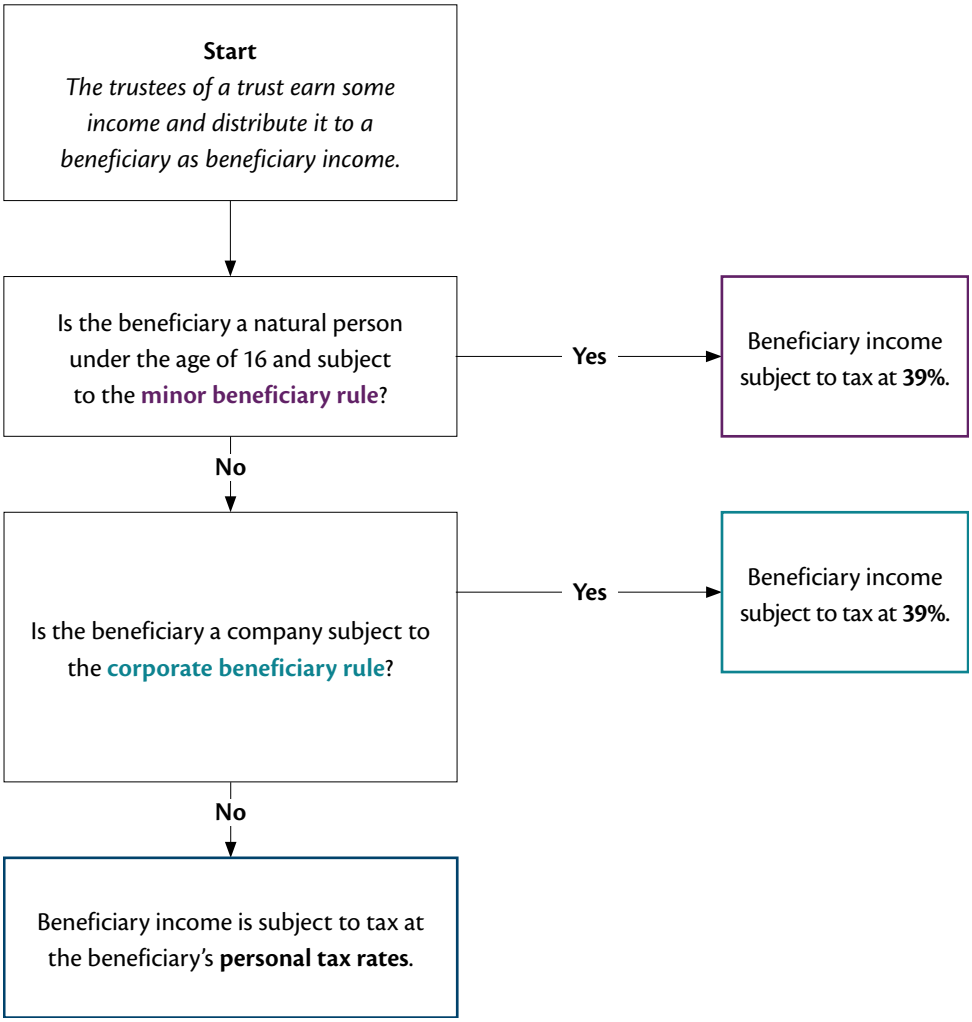
Trustee income flowchart

For the 2024–25 and later income years, trustee income is subject to tax at the 39% trustee tax rate to address the under-taxation of trust income, unless special rules to mitigate over-taxation apply. This flowchart provides a simplified explanation of how the different rules for trustee income interact.



Beneficiary income flowchart

Beneficiary income is subject to tax at the beneficiary's marginal tax rates, unless special rules apply. This flowchart provides a simplified explanation of how the different rules for beneficiary income interact.



Increasing the trustee tax rate to 39%

Sections HC 7, HC 35, HC 40 and Clauses 3 and 6B of Schedule 1, Part A of the ITA

The trustee tax rate has been increased from 33% to 39% for the 2024–25 and later income years. The 33% rate still applies if trustee income for the income year does not exceed $10,000 (after deductible expenses).

Background

The previous 33% trustee tax rate had been in place since 1989 and was intentionally chosen to align with the (then) top personal tax rate. In 2020, a new top personal tax rate of 39% for income over $180,000 was introduced for the 2021–22 and later income years. The trustee tax rate was not increased at that time.

The previous 33% trustee tax rate meant that individuals were not subject to the 39% personal tax rate on distributed tax-paid trustee income, even if they earned over $180,000 in (combined) personal income and distributed tax-paid trustee income. This **under-taxation** of trust income undermined the fairness of the tax system.

Due to the trustee tax rate being a final tax, it can also result in **over-taxation**. This does not depend on the amount of income earned by the trust, but arises when trustee income is taxed at a rate higher than the personal tax rates of the beneficiaries and settlors of the trust.

Income of a trust can be taxed at a beneficiary's personal tax rate if the income is paid or allocated to the beneficiary as beneficiary income, but this may not always be feasible.

Key features

- The trustee tax rate has been increased from 33% to 39%.
- To help mitigate over-taxation, the 33% rate still applies if trustee income for the income year does not exceed $10,000 (after deductible expenses).
- Amendments to clarify that beneficiary income subject to the minor beneficiary rule is subject to the 39% trustee tax rate have been made.

Effective date

The amendments apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Detailed analysis

De minimis

Trusts with trustee income not exceeding $10,000 (after deductible expenses) are subject to a 33% tax rate on trustee income. Trusts with more than $10,000 trustee income (after deductible expenses) are subject to the 39% trustee tax rate on **all** of their trustee income.

New section HC 40 of the ITA provides that a trust is a "de minimis trust" for an income year if the trustees have no more than $10,000 net income (trustee income less deductible expenses) for that income year. A de minimis trust is subject to a 33% tax rate on its trustee income.

Any income treated as trustee income under the following rules is ignored when determining whether a trust is a de minimis trust:

- The minor beneficiary rule in section HC 35 of the ITA (see page 10).
- The corporate beneficiary rule in section HC 38 of the ITA (see page 11).

Example 1: De minimis trust

Big Bird is the sole beneficiary of an income-earning trust. Each year, the trustees earn $20,000 of income and have $2,000 of deductible expenditure.

2024–25 income year: Big Bird asks the trustees, Gonzo and Grover, for some income – he is struggling to make ends meet. They decide to distribute $12,000 to him as beneficiary income and retain the remaining $8,000 as trustee income. Gonzo and Grover can deduct expenses of $2,000, leaving net income of $6,000 (trustee income after deductible expenses). Because the net income of the trustees does not exceed $10,000, the trust is a de minimis trust, and the trustee income is taxed at 33%.

2025–26 income year: Big Bird again asks Gonzo and Grover for some income. They have heard that Big Bird hasn't spent all his money from last year, so decide to only distribute $8,000 as beneficiary income. $12,000 is retained as trustee income. After deducting $2,000 of expenses, the trustees have net income of $10,000. Because the net income of the trustees does not exceed $10,000, the trust is a de minimis trust, and the trustee income is taxed at 33%.

2026–27 income year: Gonzo and Grover hear that Big Bird again hasn't spent all his beneficiary income from the previous year. They decide to cut him off in the 2026–27 income year and retain all the income as trustee income. The trustees have $20,000 trustee income. After deducting $2,000 of expenses, Gonzo and Grover have net income of $18,000. Because the net income of the trustees exceeds $10,000, the trust is not a de minimis trust, and the trustee income is taxed at 39%.

Income year	Trustee income (after deductible expenses)	Is the trust a de minimis trust?	Tax rate on all trustee income
2024–25	$6,000	Yes	33%
2025–26	$10,000	Yes	33%
2026–27	$18,000	No	39%

Fragmentation

Eligibility for the de minimis is determined on a per-trust basis, per income year. If a person has settled multiple trusts, each trust can separately qualify as a de minimis trust.

However, settling multiple trusts, or fragmenting an existing trust into multiple trusts, to take advantage of the 33% tax rate for trustee income of a de minimis trust would raise tax avoidance concerns for the Commissioner of Inland Revenue.

Minor beneficiary rule

The "minor beneficiary rule" provides that beneficiary income derived by a minor (under 16 years old) is taxed at the trustee tax rate, unless certain exclusions apply such as:

- the total amount of beneficiary income earned by the minor from the trust in the income year is $1,000 or less,
- the trust paying the beneficiary income is a testamentary trust, or
- all settlements on the trust were made by a person who is neither a relative or guardian of the minor (nor a person associated with a relative or guardian). For further information on the specific exclusions from the minor beneficiary rule, refer to Part 6 of Inland Revenue's Interpretation Statement on the taxation of trusts: IS 24/01.

The Act amends sections HC 7(2) and HC 35(2) to clarify that beneficiary income subject to the minor beneficiary rule is subject to the 39% trustee tax rate, regardless of whether the trust is a de minimis trust.

Corporate beneficiary rule

Sections CD 44(7)(dc), CX 58B, HC 7, HC 17, HC 24, HC 38, LE 4B and YA 1 of the ITA.

Beneficiary income derived by certain corporate beneficiaries is subject to the 39% trustee tax rate and treated as trustee income for the purposes of determining who pays the relevant tax and who provides the return of income.

Background

A company can be a beneficiary of a trust. Prior to the amendments in the Act, beneficiary income paid to a corporate beneficiary was taxed at 28%. This meant that corporate beneficiaries could be used to shelter income from the higher personal tax rates of the shareholders in those companies until such time that income was distributed to the shareholders.

If the trustees of the trust making the distribution also own shares in the corporate beneficiary (in their capacity as trustees), the income allocation achieves nothing. The income effectively remains within the trust. The principal, or in many cases the only, effect of the allocation is to ensure that the income is taxed at 28% rather than the trustee tax rate. While a subsequent distribution of the income by the company to the trust will be taxable as a dividend (with imputation credits attached), such a distribution may never be made. Similar concerns arise if the shareholder of the corporate beneficiary is the settlor of the trust or a related trust.

Key features

To ensure that companies cannot be used to shelter income from the 39% trustee tax rate, the amendments introduce a "corporate beneficiary rule". Beneficiary income earned by certain companies is subject to the 39% trustee tax rate instead of the 28% tax rate.

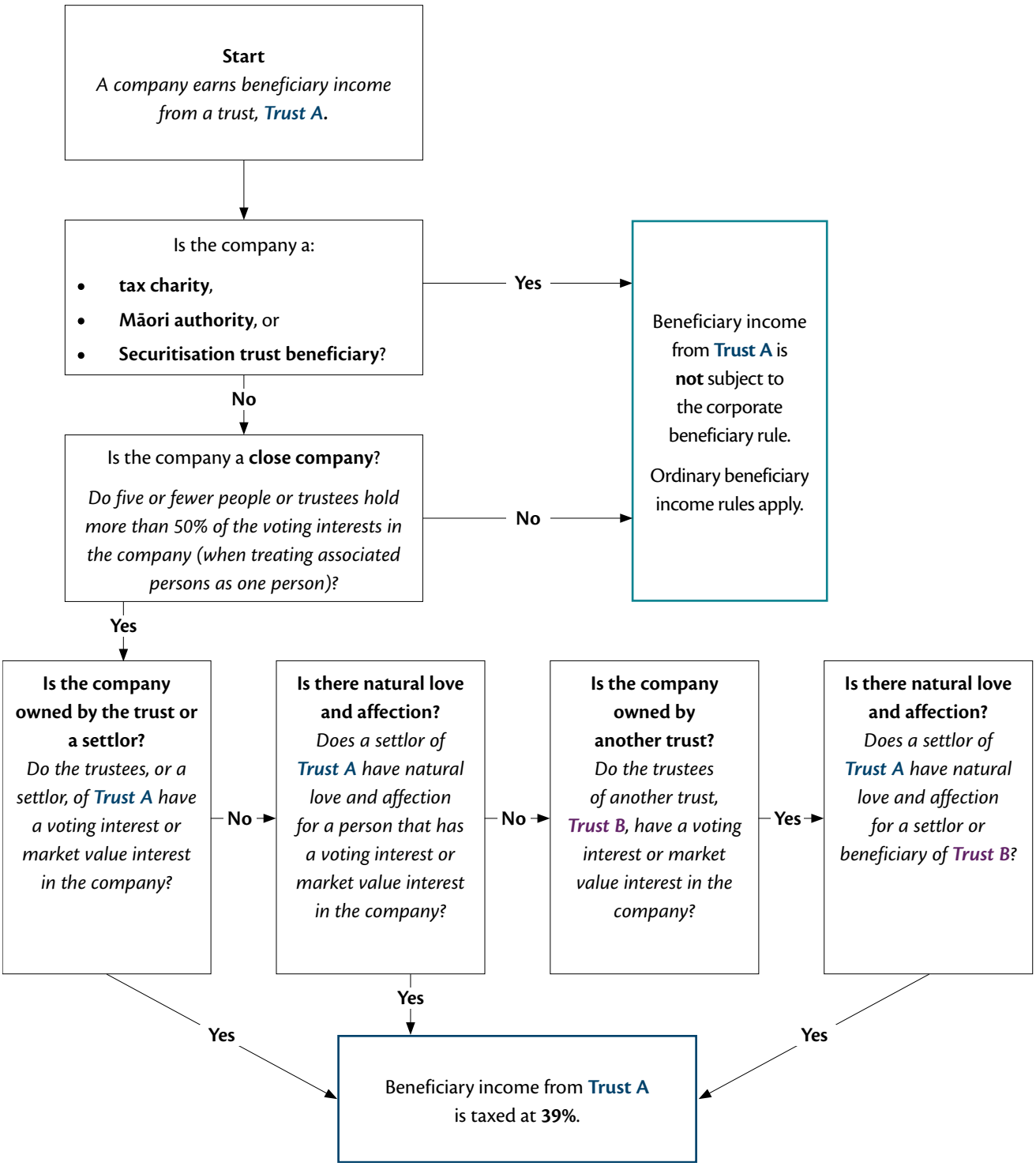
Generally, companies not subject to the corporate beneficiary rule remain taxed at 28% on beneficiary income.

Effective date

The amendments apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Corporate beneficiary rule flowchart

This flowchart provides a simplified explanation of when an amount of beneficiary income earned by a company is subject to the new corporate beneficiary rule.



Detailed analysis

To buttress the 39% trustee tax rate, new section HC 38 provides that beneficiary income derived by certain corporate beneficiaries is subject to tax at the 39% trustee tax rate. Such beneficiary income amounts are also treated as trustee income for the purposes of determining who pays the relevant tax, and who provides the return of income.

Taxing beneficiary income derived by certain close companies at the 39% trustee tax rate prevents the under-taxation that would otherwise arise if the income were taxed at the corporate tax rate.

Definition: A company is a **close company** if five or fewer natural persons or trustees hold more than 50% of the voting interests in the company, treating associated persons as one person.

Definitions: Generally, a person who holds shares issued by a company will have a **voting interest** in the company. A person's **market value interest** in a company equals their share of the total market value of shares and options held in the company if there is a **market value circumstance**.

Definition: The term **natural love and affection** is used to describe the motive of a person for an action driven not by a promise of something in return, but by the natural love and affection the person has for another. Natural love and affection is generally considered to exist between relatives, whether by blood, marriage, a non-spousal domestic relationship, or adoption. It can be present between close friends as well, although not ordinary acquaintances or colleagues.

The **corporate beneficiary rule** applies if a close company earns an amount of beneficiary income from a trust (Trust A) and any voting interest or market value interest, directly or indirectly, in the company is held by at least one of the following:

- **Criteria 1:** a settlor of Trust A,
- **Criteria 2:** the trustees of Trust A,
- **Criteria 3:** a person for whom a settlor of Trust A has "natural love and affection", or
- **Criteria 4:** the trustees of another trust (Trust B), if a settlor of trust A has "natural love and affection" for a settlor or a beneficiary of Trust B.

Criteria 1 and 2: Settlor- and trustee-owned companies

The corporate beneficiary rule applies to a close company if a settlor, or the trustees, of a trust have a voting interest or market value interest in the company, directly or indirectly. This recognises that a settlor, or the trustees, of the trust have a degree of control over the company, and it could be used to shelter income from the 39% trustee tax rate.

Criteria 3: Natural love and affection

The corporate beneficiary rule also extends to close companies where a settlor of the trust has natural love and affection for a person that holds a voting interest or market value interest, directly or indirectly, in the company. Whether a person has natural love and affection for another person is subjective and can only be considered on a case-by-case basis.

Limiting the corporate beneficiary rule to situations where a settlor, or the trustee, of a trust directly or indirectly controls a company would mean that the trustees would still be able to shelter income from the 39% trustee tax rate by allocating beneficiary income to a company that is owned by a person who is, for example, a relative or associate of a settlor of the trust.

Criteria 4: Company owned by a different trust

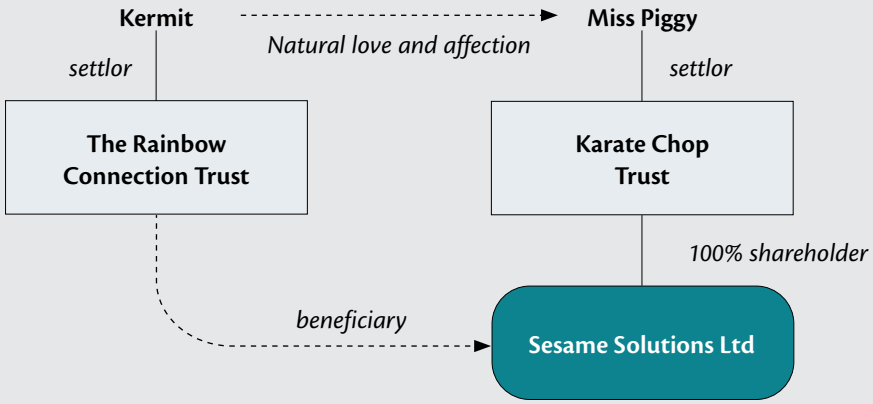
The corporate beneficiary rule also applies in situations where the close company is owned by the trustees of a different trust than the one paying the beneficiary income. This situation is not covered by Criteria 3 because it is not possible to have natural love and affection for trustees (even if those trustees are natural persons).

Example 2: Corporate beneficiary owned by a different trust

Kermit and Miss Piggy have natural love and affection for each other and are each separately the settlors of the Rainbow Connection Trust and the Karate Chop Trust, respectively. Karate Chop Trust is the sole shareholder of a close company, Sesame Solutions Ltd.

Since Kermit has natural love and affection for Miss Piggy, if the trustees of the Rainbow Connection Trust make Sesame Solutions Ltd a beneficiary of the trust, then the company will satisfy Criteria 4. Any beneficiary income paid by the trustees of the Rainbow Connection Trust to Sesame Solutions Ltd will be subject to the corporate beneficiary rule and taxed at 39%.

Sesame Solutions Ltd is a close company and is not a registered charity, Māori authority, or the beneficiary of a securitisation trust, so is not excluded from the corporate beneficiary rule.



Available capital distribution amount

New section CD 44(7)(dc) provides that income subject to the corporate beneficiary rule is a capital gain amount in the formula for determining the available capital distribution amount (ACDA) for a share on liquidation of the company. This means that the amount of ACDA will be increased on liquidation of the company so that the income subject to the corporate beneficiary rule is not subject to tax again if it is distributed to the shareholders on liquidation.

For most companies, capital gains cannot be distributed 'tax-free' to shareholders until liquidation, so any distribution (other than on liquidation) of corporate beneficiary income by the company will be subject to the ordinary dividend rules and subject to tax in the shareholders' hands.

Excluded income

New sections CX 58B and HC 38(2)(a) provide that beneficiary income subject to the corporate beneficiary rule is excluded income in the hands of the corporate beneficiary. This is consistent with the treatment of minor beneficiary income in sections CX 58 and HC 35.

No imputation credit

A company will not receive an imputation credit for any tax paid by the trustees on an amount of beneficiary income subject to the corporate beneficiary rule.

Use of tax credits

New section LE 4B ensures that the trustees can use tax credits to satisfy the tax liability on beneficiary income subject to the corporate beneficiary rule. This treatment mirrors the existing provision in section LE 4 for income subject to the minor beneficiary rule.

Exclusions

Dividends within a wholly-owned group

Section HC 38(3)(b) provides that the corporate beneficiary rule does not override the inter-corporate dividend exemption in section CW 10. The inter-corporate dividend exemption provides that a dividend is exempt income if it is paid between NZ resident companies within the same wholly-owned group.

If a trustee derives an amount of income that is of a particular character in the hands of the trustee, the income will retain this character in the hands of the beneficiary when the amount becomes beneficiary income. This means that if a trustee earns dividend income and distributes that income as beneficiary income, it will retain its character as dividend income for the beneficiary.

Example 3: The corporate beneficiary rule and dividends within a wholly-owned group

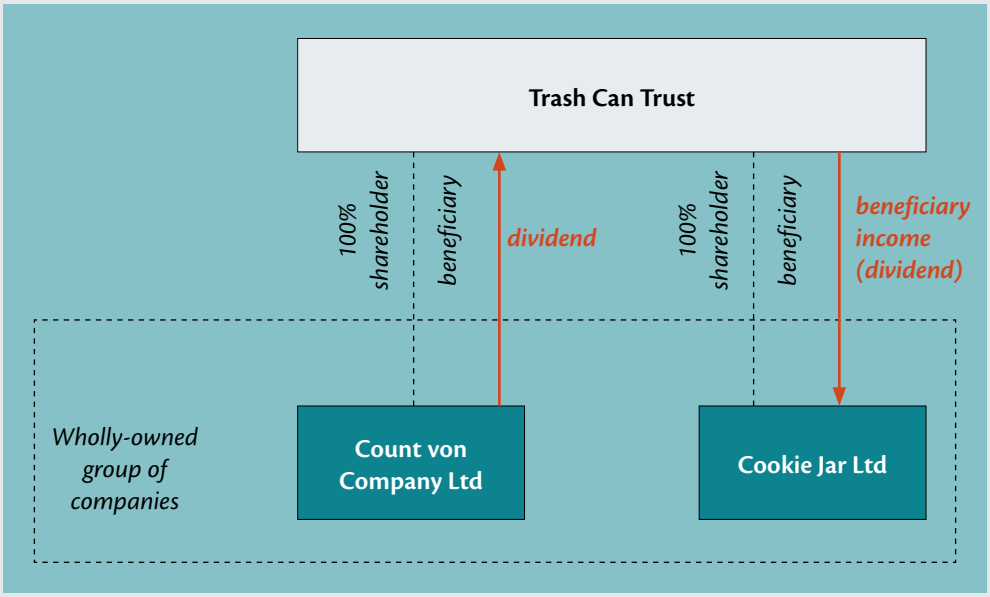
Oscar the Grouch, Count von Count, and Cookie Monster are the trustees of the Trash Can Trust. The trustees are the sole shareholders of the companies Count von Company Ltd and Cookie Jar Ltd. Both companies are beneficiaries of the trust.

Count von Company Ltd pays a dividend of $100 to Trash Can Trust, and the trustees decide to distribute the $100 to Cookie Jar Ltd as beneficiary income. Since beneficiary income retains its character, the income is dividend income in the hands of Cookie Jar Ltd.

Count von Company Ltd and Cookie Jar Ltd are both wholly-owned by the trustees of the Trash Can Trust. They have 100% common voting interests, so are a wholly-owned group of companies.

The dividend from Count von Company Ltd to Cookie Jar Ltd, via Trash Can Trust, satisfies the inter-corporate dividend exemption requirements in section CW 10 since it was paid within a wholly-owned group of companies. This means that the dividend is exempt income for Cookie Jar Ltd and not subject to the corporate beneficiary rule.

If imputation credits (and/or RWT) were attached to the dividend by the paying company, Count von Company Ltd, then a credit will arise in the imputation credit account of the recipient company, Cookie Jar Ltd.



Securitisation trusts

Section HC 38(1B)(c) excludes securitisation trust beneficiaries from the corporate beneficiary rule. This helps ensure that the rule does not impact the use of trusts in the securitisation industry. To achieve this, the amendments introduce three new definitions in section YA 1.

Definition: A trust is a **securitisation trust**, for an income year, if from the establishment of the trust to the end of the relevant income year, the trust has only one beneficiary and that beneficiary is a company, and at all times during the income year, the trust:

(a) operates to do one or more of the following:
  (i) guarantee liabilities of a financial institution (**person A**), who transferred some or all of their assets to the trust:
  (ii) guarantee liabilities of a company, incorporated in and resident in New Zealand, that is a member of a wholly-owned group of companies that includes person A:
  (iii) raise funds by issuing securities backed by its assets:
  (iv) raise funds by borrowing money backed by its assets; and

(b) has interests in assets for the sole purpose of carrying out the trust's operations described in paragraph (a); and

(c) receives only funds that—
  (i) are used to acquire assets as described in paragraph (b):
  (ii) are derived from assets described in paragraph (b); and
  (iii) are incidental to the trust's sole purpose described in paragraph (b); and

(d) derives no exempt income; and

(e) is a New Zealand resident; and

(f) meets at least one of the following requirements:
  (i) the beneficiary of the trust is a lending person:
  (ii) the trust has its assets included in financial statements that are prepared using IFRSs.

Definition: A person is a **lending person**:

(a) whose main business activity is lending funds or leasing personal property to persons who are not associated with the person; or

(b) who is a member of a group whose main business activity is lending funds or leasing personal property to persons who are not associated with any member of the group.

Definition: A beneficiary of a securitisation trust is a **securitisation trust beneficiary.**

The definition of a securitisation trust is partially based on the existing definition of "debt funding special purpose vehicle" (DF SPV) in section YA 1, with some modifications to recognise that the DF SPV definition does not capture all relevant trusts in the securitisation industry.

A securitisation trust is required to have only one beneficiary at any point in time. This does not necessarily need to be the same company throughout the trust's existence.

Unlike the DF SPV definition, the securitisation trust definition does not require all of the trust's assets to be treated as assets of its originators, recognising that a securitisation trust may not necessarily be consolidated with the originator for financial reporting purposes.

The securitisation trust is required to either (a) have a "lending person" as its beneficiary or (b) have its assets included in financial statements that are prepared using IFRSs. This ensures that the exclusion is targeted towards the securitisation industry and not available to any trust established for the sole purpose of raising funds by borrowing money backed by its assets, for example.

Deceased estates

Section HC 8B and Clause 6B of Schedule 1, Part A of the ITA

Deceased estates are excluded from the 39% trustee tax rate and remain subject to a 33% rate in the income year the estate was created, and the following three income years.

Background

Deceased estates are taxed as trusts,[22] which means income they derive is taxed at the trustee tax rate to the extent it is not beneficiary income.

Most trusts can use existing rules to pay or allocate income as beneficiary income to mitigate over-taxation. However, deceased estates may not be able to use beneficiary income allocations to mitigate over-taxation if the beneficiaries of the deceased estate are not yet known, or potential claims against the deceased estate have not yet been resolved.

Key features

A deceased estate is excluded from the 39% trustee tax rate in the income year the estate was created and the following three income years. Instead, such deceased estates are subject to a 33% tax rate on their trustee income.

Deceased estates are subject to ordinary trust tax rules outside this time period. This means a deceased estate could satisfy the criteria to be a de minimis trust.

Effective date

The amendments apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Detailed analysis

New section HC 8B of the ITA provides that during the income year the estate was created and the following three income years, a deceased estate is subject to a 33% tax rate on its trustee income instead of the 39% trustee tax rate.

If a deceased estate is not wound up by the end of the third income year following the income year the estate was created, it will be subject to the 39% trustee tax rate. However, just like trusts, deceased estates can be de minimis trusts if they earn no more than $10,000 trustee income (after deductible expenses).

These rules are not limited to deceased estates created after the enactment of the Act. Existing deceased estates are eligible provided they are still within the time limit (income year the estate was created, plus the three following income years). That is, the rules apply to deceased estates created on or after 1 April 2021.

[22] The definition of "trustee" in section YA 1 of the ITA includes an executor or administrator.

Example 4: Trustee income of an existing deceased estate

Elmo died in August 2023, so his deceased estate was formed in the 2023–24 income year. Elmo's estate earns income from a rental property on Sesame Street, with no deductible expenses. However, the trustee of his estate cannot distribute this income for many years after his death. This is because it is unclear who the beneficiaries of his estate are due to an ongoing dispute between Bert and Ernie.

Elmo's estate was created in the income year before new section HC 8B came into effect, when the trustee tax rate was 33%. Elmo's estate is also eligible to apply the 33% tax rate for deceased estates on trustee income for the 2024–25 to 2026–27 income years, inclusive.

In the 2027–28 income year (the fourth income year after the year during which the estate was created), Elmo's estate no longer qualifies for the 33% tax rate for deceased estates. This means that trustee income earned by Elmo's estate is subject to the 39% trustee tax rate (unless the deceased estate is a de minimis trust for that income year).

The dispute over Elmo's assets is finally resolved in the 2028-29 income year. The trustee of his estate can make beneficiary income allocations to Bert and Ernie, leaving $8,000 of trustee income. Elmo's estate qualifies as a de minimis trust for this income year, so is subject to the 33% tax rate on its trustee income.

Income year	Trustee income	Does the 33% rate for deceased estates apply?	Is the trust a de minimis trust?	Tax rate for trustee income
2023–24	$15,000	No	No	33%
2024–25	$30,000	Yes	No	33%
2025–26	$30,000	Yes	No	33%
2026–27	$30,000	Yes	No	33%
2027–28	$30,000	No	No	39%
2028–29	$8,000	No	Yes	33%

Disabled beneficiary trusts

Section HC 39 and Clause 6B of Schedule 1, Part A of the ITA

Trusts settled for one or more disabled beneficiaries are excluded from the 39% trustee tax rate and remain subject to a 33% tax rate on trustee income, provided certain criteria are met.

Background

Prior to the amendments, "disabled beneficiary trusts" were not defined in the Inland Revenue Acts. These targeted rules were introduced to help mitigate the risk of over-taxation for trusts settled for disabled people following the introduction of a 39% trustee tax rate.

Key features

Trustee income derived by the trustees of a trust is taxed at 33% if an eligible Government support payment for a disability is paid to, or on behalf of, each of the beneficiaries of the trust.

- Support payments can be made for some, or all, of the relevant income year.
- Beneficiaries can be added or removed, as long as there is at least one disabled beneficiary remaining.
- The targeted rules do not have an income test, but three of the four eligible support payments are income-tested.
- A disabled beneficiary under 16 years of age is excluded from the minor beneficiary rule.

Effective date

The amendments apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Detailed analysis

Beneficiaries must meet "disabled beneficiary" definition

The amendments allow trustee income derived by a trustee of a trust settled for a disabled person (or persons) to be taxed at a 33% rate, provided the trust has at least one "disabled beneficiary".

Definition: A beneficiary is a **disabled beneficiary** for an income year if they derive (including where the payment is made to their carer on their behalf) one or more of the following support payments for at least part of the income year (or the income year in, or before, the person turned 65 years of age):

- the Disability Allowance,
- the Child Disability Allowance,
- the Supported Living Payment on the ground of restricted work capacity, or
- the JobSeeker Support Health and Disability (if this has been paid for at least 6 months).

Table 4: Summary of eligible payments

Name	Detail	Further information
Disability Allowance	Means tested weekly payment for people who have regular, ongoing costs because of a disability (e.g., medicine or visits to the doctor).	Disability Allowance (workandincome.govt.nz)
Child Disability Allowance	Fortnightly payment made to the main carer of a child with a serious disability. It is paid in recognition of the extra care and attention needed for that child.	Child Disability Allowance (workandincome.govt.nz)
Supported Living Payment on the ground of restricted work capacity	Means tested weekly payment for people who have, or are caring for someone with, a significant health condition, injury, or disability.	Supported Living Payment (workandincome.govt.nz)

Name	Detail	Further information
Jobseeker Support Health and Disability	Means-tested weekly payment for people who cannot work, or are working fewer hours because of a health condition, injury or disability	Jobseeker Support (workandincome.govt.nz)[23]

Trust must only have disabled beneficiaries

The amendments allow a disabled beneficiary trust to have multiple beneficiaries, provided they all meet the "disabled beneficiary" definition (ignoring any residual beneficiaries, who can only receive trust property if there are no longer any living disabled beneficiaries).

Support payments can be made for some, or all, of the relevant income year

To qualify, a beneficiary must have derived at least one of the four eligible Government support payments for at least part of the relevant income year (including where the payment is made to their carer on their behalf). This means trustee income derived by a trust settled for the care of a person who becomes disabled and starts receiving Government support part way through an income year can be taxed at the 33% rate for that income year.

Ability to add/remove disabled beneficiaries

Many trust deeds include a power to add or remove beneficiaries. The amendments allow disabled beneficiaries to be added or removed, as long as there is at least one disabled beneficiary remaining.

[23] Also see: Income support for the person being cared for – A guide for carers (msd.govt.nz), Jobseeker Support cut-out points (current) – Map (workandincome.govt.nz)

Energy consumer trusts

Schedule 1, Part A, Clause 6B(c) of the ITA

Energy consumer trusts are excluded from the 39% trustee tax rate and remain subject to a 33% tax rate on trustee income.

Background

Definition: A **lines trust** (or an energy consumer trust) is a trust that owns shares in an electricity distribution company. A lines trust is a trustee of a trust that has had (and continues to hold) shares allocated, transferred to or vested in it, being shares in:

- an energy company as defined in section 2(1) of the Energy Companies Act 1992 under an approved establishment plan under that Act:
- a company under section 76 of the Energy Companies Act 1992:
- a company that received assets and liabilities of the Crown under section 16 of the Southland Electricity Act 1993.

The beneficiaries of these trusts are the persons whose premises are connected to the energy company's distribution network. These trusts have an increased risk of over-taxation as they may face administrative issues or restrictions in their trust deeds that impact their ability to make beneficiary income allocations.

Key features

Energy consumer trusts are excluded from the 39% trustee tax rate and remain subject to a 33% tax rate on trustee income.

Effective date

The amendment applies for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Legacy superannuation funds

Section YA 1 and Schedule 1, Part A, Clause 6(d) of the ITA

"Legacy superannuation funds" are excluded from the 39% trustee tax rate. These funds are instead taxed at a 28% tax rate on all their income, the same as widely-held superannuation funds.

Background

Definition: A **superannuation fund** is defined in the ITA as a **retirement scheme** within the meaning of section 6(1) of the Financial Markets Conduct Act 2013. This includes:

- a registered scheme that is a KiwiSaver scheme or a superannuation scheme
- a workplace savings scheme
- a "Schedule 3" (single-person) scheme

Definition: A **widely-held superannuation fund** is a superannuation fund that has 20 or more members (counting associated persons as one person).[24]

Widely-held superannuation funds are taxed at a 28% rate on all their income.[25] If a superannuation fund is a trust and is not a portfolio investment entity (a PIE) or widely-held, it is subject to ordinary trust rules including the 39% trustee tax rate.

Many widely-held superannuation funds are "restricted" schemes that are closed to new members. Over time, these funds would fall out of the widely-held superannuation fund definition due to declining membership.

Superannuation funds have an increased risk of over-taxation as all their income is trustee income.[26] They cannot make beneficiary income allocations to mitigate over-taxation.

Key features

The amendments define a "legacy superannuation fund" as a scheme that previously qualified as a widely-held superannuation fund and is a restricted workplace savings scheme.

Legacy superannuation funds are subject to a 28% tax rate on all their income, the same as widely-held superannuation funds.[27]

Effective date

The amendments apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

Detailed analysis

The amendments introduce a new definition for a "legacy superannuation fund".

Definition: A trust is a **legacy superannuation fund** if it formerly satisfied the "widely-held superannuation fund" definition and is either:

- a restricted workplace savings scheme, as designated by the Financial Markets Conduct (Designation of Restricted Schemes) Order 2016, or
- treated as a registered scheme that is a superannuation fund by section 59A(1)(b) of the National Provident Fund Restructuring Act 1990.

For the 2024–25 and later income years, legacy superannuation funds are subject to a 28% tax rate, similar to widely-held superannuation funds. This ensures that these funds are not worse off simply due to declining membership.

[24] The definition of "widely-held superannuation fund" in section YA 1 of the ITA requires that the fund has 20 or more persons, as set out in HM 14(1) of the ITA.

[25] Schedule 1, Part A, Clause 6(c) of the ITA.

[26] Section HC 6(2)(a) of the ITA.

[27] Schedule 1, Part A, Clause 6(c) and(d) of the ITA.

Private family trusts operated as retirement savings vehicles and "Schedule 3" (single-person) schemes are not included within the legacy superannuation fund definition. This is because, generally, the settlors of these trusts retain a large degree of control over these trusts and do not need to invest on arm's length terms. Providing a lower tax rate for these types of trusts would be inconsistent with the widely-held requirements for retirement savings vehicles like PIEs.

A trust operated as a retirement savings vehicle that does not qualify for the widely-held superannuation fund or legacy superannuation fund definitions would still be eligible to be a de minimis trust (and able to apply the 33% tax rate) if trustee income for the income year does not exceed $10,000 (after deductible expenses).

Corpus and settlements on other trusts

Section HC 4(3) of the ITA

Amounts paid as beneficiary income and then settled on a new trust on the beneficiary's behalf are included in the corpus of the new trust.

Background

A settlement by a trustee of a trust (Trust A) on another trust (Trust B) is excluded from corpus of Trust B to the extent to which, if it were distributed to a New Zealand-resident beneficiary of Trust A, it would be beneficiary income or a taxable distribution to that beneficiary.[28] This rule is intended to ensure that trustees cannot avoid paying tax on distributions of amounts accumulated in trusts simply by settling those amounts on other trusts and then distributing them as tax-free corpus.

Trustees can make resettlements on behalf of beneficiaries. This involves:

- a payment made by the trustee to the beneficiary for the purposes of the definitions of "beneficiary income"[29] and "distribution"[30], and
- a settlement by (trustees on behalf of) the beneficiary on the new trust.

Key features

The amendment clarifies the definition of corpus to ensure that a resettlement on behalf of a beneficiary is not excluded from corpus of the new trust. These settlements have not been made to avoid paying tax. The amendment ensures that such settlements are not subject to tax twice – first as beneficiary income (or a taxable distribution), then when the settlement is distributed to the beneficiary.

Effective date

The amendment applies for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

[28] Section HC 4(3) of the ITA.

[29] Section HC 6 of the ITA.

[30] Section HC 14 of the ITA.

Further information

Description	Further information
The landing page on the IRD website for general information about trusts and estates, including how to file a trust tax return.	https://www.ird.govt.nz/roles/trusts-and-estates
The Act amended the Income Tax Act 2007 to increase the trustee tax rate and make consequential changes.	Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Act 2024 Income Tax Act 2007
In February 2024, Inland Revenue published an article providing high-level guidance on how it may perceive some taxpayer transactions and structural changes in response to the 39% trustee tax rate.	GA 24/01: Proposed increase in the trustee tax rate to 39%
In February 2024, Inland Revenue published a revised Interpretation Statement that explains the taxation of trusts (and deceased estates) under the trust rules in the Income Tax Act 2007. This does not cover the changes in the *Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Act 2024*.	IS 24/01: Taxation of trusts

Taxation of backdated lump sum payments

Sections RD 20(B), (C) and YA 1 and Schedule 1 Part A Clauses 13 and 14 of the Income Tax Act 2007.

Background

A backdated lump sum payment is a payment made to a person that relates to a period of one or more income years. Under previous legislation, a backdated lump sum payment to a person of their Accident Compensation Corporation (ACC) or Ministry of Social Development (MSD) entitlements could result in that person having to pay a higher amount of tax. This was because, for most individual taxpayers, income is taxed in the year it is received. This may have been seen as unfair when the person was entitled to receive the payments in earlier years.

Receipt of the lump sum artificially pushed people into a higher tax bracket for a single year. This compounded the disadvantage suffered by the affected person who, in addition to having had a delay in receiving their entitlements, also received a smaller net amount than if the amount had been paid over multiple years (i.e., when it should have been paid).

Key features

The Taxation (Annual Rates for 2023-2024, Multinational Tax, and Remedial Matters) Act 2024 introduces the following two alternative tax treatments for backdated ACC payments and backdated MSD entitlements.

The tax treatment for each payment differs due to the way in which tax is calculated by MSD and ACC.

The changes only alter the tax treatment of these types of payments. The backdated lump sum payment would still be included when calculating social policy entitlements in the year of receipt because these entitlements are, generally, calculated with reference to cash in hand.

Effective date

The amendments apply to payments made on or after 1 April 2024.

Detailed analysis

ACC compensation payments

Each year, ACC pays around 1,200 backdated compensation or reimbursement payments averaging around $48,000 each. In some cases, whether a person is entitled to ACC compensation may be the subject of dispute or delay in awarding compensation and making payment to the person.

Before these amendments, a person may have had a higher tax liability if an amount was paid in a lump sum in one tax year rather than being paid over multiple years. This is because for most individual taxpayers, income is taxed in the year it is received. The receipt of the lump sum artificially pushed people into a higher tax bracket for a single year.

Section RD 20B provides the method to calculate the alternative tax rate for ACC backdated lump sum payments (a "multi-year compensation payment"). Multi-year compensation payment is defined as an accident compensation earnings-related payment,[31] consisting of a lump sum and relating to more than one income year.

The tax rate that applies to these multi-year compensation payments is either:

- 10.5% if the average basic tax rate is less than 10.5%, or
- The person's average basic tax rate, or
- The person's basic tax rate for the income year they receive the multi-year compensation payment if the person's basic tax rate is less than the average basic tax rate.

Section RD 20B(4) provides a formula to calculate the average tax rate for ACC backdated lump sums (the average basic tax rate). This rate would be the person's average tax rate for up to the previous four years, calculated based on the income information Inland Revenue holds.

[31] Defined in section YA 1 of the Income Tax Act 2007.

Where total basic rates are calculated over the period of the four income years (the rate averaging period) ending before the income year in which the person derives the multi-year compensation period, the formula is:

total basic rates ÷ number of income years.

"Basic rate" is defined in schedule 1 of the Income Tax Act 2007, but effectively means the average tax rate in a given income year.[32]

This rate would apply to the backdated lump sum payment separately from the person's other income in the year they receive the payment.

Section RD 20B(3) also sets alternative ways to calculate the relevant tax rate. The section introduces a minimum tax rate of 10.5% to recognise the tax required to be withheld from the payment if the payment was the person's only income.

The section also introduces a 'lower of' test to prevent recipients from being worse off under the alternative tax treatment compared to the status quo. This means that if the recipient has had a higher tax rate in the four years prior to receiving the backdated lump sum but has a lower tax rate in the year the backdated lump sum payment is paid, the previous tax treatment would apply.

ACC is able to request the recipient's tax rate before the backdated lump sum is made and then apply that as the withholding rate on the payment. This would mean no additional amount of tax should be payable for the backdated lump sum (assuming the recipient's circumstances do not change).

Example 1 – taxation of Scotty's ACC Backdated Lump Sum Payment before the new amendments were made

Montgomery Scott (Scotty) was a forklift operator for one of the major ports in New Zealand. In 2019, he was involved in a workplace accident that saw him suffer long-term damage to his leg.

For a time, Scotty received weekly compensation under the Accident Compensation Act 2001 for loss of earnings. However, ACC stopped paying him weekly compensation in 2019 when it considered he was able to return to paid employment. Scotty disputed this decision, but it took some years to resolve as there were several investigations that needed to be completed before final eligibility was established.

In 2023, Scotty was awarded a payment of $50,000 per year. This was paid in a lump sum of $200,000 in March 2023. If Scotty had received this amount in the relevant years, his tax liability for the payments would have been as follows:

	2020	2021	2022	2023	Total
Income	$50,000	$50,000	$50,000	$50,000	$200,000
Tax liability	$8,020	$8,020	$8,020	$8,020	$32,080

However, for tax purposes the payment is only taxed on receipt of the full amount in 2022. This will result in income in the 2023 year of $200,000, and a tax liability for Scotty of **$58,120**.

The difference between the two treatments is an additional tax liability for Scotty of **$26,040**.

[32] The average tax rate each year is tax payable/taxable income.

Example 2: taxation of Scotty's ACC backdated lump sum payment in 2024 after the amendments were made

Following from example one, if Scotty was paid his payment on or after 1 April 2024, the new tax treatment would apply.

If Scotty had no other income – minimum tax rate

While disputing the claim with ACC, Scotty was able to live mainly on his savings and with support from his partner.

Before ACC pays his BLSP, ACC contacts Inland Revenue for Scotty's average tax rate over the previous four years. Since the calculation ignores the backdated lump sum, Scotty's average tax rate for each year was 0%. However, since the new treatment has a minimum tax rate of 10.5%, this minimum rate will apply.

ACC would be able to apply this rate to Scotty's payment ($200,000 x 10.5%) and his tax liability would be **$21,000**. If Scotty's income remained the same in the year of payment, no additional tax would be owing.

If Scotty was earning other income

While disputing the claim with ACC, Scotty was able to find a part-time office job.

Before ACC pays his backdated lump sum payment, ACC contacts Inland Revenue for Scotty's average tax rate over the previous four years. His income and average tax rate, excluding the BLSP, for each year is as follows:

	2019	2020	2021	2022
Income	$18,000	$21,000	$26,000	$30,000
Tax on that	$2,170	$2,695	$3,570	$4,270
Basic (average) tax rate [33]	12%	12.8%	13.7%	14.2%

Scotty's payment would be taxed at his average tax rate from the previous four years. Using the formula, this rate would be calculated as follows: (12 + 12.8 + 13.7 + 14.2) ÷ 4 = 13.175%.

Under this treatment, Scotty's backdated lump sum payment will be taxed separately from his other income and brought back into his total taxable income for social policy purposes.

Outcome

ACC can apply the average tax rate to the BLSP ($200,000 x 13.175%) and withhold his tax before paying the payment to Scotty. Scotty's tax liability would be **$26,350**.

Provided Scotty's circumstances do not change (for example one of those earlier years is reassessed), no additional tax will be owed.

Without the alternative tax treatment, Scotty's payment would have been included along with his other taxable income for 2024 ($30,000 + $200,000). Under ordinary treatment, his tax liability would have been **$69,820.**

Attendant Care Payments

The tax treatment of backdated ACC lump sums which relate to attendant care payments differs slightly from payments made for compensation payments. The existing tax treatment for attendant care payments which are passed on to third parties remains the same and the income will be exempt income to the recipient to the extent that income is passed on. Those amounts are then taxable to the person providing those care services.

Where the amount is not passed on it will be taxable to the recipient under these new rules. It is likely the majority of backdated lump sum payments that relate to attendant care will be retained by the recipient.

Because of the existing treatment of attendant care payments, the withholding tax treatment for backdated lump sum payments differs from compensation payments. For attendant care payments the standard withholding tax rate is 10.5%. This will be the same for attendant care backdated lump sums.

[33] This is calculated by dividing tax paid by taxable income x 100.

However, the recipient might want tax on their payment to be withheld at their average tax rate for the prior four years. This would essentially be a tailored tax rate, however it should be noted that average tax rates inevitably result in a higher rate of withholding than the standard amount.

For these types of payments, it is more than likely the tax rate that will ultimately apply to these payments will be 10.5% and thus the standard rate is likely to be the most appropriate rate for these types of payments.

MSD backdated entitlements

Backdated payments of MSD entitlements may also give rise to an increased tax liability if they are paid in a subsequent tax year. Backdated lump sums are paid by MSD where, for example, there has been a past system error, or where incorrect or incomplete information was provided at the time of an assessment. These changes only apply to MSD entitlements that are "main benefits"[34].

These lump sums are calculated "net of tax". MSD determines how much the recipient is entitled to in their hand and then gross up that amount for the tax payable. MSD calculates the tax to withhold as if the payments had been made on time (by reference to previous years).

Since Inland Revenue taxes the backdated lump sum in the year of receipt, this may result in a higher amount of tax payable for the recipient.

Section RD 20C provides the method to calculate an alternative tax rate for backdated payments of MSD entitlements (a "multi-year benefit payment"). Multi-year benefit payment is defined as a main benefit, consisting of a lump sum that relates to more than one income year.

The new calculation treats the tax deducted by MSD before paying the person as the correct amount of tax owed. This means that the backdated lump sums would be ignored for the person's income tax liability. As with backdated ACC lump sums these amounts are treated as they are now for social policy purposes.

[34] As defined in paragraph (a) of the definition of main benefit in section YA 1 of the Income Tax Act 2007.

Disposals of trading stock at below market value

Sections GC 1, GZ 3, GZ 4, GZ 5, CZ 38, FC 1, GC 20, GC 21 and EB 24 of the Income Tax Act 2007; section 225ABA of the Tax Administration Act 1994

Section GC 1 of the Income Tax Act 2007 (ITA) deems a person who disposes of trading stock at below market value to derive as income the market value of that trading stock on the date of disposal. The amendments limit the application of the market value adjustment in section GC 1(2) to the following instances outlined in section GC 1(1):

- Where trading stock is disposed of to an associated person.
- Where a person disposes of trading stock to themselves for their own use or consumption.
- Where trading stock is not disposed of in the course of carrying on a business for the purpose of deriving assessable income or excluded income, or a combination of both.

An amendment to section GC 1(5)(a) ensures that a market value adjustment is not required for trading stock disposed of outside the course of business to a donee organisation (whether or not that donee organisation is associated with the person making the disposal).

Background

A business is allowed a deduction for the costs of acquiring, growing or manufacturing trading stock in the year of disposal. Where a business disposed of its trading stock for less than market value, previous section GC 1 would deem the business to have derived income equal to the market value of the trading stock on the date of disposal. The recipient of the trading stock was also deemed to have acquired the trading stock at its market value on the date of disposal.

Section GC 1 previously required a market value adjustment to be made regardless of whether there was an integrity concern or whether an adjustment was in fact required to reflect general income tax principles. It could therefore result in an overreach in relation to disposals that were made in the course of carrying on a business between non-associated parties. It also resulted in a disincentive for businesses to donate to donee organisations.

The amendments to section GC 1 address these issues by limiting the application of the market value adjustment to a narrow range of disposals. They clarify that where prices are agreed at arm's length in the course of carrying on a business, a valuation rule is not required. They also remove the disincentive to donate trading stock to donee organisations.

Further amendments repeal sections GZ 4 and GZ 5 of the ITA and section 225ABA of the Tax Administration Act 1994, which provided for temporary relief from section GC 1 to be switched on by Order in Council in times of emergency. The permanent amendments to the deemed income rule remove the need for a temporary emergency regime.

Effective date

The amendments apply to all trading stock disposed of below market value on or after 1 April 2024.

Detailed analysis

The amendments to section GC 1 limit the application of a market value adjustment to disposals of trading stock that raise potential integrity concerns and disposals where an adjustment is necessary to reflect general income tax principles.

Associated person disposals

Where trading stock is disposed of to an associated party at below market value, a market value adjustment will continue to be required under subsection (1)(b)(iii), requiring the transferor to return as income the market value of the trading stock on the date of disposal, and the transferee to enter the equivalent value in their books on acquisition of the trading stock. Without a valuation rule, for example, associated parties could manipulate prices to achieve timing advantages or benefit from a lower tax rate. In this context the application of section GC 1 is a necessary integrity measure.

Trading stock taken for private use

Where trading stock is taken for private use, a market value adjustment will also continue to be required under subsection (1)(b)(i). The person taking the trading stock for their private use is required to return income equivalent to the market value of the trading stock on the date they take it for their private use (this is considered a "disposal" for the purposes of section GC 1).

Donated trading stock

Where trading stock is donated, there may be a connection between the trading stock expense and the derivation of business income. For example, a donation may be made for promotional or marketing purposes, where there is a nexus between the cost of the trading stock and the income earning activities of the business. A market value adjustment will no longer be required for these disposals because the trading stock is disposed of in the course of carrying on a business.

There are situations where a donation of trading stock will not have any connection with the derivation of business income. For example, when a farmer donates their livestock to a foodbank, on the face of it there is no connection between this donation and the derivation of farm income, although the exact connection between a donation and the derivation of business income will be fact specific. The amendments clarify that a market value adjustment is necessary when trading stock is disposed of outside of the course of carrying on a business under subsection (1)(b)(ii).

However, a further amendment to section GC 1 introduces an exception to this rule where trading stock is disposed of to a donee organisation, whether or not the donee organisation is associated with the transferor. Donee organisations are, in most cases, a defined subset of registered charities that significantly benefit New Zealanders. This exception would remove the disincentive to donate for many businesses, while addressing integrity concerns by limiting the exception to donee organisations. The exception means that businesses can donate their trading stock to approved donee organisations without making an adjustment under section GC 1 and therefore claim a net deduction for the cost of their donated trading stock.

Consequential amendment to section FC 1

Section FC 1 of the ITA outlines a number of types of disposal of property, including a "gift of property" (which includes trading stock), that are subject to a deemed market value adjustment in section FC 2(1) that is identical in effect to the valuation rule in section GC 1.

To provide clarity and uphold the policy intent of the section GC 1 amendments, gifts of trading stock are removed from the scope of section FC 2 to ensure that gifts of trading stock are entirely governed by section GC 1.

Amendments to the purchase price allocation rules

The purchase price allocation rules interact with section GC 1 to the extent that they determine the price of trading stock disposed of to another party alongside other property. Minor amendments to these rules clarify their application and align them with the proposed changes to section GC 1.

Section EB 24, which applies when trading stock is disposed of with other assets of a business, is repealed. This provision is redundant because it has been superseded by the purchase price allocation rules, which provide a more specific method of apportioning the price between assets depending on whether there is an agreement between the parties.

Section GC 20 specifies a method for allocating the price between two or more types of property that are disposed of together when there is an allocation agreement between parties. New sections GC 1(5)(e) and GC 20(2B) ensure that where the parties to a disposal are associated, any trading stock is deemed to be disposed of for market value. This has no effect on the amount allocated to other items of property that are not trading stock. The amendment ensures that associated parties make a market value adjustment for trading stock even if they add another type of property to their transaction that causes them to fall under the purchase price allocation rules.

Section GC 21 specifies a method for allocating the price between two or more types of property that are disposed of together where there is no allocation agreement between the parties. Section GC 21 overrides provisions of the ITA requiring transfers to occur at market value, meaning that section GC 1 does not deem the trading stock portion of the section GC 21 disposal to occur at market value. To give effect to the policy intent of the section GC 1 changes, new sections GC 1(5)(e) and GC 21(11B) ensure this override does not apply where the disposal is between associated parties. Where trading stock is disposed of alongside other business assets for less than market value, section GC 1 now deems the trading stock portion of the disposal to be at market value.

Offshore gambling duty

Sections 12S to 12X of the Gaming Duties Act 1971

From 1 July 2024, a 12% offshore gambling duty applies to online gambling provided by offshore operators to New Zealand residents.

The Gaming Duties Act 1971 has been amended to include a new type of gaming duty, known as offshore gambling duty. It applies to GST-registered persons that are located outside New Zealand to the extent they make supplies of remote gambling services to New Zealand residents.

The offshore gambling duty excludes amounts from betting on sports and racing because there is an existing requirement to pay "consumption charges" to the Department of Internal Affairs on these amounts.

Background

Under the Goods and Services Tax Act 1985 (GST Act) there are existing requirements for non-resident suppliers of remote services of gambling supplied to New Zealand residents to register and return GST on these supplies. The offshore gambling duty applies to these suppliers of remote gambling services if they are located outside New Zealand.

Most of the offshore gambling duty rules have been designed to align with the existing rules for GST on remote services, to allow existing systems and calculations for GST to be adapted to apply the offshore gambling duty.

The main difference from the GST rules is that the offshore gambling duty is calculated by excluding amounts for which the offshore operator is required to pay "consumption charges" to the Department of Internal Affairs. Consumption charges are 10% charges on betting on sports and racing by New Zealand residents conducted through offshore operators.

Gambling provided by offshore gambling operators remains subject to GST.

Key Features

The key features of the offshore gambling duty are:

- It applies to GST-registered persons that are located outside New Zealand to the extent they make supplies of remote gambling services to New Zealand residents.
- The rate of offshore gambling duty is 12% of the offshore gambling profits.
- Offshore gambling profits are calculated as the amounts received from residents, minus the prizes paid to residents, minus any offshore betting amounts.
- Offshore gambling profits are calculated by subtracting any amounts of "offshore betting amounts" on which the offshore operator is required to pay "consumption charges" to the Department of Internal Affairs. Consumption charges are 10% charges on betting on sports and racing by New Zealand residents conducted through offshore operators.
- If the offshore operator has a negative amount of offshore gambling profits for a return period (because it has a greater amount of prize money paid or payable to New Zealand residents, than the amount of money it has received from residents) it will carry forward this negative amount to offset future offshore gambling profits in its next return periods.
- The return periods and due dates for the offshore gambling duty provide for the same three-monthly periods and due dates that apply to non-resident suppliers of remote services in respect of their GST returns.
- The rules for the Commissioner of Inland Revenue (the Commissioner) making an assessment of offshore gambling duty and for recovering any amount of unpaid gaming duty as a debt to the Crown, are identical to the existing rules that apply for casino duty.
- The disputes process, penalties and interest rules that are prescribed by the Tax Administration Act 1994 (TAA) will apply to the offshore gambling duty.

Effective date

The offshore gambling duty applies to offshore gambling profits arising on or after 1 July 2024.

Detailed analysis

Key terms

Section 12S(1) of the Gaming Duties Act defines offshore gambling operators along with the other key terms that are used to apply the offshore gambling duty.

The offshore gambling duty applies to offshore gambling operators who are defined as registered persons located outside New Zealand who conduct any offshore gambling.

Registered persons are persons who are either registered or liable to be registered under the GST Act. An offshore operator is required to register for GST if they make $60,000 or more of taxable supplies in a 12-month period, where taxable supplies include supplies of gambling to New Zealand residents (measured by the amount of money received from residents, minus prize money paid out to residents).

Offshore gambling means any gambling or prize competition supplied through remote services that are physically performed outside New Zealand that a person who is resident in New Zealand pays an amount of money to participate in.

The offshore gambling duty does not apply to existing online products offered by the Lotteries Commission (operating as Lotto NZ) and TAB NZ. This is because these operators use entities that are located within New Zealand to conduct their online gambling operations. Under the Gambling Act 2003, it is generally illegal for operators who are located within New Zealand to conduct remote interactive (ie, online) gambling, with exceptions for the Lotteries Commission and TAB NZ.

The offshore gambling duty applies to offshore websites owned by New Zealand casinos because this gambling is conducted by entities that are located outside New Zealand.

Remote services are defined using the same definition as how remote services are defined in the GST Act. Remote services are a service, that at the time it is performed, there is no necessary connection between the place where the service is physically performed and the location of the recipient of the service. That is, the service provider and the recipient could be in different locations. This definition includes online gambling services.

Calculating offshore gambling profits

The rate of the offshore gambling duty is 12% of the offshore gambling profits.

Offshore gambling profits are calculated under section 12T of the Gaming Duties Act by using the following formula:

amounts received from residents – prizes paid to residents – offshore betting amounts

When measuring the "amounts received from residents" and "prizes paid to residents", it is intended that the offshore gambling operator will be able to use the same values that they calculate for the GST remote services rules. This is because equivalent terms are used in the formula used to determine the amount of consideration in section 10(14B) of the GST Act.

However, a difference from the GST calculation is that the offshore gambling profits are calculated by subtracting "offshore betting amounts". Offshore betting amounts are the total amount in money on which consumption charges are payable under section 113 of the Racing Industry Act 2020. The offshore betting amounts arise from bets placed by New Zealand residents on sports and racing events where there is a requirement to pay "point of consumption charges" to the Department of Internal Affairs.

The offshore gambling profits are determined for supplies of offshore gambling for which the "time of supply" under section 9 of the GST Act has occurred for the return period. The GST remote services rules also use the same "time of supply" rules. Under these rules, the supply occurs for each amount received (the bet) on the date on which the first drawing or determination of the corresponding gambling result (or prize competition) commences.

The foreign currency rules in section 77 of the GST Act apply for determining the New Zealand dollar amounts of offshore gambling profits. This is intended to allow the offshore gambling operators to use the same foreign currency conversions as they already use for GST purposes. Section 77 of the GST Act generally requires amounts of money be expressed in New Zealand dollars at the time of supply. Alternatively, the non-resident supplier (the offshore gambling operator) can make an election to express the amounts in a foreign currency. If they elect to use a foreign currency, they must use one of the methods in section 77(3) to convert the foreign currency amounts to New Zealand dollar amounts and must maintain the same conversion method for at least 24 months unless the Commissioner agrees otherwise.

Example 1: Online casino games only

An offshore gambling operator conducts online casino games that are supplied to New Zealand residents.

In the three-month period between 1 July 2024 and 30 September 2024, it receives $151.5 million of bets from New Zealand residents and these residents have been paid or credited prizes valued at $140 million.

The operator's offshore gambling profits for the return period are $11.5 million ($151.5 million minus $140 million). The 12% offshore gambling duty applies to the offshore gambling profits.

The operator files a return and pays $1.38 million of offshore gambling duty to Inland Revenue on or before 28 October 2024.

For the same three-month period, the operator files a GST return and pays GST of $1.5 million (3/23rds of the $11.5 million of consideration for the remote services of gambling by New Zealand residents) to Inland Revenue on or before 28 October 2028.

Example 2: Online gambling including sports betting

An offshore gambling operator conducts online casino games, tickets to instant prize competitions and sports betting.

In the three-month period between 1 July 2024 and 30 September 2024, it receives $246 million from bets/ticket sales to New Zealand residents and these residents have been paid or credited prizes valued at $200 million. These amounts include $100 million of sports bets and $70 million of prizes paid or credited on the sports bets. The operator is required to pay consumption charges to the Department of Internal Affairs on the $30 million of offshore betting amounts ($100 million minus $70 million) from these sports bets.

The operator's offshore gambling profits for the return period are:

$246 million – $200 million – $30 million = $16 million

The 12% offshore gambling duty applies to the offshore gambling profits. The operator files a return and pays $1.92 million of offshore gambling duty to Inland Revenue on or before 28 October 2024.

For the same three-month period, the operator files a GST return and pays GST of $6 million (3/23rds of the $46 million of consideration for the remote services of gambling by New Zealand residents) to Inland Revenue on or before 28 October 2028.

For the same three-month period, the operator will pay consumption charges of $3 million (10% of the $30 million of offshore betting amounts from the sports bets) to the Department of Internal Affairs.

If the only gambling products that an offshore gambling operator supplies to New Zealand residents (for a return period) are sports and/or racing bets on which they are required to pay consumption charges, their offshore gambling profits will be nil. They are still required to register for the offshore gambling duty and file a return including a nil value of offshore gambling profits for the relevant return period.

If the offshore gambling operator has a negative amount of offshore gambling profits for a return period (because it has a greater amount of prize money paid or payable to New Zealand residents than the amount of money it has received from residents), it will carry forward this negative amount to offset future offshore gambling profits in its next return periods.

Return periods and due dates for return filing and payment

The return periods and due dates for the offshore gambling duty are the same periods and due dates that already apply to non-resident suppliers of remote services in respect of their GST returns.

The **return periods** are the period of three consecutive calendar months ending on the last day of either March, June, September or December. In other words, they are for quarterly periods with the first period commencing on 1 July 2024 and ending on 30 September 2024.

Section 12V of the Gaming Duties Act requires that returns for offshore gambling duty must be filed on or before:

- 28 October for the return period and ending on 30 September
- 28 January for the return period ending 31 December
- 7 May for the return period ending 31 March, and
- 28 July for the return period ending 30 June.

Section 12W of the Gaming Duties Act requires that the offshore gambling duty must be paid to Inland Revenue no later than the relevant due date that the offshore gambling return must be filed for the corresponding return period.

Assessments, challenges, disputes process, penalties and interest

The rules for the Commissioner of Inland Revenue making an assessment of offshore gambling duty and for recovering any amount of unpaid gaming duty as a debt to the Crown, are identical to the existing rules that apply for casino duty.

This is provided for by section 12X of the Gaming Duties Act. Similar rules also apply for gaming machine duty, aside from existing section 12K(2) of the Gaming Duties Act, which sets out a joint and several liability rule that only applies to gaming machine duty. Section 12K(2) does not apply to casino duty and also does not apply to the offshore gambling duty.

The disputes process and challenges rules that are prescribed by Parts 4A and 8 of the Tax Administration Act 1994 (TAA) apply to the offshore gambling duty.

The tax penalties of the TAA also apply to gaming duties, including the offshore gambling duty. Existing section 15 of the Gaming Duties Act references the fact that Part 9 (Penalties) of the TAA applies to gaming duty.

Use of money interest applies to unpaid amounts of gaming duty under Part 7 (Interest) of the TAA. This is because the definition of "tax" in the TAA includes gaming duty.

Payment of KiwiSaver contributions to paid parental leave recipients

Section 4 of the KiwiSaver Act 2006

The amendment will result in the Government paying a three percent KiwiSaver contribution to eligible Paid Parental Leave (PPL) recipients, provided they also contribute three percent of their PPL to their KiwiSaver accounts.

Background

The financial position of women at retirement is typically less secure than men. Although women tend to live longer than men, the average KiwiSaver balances of men are 20 percent higher than those of women. In part, this is because women tend to be over-represented in lower paid roles, have lower rates of labour force participation, and spend time out of the workforce to raise children or care for family members.

Effective date

The change will come into force on 1 July 2024.

Key features

The key change is that the amendment will require the Government to pay a three percent KiwiSaver contribution to eligible Paid Parental Leave (PPL) recipients, provided these KiwiSaver members also contribute three percent of their PPL payments to their KiwiSaver accounts.

Detailed analysis

Paid Parental Leave (PPL) is a payment made to qualifying individuals and is intended to make up for lost income when a person takes time out of the workforce to have a baby. For the period 1 July 2023 – 30 June 2024, PPL payments will match a person's weekly income up to a maximum of $712.17 per week before tax.

Under the amendment, the government will pay a three percent KiwiSaver contribution on amounts of PPL received by KiwiSaver members where the PPL recipient also pays a corresponding three percent KiwiSaver employee contribution into their KiwiSaver account. Employer Contribution Superannuation Tax (ESCT) will be deducted from this contribution in the same way as if the contribution were made by an employer. Employer Contribution Superannuation Tax (ESCT) will be deducted from this government contribution in the same way as if the contribution were made by an employer. This initiative will help to increase the KiwiSaver balances of PPL recipients, many of whom are women.

Schedule 32 – overseas donee status

Schedule 32 of the Income Tax Act 2007

The following charities have been granted overseas donee status from 1 April 2023, unless specified below:

- Butterfly Trust
- Develop Together
- Ekal Vidyalaya Foundation of New Zealand, until 31 March 2028
- Emergency Alliance, from 26 October 2023
- Pasifika Safe Shelter Trust
- The Limapela Foundation
- The Make My Name Count NZ Charitable Trust, until 31 March 2028.

The Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Act 2024 also removes the following organisations from the donee list:

- Akha Rescue Ministry Charitable Trust
- Astha Childrens Home (Nepal/New Zealand)
- Bangladesh Flood Appeal Trust
- Nelson Mandela Trust (New Zealand)
- Operation Hope (Aid Ship to Africa)
- The Bougainville Library Trust
- The Mutima Charitable Trust

The organisations named above have ceased their activities and have otherwise wound up. The organisations are removed from the date the bill received Royal assent.

Exemption for non-resident oil rig and seismic vessel operators

Section CW 57 of the Income Tax Act 2007

Section CW 57 contains a temporary exemption for non-resident offshore oil rig and seismic vessel operators. This exemption was due to expire on 1 January 2025, but has been extended to 31 December 2029.

Background

Income derived by non-resident companies from operating offshore oil rigs and seismic vessels is covered by an exemption in section CW 57 of the Income Tax Act 2007. These rigs and vessels are used to drill for oil and gas and gather data on potential oil and gas finds. There is a worldwide market in rigs and seismic vessels. No New Zealand company owns offshore rigs or seismic vessels, so any company wishing to explore in New Zealand waters needs to use a rig or seismic vessel provided by a non-resident owner.

Section CW 57 was introduced to deal with a problem created by our double tax agreements (DTAs). New Zealand generally taxes non-residents on income that has a source in New Zealand. However, our DTAs provide that non-residents are only taxable on their New Zealand-sourced business profits if they have a "permanent establishment" in New Zealand. Many of our DTAs (such as the New Zealand-United States DTA) have a specific rule providing that a non-resident enterprise involved in exploring for natural resources only has a permanent establishment in New Zealand if they are present for a particular period, often 183 days in a year. Once a non-resident has a permanent establishment in New Zealand, they are taxed on all their New Zealand business profits starting from day one.

The issue caused by this DTA provision was that seismic vessels and rigs used in petroleum exploration were leaving New Zealand waters before the 183-day period had expired to ensure they would not be subject to New Zealand tax. This meant that, in some cases, a rig would leave and a different rig would be mobilised to complete the exploration programme. This "churning" of rigs increased the cost for companies engaged in exploration and had the potential to delay exploration drilling and any subsequent discovery of oil or gas.

A temporary five-year exemption from tax on the income of non-resident offshore oil rig and seismic vessel operators was introduced in 2004. This exemption was previously rolled over for a further five years in 2009, 2014 and 2019, and would have expired on 31 December 2024 if not for the further extension.

Key features

The temporary tax exemption for non-resident offshore oil rig and seismic vessel operators in section CW 57 of the Income Tax Act 2007 has been extended to 31 December 2029.

Effective date

The exemption takes effect at the expiry of the existing exemption, on 1 January 2025.

Deductibility of co-operative company dividends

Sections CD 2, CD 34B, CZ 41, DV 11 and YA 1 of the Income Tax Act 2007

Fonterra's existing ability to deduct certain distributions to its shareholders has been temporarily extended until the 2024-25 income year. These deductions will be consistent with the deductions that would have been available had Fonterra continued to apply its previous constitution.

Background

Section CD 34B of the Income Tax Act 2007 (ITA) provides the ability for a co-operative company to choose to treat distributions paid to its shareholders as a deductible expense that reduces the co-operative's taxable income, and not to treat them as dividends.

Fonterra historically required its shareholders to hold one share for each kilogram of milk solids they supply[35] to Fonterra but has recently changed its constitution so that farmers are only required to hold one share for each three kilograms of milk solids they supply. One share per kilogram continues to be referred to as the share standard, but now Fonterra suppliers have a minimum holding of 33% of the share standard. This allows, but does not require, farmers to hold fewer shares than under the previous constitution. However, it also reduces the linkage between supply and ownership.

Inland Revenue has considered this scenario and concluded that, under section CD 3B as it originally applied to Fonterra, distributions on the 33% of shares required to be held remained deductible, but that distributions on the 67% that farmers may (and often will) voluntarily hold became non-deductible.

This means that, given the interaction of rules under the ITA and the Companies Act 1993, without a law change, Fonterra would pay non-deductible distributions that could not have imputation credits attached, which would result in the income derived by Fonterra and then distributed to its shareholders being effectively overtaxed — ie, once as a tax on Fonterra's profit and then again when that profit is distributed to the shareholder.

Key features

New section CZ 41, which applies only to Fonterra for the 2022–23, 2023–24 and 2024–25 income years, has been introduced. Section CZ 41:

- retains Fonterra's existing deductions for distributions, and
- introduces deductions for two additional classes of shares that support supply, but suppliers are not required to hold.

Consequential amendments have also been made to sections CD 2, CD 34B and DV 11 to ensure proposed section CZ 41 operates in the same manner as CD 34B.

Effective date

The amended is effective for the 2022–23, 2023–24 and 2024–25 income years.

Detailed analysis

New section CZ 41 determines the treatment of distributions made by Fonterra to a supplying shareholder for Fonterra's 2022–23, 2023–24 or 2024–25 income year. It specifies that the distribution is not a dividend to the extent to which the distribution is for the supplying shareholder's:

- Transaction shares – equivalent to the same term in section CD 34B – the number of shares that the supplying shareholder is required to hold for their supply to Fonterra.
- Projected transactions shareholding – equivalent to the same term in section CD 34B – the number of shares that the supplying shareholder would have had to hold if the supply they had projected had actually occurred.
- Qualifying non-transaction shares – shares held above the number of transaction shares but capped at 2.0303 times the number of transaction shares.
- Projected qualifying non-transaction shareholding – the number of qualifying non-transaction shares the supplying shareholder would have had to hold if the supply they had projected had actually occurred.

[35] Generally based on average supply over the previous three years.

The definitions of "transaction shares" and "projected transactions shareholding" do not exactly match the methodology Fonterra applies to calculate the number of shares each supplying shareholder is required to hold. However, section CZ 41 attempts to follow the existing approach of section CD 34B to the extent possible. There is no known difficulty of section CD 34B applying to Fonterra prior to its change in constitution.

The 2.0303 number in the definition is based on Fonterra's constitution setting the minimum holding (referred to as transaction shares in the legislation) at 33% of the share standard. 2.0303 is calculated as 1 ÷ 0.33 – 1.

By applying to distributions to the extent that they meet the above, section CZ 41 covers the shares up to the share standard (one share per kilogram of milk solids).

In contrast to section CD 34B, section CZ 41 does not refer to limited non-transaction shares. This is because section CD 34B(3) ignores limited non-transaction shares where a member holds, or a constitution allows a member to hold, shares above those required to be held to enter trading transactions. As Fonterra's constitution allows a supplying shareholder to hold more shares than the share standard it has not been able to include limited non-transaction shares in its calculation and, therefore, they have been intentionally omitted from section CZ 41.

"Supplying shareholder" is defined in section CZ 41(4) as within the meaning of that term in section 34 of the Co-operative Companies Act 1996, in relation to Fonterra. A distribution to a shareholder who was not a supplying shareholder would continue to have the existing treatment consistent with prior to the constitution change (ie, a non-deductible dividend).

Section CZ 41(3) applies a consistent treatment to existing section CD 34B(9) to allow Fonterra to pay a distribution more than 20 days after the end of its year. This allows the distribution to be deductible in the year the income that supports that distribution was derived rather than the year in which that distribution is made.

Consequential amendments have been made to sections CD 2 and DV 11 of the ITA. These changes ensure that a distribution that is not treated as a dividend under section CZ 41 will apply that treatment consistently throughout the ITA. New subsection CD 34B(1B) ensures that section CD 34B will not also apply to a distribution that is covered by section CZ 41.

Further, consequential definitions have been added to section YA 1. These are for:

- Fonterra
- projected qualifying non-transaction shareholding
- projected transactions shareholding
- qualifying non-transaction shares
- supplying shareholder
- trading transactions; and
- transaction shares

Flooding relief measures

Taxation rollover relief for the 2023 North Island floods

Sections CZ 25C, CZ 25D, DZ 20B, EZ 23BE, EZ 83 to EZ 87, FZ 7B and YA 1

Summary of amendments

Amendments have been made to the Income Tax Act 2007 (ITA) to provide temporary tax relief in response to the January and February 2023 North Island flooding events.

This relief enables the profits and depreciation recovery income arising when insurance, buy-out or other compensation proceeds are received for business assets destroyed by the North Island flooding events to be deferred provided the assets are replaced. There are also several minor associated amendments to the ITA, particularly the depreciation rules.

Similar optional temporary relief was provided for assets destroyed by the Canterbury and Hurunui-Kaikōura earthquakes.

Effective date

The amendments are effective for the 2022–23 and later income years, ceasing in the 2027–28 income year.

Background

Normally, the receipt of insurance proceeds for a destroyed business asset gives rise to either depreciation recovery income on a depreciable asset, or income on a revenue account asset. Similarly, a local authority buy-out of a flood/rain event damaged residential property can give rise to income for an owner of a residential rental property. The resulting upfront tax liability means that a taxpayer seriously impacted by a North Island flooding event will have less cash available to pay for the replacement assets needed to recommence business or provide rental accommodation. In many cases, it would also mean a windfall revenue gain to the Government from the events.

While these taxable gains would normally have arisen if the assets were sold, the unexpected nature of the flooding destruction is a very different circumstance, and the resulting tax liability is unexpected. This issue was recognised in relation to the assets destroyed by the Canterbury and Hurunui-Kaikōura earthquakes and rollover relief was provided.[36]

Rollover relief is also now available for flood destroyed assets and properties, to provide taxpayers with the option of deferring the recognition of this unexpected income. This option is supported by associated amendments that clarify the timing around the deductibility of expenditure and recognition of income for the damaged assets.

Key features

The amendments to the ITA:

- provide rollover relief for both revenue account assets and depreciable assets that are destroyed or uneconomic to repair (see sections CZ 25C and EZ 23BE);
- provide similar relief for income that arises from the destruction of amortised land improvements (e.g. supporting frames for growing crops) (see section CZ 25D);
- clarify that on-going expenses or losses can continue to be deducted when a business activity is so disrupted by a flooding event that there is no longer a sufficient nexus between the expenses and the income-earning activity (see section DZ 20B);
- align the tax treatment of depreciable assets that are uneconomic to repair with the treatment of depreciable assets that have been "irreparably damaged" or are "useless for earning income" for tax purposes (see section EZ 83);
- limit the recovery income that arises under the tax rules when insurance proceeds have been received for a damaged asset that is repairable to the amount of depreciation deductions previously claimed for the asset (see section EZ 84);
- clarify that a depreciation deduction may be claimed on depreciable property when access to the property is temporarily restricted because of a flooding event (see section EZ 85);
- provide optional matching rules to smooth the timing of income and deductions/disposal losses when insurance proceeds have been received for flood affected depreciable assets (see section EZ 86 and 87), and

[36] For more detail and examples on the Canterbury legislation, see *Tax Information Bulletin* Volume 24, No 10, December 2012.

- provide an optional adjustment rule for measuring group assets for the purposes of the thin-capitalisation rules when an insurance pay-out is pending for destroyed assets (see section FZ 7B).

Definition of flooding events and affected area

"North Island flooding events" is defined as the flooding and other damage that occurred in an affected area caused by any of the following weather events:

- Cyclone Hale, which crossed the North Island of New Zealand during the period commencing on 8 January 2023 and ending on 12 January 2023.
- The heavy rainfall commencing on 26 January 2023 and ending on 3 February 2023 in the Northland, Auckland, Waikato, and Bay of Plenty regions.
- Cyclone Gabrielle, which crossed the North Island of New Zealand during the period commencing on 12 February 2023 and ending on 16 February 2023.

The definition also includes circumstances where any damage caused by any of the above events is exacerbated by a subsequent weather event. An example of such a subsequent event would be the February 2023 Mangawhai floods, or the June 2023 East Coast floods.

"Affected area" means any of the following regions or districts:

- The regions of Northland, Auckland, Waikato, Bay of Plenty, Gisborne, and Hawke's Bay.
- The districts of Tararua, Masterton, Carterton, South Wairarapa, Manawatū, and Rangitikei.

Detailed analysis

New sections CZ 25C, CZ 25D, DZ 20B, EZ 23BE, EZ 83 to EZ 87, and FZ 7B are based on the previous earthquake provisions. A key exception is that the provisions do not include a requirement that replacement land and buildings be located in the same region in New Zealand. Also, the previous provisions did not address the income arising in relation to amortised farmland improvements as that aspect was not relevant in past events.

Key taxation rollover provisions

The key rollover provisions are in:

- new section CZ 25C, which provides the option of rollover relief for profits arising because of an insurance or compensation pay-out on revenue account property destroyed by a North Island flooding event
- new section CZ 25D which provides a similar relief option for the income arising from an insurance pay-out on amortised farmland improvements subject to either sections DO 4 or DO 5, and
- new section EZ 23BE, which provides rollover relief for depreciation recovery income on depreciable property.

Common features

In all three cases, the additional income is suspended until the replacement asset is acquired. The destroyed[37] asset must be replaced by the end of the 2027–28 income year. When the asset is replaced, the suspended income impacts on the cost of the replacement asset, reducing the cost of that asset for tax purposes (see later discussion).

The income suspension also ceases if the business ceases operations before the 2027–28 income year or no longer intends to acquire a replacement asset, in which case income is brought to account in that earlier income year.

As rollover relief is optional, the taxpayer will need to elect to use their chosen option and notify the Commissioner of their election. This must be done by the date their return of income is required to be filed for each income year that they elect to use rollover relief, or by 30 April 2024 if the first year in which the insurance for the affected property can be estimated (and therefore the additional income arises) is the 2022–23 income year. The Commissioner may allow the person to file the notice at a later date if the Commissioner considers there are exceptional circumstances.

[37] To be eligible, the asset has to have been irreparably damaged or useless for income-earning purposes.

Whether there are "exceptional circumstances" will depend on the facts and circumstances of the particular case and on whether those facts and circumstances provide a person with a reasonable justification for not filing a notice by a due date. For example, an orchardist or farmer might fail to elect in time due to mental health issues caused by the stress of the flooding/cyclone destruction and its aftermath. A reasonable justification will generally be satisfied if a medical certificate is provided stating the person's mental health issues were a significant contributing factor as to why the person failed to elect in time.

Certain information (such as a description of the affected property, the amount replaced in the year and the remaining amount of suspended income) is required as part of the notification. Its purpose is to ensure that the taxpayer turns their mind each year to deciding whether they still intend to replace the asset.

Points of difference

The cost of the replacement asset for tax purposes is reduced to reflect the deferred income in the year the asset is replaced, or partially replaced if the replacement expenditure is incurred gradually. However, the formula varies for each of the three types of rollover relief given the income being deferred differs.

Example 1: Revenue account asset

A taxpayer's revenue account building located in the Hawke's Bay is destroyed by a North Island flooding event. The building originally cost $1.5 million. The replacement insurance proceeds are $3 million, and the replacement building is completed on 15 June 2026. In the absence of rollover relief, the building owner will have taxable income of $1.5 million (under section CG 6). New section CZ 25C allows the owner to defer that income tax liability by allocating an amount of $1.5 million to the replacement building.

As a result of negotiations between the building owner and the insurance company, the insurance proceeds can be reasonably estimated on 30 September 2023.

In the tax return for the tax year ending on 31 March 2024, the building owner files an election to defer the $1.5 million of income pending replacement of the building. Provided the taxpayer continues to elect to defer the income, it remains suspended for the tax years ending on 31 March 2025 and 31 March 2026.

As the replacement building is completed on 15 June 2026, the tax return for the tax year ending 31 March 2027 will include the new building at a cost of $1.5 million (being the $3 million cost of the new building less the $1.5 million rollover relief).

A notice will have to be filed with the tax return for the year ended 31 March 2027 advising that the deferred income has been rolled into the tax base for the replacement asset. The taxpayer must also give notice that the amount of unallocated suspended income has been reduced by $1.5 million to $0.

When the replacement asset is eventually sold, the difference between the $1.5 million cost and the sales proceeds will be taxable, provided the building is sold for more than $1.5 million.

Example 2: Depreciable asset

Plant and equipment (not previously depreciated under the pool method) destroyed by a North Island flooding event had a cost of $1 million. On the day of the flood, the plant and equipment had an adjusted tax book value of $700,000. The owner receives an insurance pay-out of $1 million. The net depreciation recovered is, therefore, $300,000, and this becomes the suspended recovery income. The replacement assets are acquired over two years at a cost of $400,000 per year. In year three, the owner decides to acquire no more replacement assets.

Under section EZ 23BE, the $300,000 suspended recovery income is allocated as follows:

Year 1 ($400,000 x $300,000) / $1,000,000 = $120,000)

Year 2 ($400,000 x $300,000) / $1,000,000 = $120,000)

The cost of the replacement plant and machinery is reduced in total by $240,000.

The remaining suspended recovery income balance of $60,000 (representing the portion of assets not replaced) is taxed in the year the taxpayer decides to make no further investment in replacement property.

Example 3: Farmland improvement

Crop support frames costing $50,000 have been amortised under section DO 4 (improvements to farmland). Their amortised value is $26,500 when they are destroyed by cyclone Gabrielle. Insurance proceeds of $75,000 are received.

The remaining expenditure ($26,500) can be deducted under section DO 11.

Under section CG 4, the insurance pay-out is income to the extent of the various deductions that have been allowed ($50,000 in total).

The taxpayer elects, under new section CZ 25D, to apply rollover relief to this amount of income and replaces the destroyed frames at a cost of $75,000.

In accordance with section CZ 25D(4), the cost of the replacement frames for the purposes of amortisation under section DO 4 is $25,000 as the insurance income of $50,000 is less than the replacement cost of $75,000 by that amount.

Deductibility of expenses when no income-earning activity

New section DZ 20B addresses the situation where some taxpayers are no longer able to deduct their on-going expenses or losses relating to their income-earning activity. For example, when land is not physically accessible due to silt, resulting in the business activity being so disrupted by the flooding event that there is no longer a sufficient nexus between the expenses and the income-earning activity.

The new section provides certainty on the deductibility of expenses or losses for affected taxpayers who intend to continue their income-earning activities. To qualify, the person must:

- have an income-earning activity in the "affected area" immediately before the flooding event, and
- in the current year, during the period of interruption, have incurred expenditure or loss in meeting an obligation relating to the income-earning activity and that interruption expenditure does not meet the requirements of the general deductibility permission in section DA 1, but would have done so but for the interruption, and
- resume the income-earning activity in an income year before the 2028–29 income year.

If all these conditions are met, the person is allowed to deduct the expenditure in the year their income earning is resumed.

Damaged depreciation property that is uneconomic to repair

The tax depreciation rules did not provide an appropriate outcome when there was an insurance pay-out on an asset damaged by a North Island flooding event and the asset was assessed as uneconomic to repair. This is because the tax rules distinguish between assets that are repairable and those that are irreparably damaged or rendered useless for earning income. Assets that are uneconomic to repair are generally included in the former category as they can be technically repairable. The consequence was that a taxpayer might face a significant unexpected tax liability when an insurance amount was received for the damaged asset.

To help overcome this problem, new section EZ 83 provides for a deemed disposal and reacquisition of assets that are damaged by a North Island flooding event and are assessed by the person receiving the insurance payout as uneconomic to repair. This better aligns their depreciation treatment with those of assets that have been irreparably damaged by a flooding event. Rollover relief is then available for those assets.

The asset is deemed to be reacquired for nil consideration on the same day as the deemed disposal (which is for the amount of insurance), meaning that any post-flooding event repairs to the damaged building are capitalised rather than being treated as deductible expenditure.

Example 4: Asset uneconomic to repair

A building has a cost of $5 million, accumulated depreciation deductions of $4 million, and an adjusted tax value of $1 million. It is damaged by a North Island flooding event and the insurance company decides it has an obligation under the insurance policy to pay out $10 million. The owner makes the reasonable assessment that the building is no longer fit for purpose and uneconomic to repair. The insurance pay-out is sufficient to build a replacement. The damaged building is retained by the insured party and put to another, less productive, use.

New section EZ 83 applies in these circumstances. The damaged building is treated as being disposed of for $10 million and reacquired for nil consideration on the date of the flooding event that caused the asset to be uneconomic to repair. As the building is treated as having been disposed of, the owner of the asset can apply the optional matching rule in new section EZ 86 to smooth the timing of income calculated under section EE 48. Under section EE 48, the result will be:

Original cost	$5,000,000
Depreciation deductions	$4,000,000
Adjusted tax value	$1,000,000
Amount for disposal (consideration)	$10,000,000
Depreciation recovery income	$4,000,000
Capital gain	$5,000,000

Rollover relief (under new section EZ 23BE) is available to the building owner for the $4 million of depreciation recovery income provided a replacement building is acquired.

Cap on depreciation recovery income

Any insurance proceeds that exceed the sum of the asset's adjusted tax value and expenditure on repairing the asset are taxable under section EE 52 of the ITA. As a result, the tax rules may end up taxing more than the amount of earlier depreciation deductions allowed for the asset. In the context of the North Island flooding events, this means that some taxpayers may face significant unanticipated income tax liabilities in relation to damaged (but repairable) assets.

Accordingly, new section EZ 84 limits depreciation recovery income to the amount of depreciation deductions previously taken when insurance proceeds are received for a repairable depreciable asset damaged by a North Island flooding event.

Example 5: Depreciation recovery income cap

A building costing $5 million is damaged by a flooding event but is repairable. The building has an adjusted tax value of $1 million, with depreciation deductions of $4 million taken. Insurance proceeds of $7 million are received, with $1 million of the proceeds being spent on repairing the asset. New section EZ 83 does not apply because the asset is not uneconomic to repair. Under section EE 52, the depreciation recovery income would be $5 million. However, section EZ 84 caps the amount of depreciation recovery income at $4 million. The remaining $1 million is treated as a capital gain.

Property that is available for use

For an item of property to be depreciated for tax purposes, it must be used in a business or be available for use. However, it was not clear how this rule should be applied when access to depreciable property is temporarily restricted by a North Island flooding event. New section EZ 85 addresses this issue by treating the item as being available for use during the period of restricted access, provided it was available for use immediately before the restriction was imposed. Depreciation can therefore be claimed.

Optional timing rule when damage results in a disposal

New section EZ 86 provides an optional rule to smooth the timing of income and deductions when insurance proceeds have been received for depreciable property that has been irreparably damaged or rendered useless for earning income because of a North Island flooding event. The timing rule also applies to depreciable assets that are uneconomic to repair and to which new section EZ 83 applies.

The optional rule applies to individual items of depreciable property, in line with the general approach under the depreciation rules.

The section provides that any income or deductions are recognised at the earlier of:

- the first income year in which
  - the insurance receipt is, or has been, derived or able to be reasonably estimated, and
  - the cost of disposing of the item is, or has been, incurred or able to be reasonably estimated, and
  - the consideration from the disposal of the item is, or has been, derived or able to be reasonably estimated, or
- the 2027–28 income year.

Whether insurance proceeds and other amounts can be reasonably estimated is essentially a question of fact, which will depend on the individual circumstances of each case.

New section EZ 86 overrides the normal depreciation timing rules. The section could also be applied to assets depreciated in a pool. A person who opts to use the matching rule is required to use it for all their items of depreciable property that meet the criteria for applying the rule. This is to prevent taxpayers "cherry-picking" the assets to which they apply the rule.

A taxpayer's election to use the matching rule would be reflected in the tax position they take in their return of income for each tax year – no prior notice of election would be required.

Example 6: Optional timing rule for disposal

Equipment originally costing $10,000 is irreparably damaged by a North Island flooding event. The asset's tax book value is $7,000, with $3,000 of accumulated depreciation deductions. The disposal costs are reasonably estimated in 2022–23 to be $1,000. The insurance proceeds received for the asset are reasonably estimated in 2023–24 as being $9,000. The equipment has a scrap value of $100, which is reasonably estimated in 2022–23.

Applying the new matching rule, any income or deductions is recognised in the 2023–24 income year, as this is when all the insurance proceeds, disposal costs and disposal proceeds can be reasonably estimated. Accordingly, in the 2023–24 income year, section EE 48 applies to determine the amount of depreciation recovery income or depreciation loss.

Optional timing rule when damage does not result in a disposal

New section EZ 87 introduces an optional rule to smooth the timing of income and deductions when insurance proceeds have been received for a depreciable asset that has been damaged in a North Island flooding event, but the asset is repairable. The rule is broadly similar to new section EZ 86 in design, except in this case, the asset is economically repairable.

Again, the owner needs to choose to apply the timing rule to all their depreciable assets that meet the requirements.

The timing rule provides that any income or deductions would be recognised at the earlier of:

- the first income year in which
  - the insurance receipt is, or has been, derived or able to be reasonably estimated, and
  - the cost of repairing the asset is, or has been, incurred or able to be reasonably estimated, or
- the 2027–28 income year.

New section EZ 87 overrides the timing rules in sections CG 4, EE 22 and EE 52 of the ITA. The section is also applicable to assets depreciated in a pool.

Example 7: Optional timing rule when no disposal

Machinery originally costing $100,000 is damaged by a flooding event. The asset's adjusted tax value is $60,000, with $40,000 of accumulated depreciation deductions. The insurance proceeds are estimated in 2022–23 as being $110,000. Repair costs are estimated in 2023–24 to be $20,000, and $10,000 is actually incurred in each of 2023–24 and 2024–25.

Applying the matching rule, any income or deductions is recognised in the 2023–24 income year, as this is when the insurance proceeds and total repair costs can reasonably be estimated. Accordingly, in the 2023–24 income year, sections CG 4 and EE 52 would apply.

The repair costs are deductible under the general deductibility rules.

Section CG 4 would treat $20,000 of the insurance proceeds as taxable, as this is the amount of insurance proceeds that recovers deductible expenditure.

Section EE 52 requires the amount by which the insurance proceeds are more than the repair expenditure to be deducted from the adjusted tax value, as follows:

Adjusted tax value of $60,000 less ($110,000 – $20,000) = -$30,000

If the result is negative, the adjusted tax value is reduced to nil and depreciation recovery income under section EE 52 would be $30,000.

Optional adjustment to assets under thin-cap rules

New section FZ 7B provides an optional adjustment to how group assets are measured for the purposes of the thin-capitalisation rules. The adjustment mitigates a timing problem that arises because insurance proceeds may be recognised for tax purposes at a later date than the damage caused by a North Island flooding event.

The thin-capitalisation rules are based on accounting measures of assets. For accounting purposes, damaged assets are immediately impaired or derecognised (i.e. no longer considered an asset). In contrast, insurance proceeds cannot be recognised until they are reasonably expected.

New section FZ 7B is designed to mitigate this timing difference by allowing certain taxpayers to carry back known insurance proceeds to the date on which an asset was impaired or derecognised as a result of damage caused by a flooding event. The amount that can be carried back is limited to the lesser of the amount of damage or the related insurance proceeds.

Without this option, a business could be temporarily disadvantaged in terms of how much debt they could carry on their balance sheet under the thin-capitalisation rules, resulting in reduced interest deductions.

A person who chooses to use this option is required to notify the Commissioner and provide certain information.

Flooding relief: turning off the bright-line and other timing tests

Sections CZ 26B and YA 1 of the Income Tax Act 2007

These amendments ensure that both the 5-year and 10-year bright-line tests and other land-based timing tests in the Income Tax Act 2007 (ITA) do not apply when the Crown or a local authority purchases a property affected by a North Island adverse weather event.

Effective date

The amendments are effective for the 2022–23 and later income years.

Background

As part of its work to support the Future of Severely Affected Locations (FOSAL), the Government announced its willingness to enter into a funding arrangement with councils in regions severely affected by the January 2023 Auckland flood events and Cyclone Gabrielle. Central government support includes contributions towards residential property acquisitions (buy-outs). The Government later announced similar assistance in relation to the property buy-outs proposed by the Nelson City Council for certain properties severely impacted by the August 2022 Nelson floods.

The ITA contains a set of time-based tests which, if not met, result in any gain or loss on disposal of the property being either taxable or deductible[38]:

- The most well-known test is the "bright-line". For properties purchased on or after 27 March 2021, the minimum ownership period is 10 years unless it is a new build, in which case the minimum ownership period is five years. The main home is generally excluded from the bright-line test.
- Properties purchased between 29 March 2018 and 26 March 2021 (inclusive) continue to be subject to the previous 5-year bright-line test. (Given that property prices have declined over the last two years, losses on a buy-out are probably more likely to arise under this test.)
- Separate 10-year tests apply to properties that are owned by dealers in land, property developers/subdividers, builders, and their associates.

These tests could be triggered through a buy-out as it is a disposal for tax purposes. Because the time-based tests have exclusions for the person's main home, most buy-outs will not be impacted, but landlords of rental properties, for example, could be impacted. It is also feasible that such landlords may be property developers, builders or subdividers, or be tainted by association with such parties for tax purposes.

If so, any gain over the purchase price as a result of the owner accepting the buy-out offer would be taxable. Under normal circumstances, the owner could have held on to the property for more than the minimum period. However, because of the weather events, the owner has, in effect, little option other than to sell to the local authority (or potentially, in some cases, the Crown).

Normally the various time-based tests should potentially apply when there is a compensatory buy-out. However, given the nature of the specific flooding events, it was agreed there were grounds for an exception, as was done for the Canterbury earthquakes where the Crown purchased properties under the Greater Christchurch Regeneration Act 2016.

Key features

New section CZ 26B ensures that the bright-line tests and other time-related tests in the ITA that tax disposals of land do not apply when there is a Crown or local authority buy-out of a property affected by a "North Island adverse weather event".

A "North Island adverse weather event" is defined in section YA 1 as any of the following:

- heavy rainfall commencing on 26 January 2023 and ending on 3 February 2023 in the Northland, Auckland, Waikato, and Bay of Plenty regions
- Cyclone Gabrielle, which crossed the North Island of New Zealand during the period commencing on 12 February 2023 and ending on 16 February 2023
- severe weather in the Nelson-Tasman region that resulted in a state of emergency being declared under the Civil Defence Emergency Management Act 2002, beginning on 17 August 2022 and ending on 31 August 2022.

[38] In the case of a bright-line loss deduction, it can only be applied against income from land, including bright-line gains.

Detailed analysis

Section CZ 26B specifically turns off both the 5-year and 10-year bright-line tests (sections CZ 39 and CB 6A) and the timing tests in sections CB 9 (Disposal within 10 years: land dealing business), CB 10 (Disposal within 10 years: land development or subdivision business) and CB 11 (Disposal within 10 years of improvement: building business).

Section CB 14 was also included in the equivalent Canterbury earthquake provision (section CZ 26) but has not been included in section CZ 26B because it is considered unlikely to be relevant in this case. That section relates to disposals within 10 years of acquisition where the disposal results in a gain and at least 20 percent of the gain arises from a consenting or planning change.

Turning off the timing tests for the buy-outs means that not only are there no gains but also no losses for tax purposes. For example, some property owners who have bought their properties in the last couple of years may have wanted to utilise any losses from a buy-out against any land income, and that will not be possible. However, it was considered fairer to neutralise the timing test implications for all parties receiving a buy-out.

These amendments ensure that the timing tests are turned off irrespective of the legislative vehicle used to make the buy-out offers, provided that the disposal is as a result of a "North Island adverse weather event".

Extension to the main home exclusion for flood-affected properties

Section CB 16A(1C)(b)(ii) of the Income Tax Act 2007

The main home exclusion from the bright-line test can now be extended to a person has been displaced from their home for more than 12 months as a result of a North Island flooding event.

Background

The main home is generally excluded from the bright-line test. Under current rules for the 10-year bright-line test, this exclusion can still apply even when the property owner has been away from their home for part of the period, provided they are away for no more than 12 months.

This 12-month period can also be extended to any reasonable period of time when a person is constructing a dwelling used as a main home. This would cover cases where a property has been so irreparably damaged by a flood or cyclone that it needs to be rebuilt. However, the 12-month period cannot currently be extended when a person has been displaced from their home because of a flood or cyclone and they are repairing their home rather than rebuilding it.

Effective date

The amendment takes effect on 27 March 2021, the date the 10-year bright-line test applied from.

Detailed analysis

Section CB 16A(1C)(b)(ii) extends the 12-month period from which a person may be away from their home without tax implications to a reasonable period where the person has been displaced from their home because it needs to be remediated because of a North Island flooding event.

The following three events from early 2023 qualify as a North Island flooding event:

- Cyclone Hale
- the heavy rainfall of late January (which was particularly associated with the Auckland floods), and
- Cyclone Gabrielle.

This amendment only applies to the 10-year bright-line test. Any property disposed of after 1 July 2024 is now subject to a 2-year bright-line test.

Flooding tax relief remedials

Sections CE 1, CW 16B, CW 16C, CZ 29B, and YA 1(1) of the Income Tax Act 2007

The amendments ensure that the flooding tax relief provisions introduced in Taxation (Annual Rates for 2022–23, Platform Economy and Remedial Matters) Act 2003 mirror the provisions relating to the Canterbury earthquakes, align the definitions of flood affected areas with other legislation and correct a number of cross references.

Background

The original wording of the provisions relating to accommodation supplied to employees working on projects of limited duration incorrectly did not mirror that used in the Canterbury earthquakes. These amendments correct those provisions.

Key features

The amendments:

- extend the timeframe for employees to relocate to a flood-affected area to work on projects of limited duration
- amend the definition of North Island flooding events to standardise this with other government legislation, and
- correct cross references to the new flooding provisions that were omitted in the original amendments.

Effective date

The amendments take effect on 8 January 2023.

Charities-related remedial amendments

Deregistration tax

Section HR 12 of the Income Tax Act 2007

The deregistration tax generally applies to the net assets of deregistered charities one-year after deregistration. Previously, assets transferred to another person for charitable purposes were excluded from this tax. This exclusion has been narrowed to only apply if assets are transferred for charitable purposes to another tax charity (except for non-resident charities) or to a New Zealand resident tax-exempt entity.

Background

Most charities registered under the Charities Act 2005 receive tax benefits, including an income tax exemption. In 2014, new rules were introduced to impose income tax on the value of the net assets of charities that have been deregistered under the Charities Act 2005. These rules were designed to be a disincentive to transferring net assets out of the charitable base once they are settled there. The imposition of tax also ensured deregistered charities are held to account for the assets and income they built up while they enjoyed the benefit of the tax concessions.

Section HR 12 of the Income Tax Act 2007 (ITA) provides that one year after the day an entity is removed from the Charities Register (or one year after the day on which that entity exhausts all disputes and appeals in relation to its charitable status, whichever is the latter), certain net assets are included as income of that entity and subject to income tax.

Adjustments are made to carve out assets that meet certain criteria, which reduces the net assets balance subject to tax. A carve-out exists for assets that, within the one-year period mentioned above, are disposed of or transferred for charitable purposes or in accordance with the entity's rules contained on the Charities Register.

This carve-out did not require assets to be disposed of or transferred to another registered charity. In practice, the breadth of this carve-out means assets may be transferred to entities that are not subject to regulatory oversight. With no regulatory oversight, the funds and their accumulated tax benefits may be used for non-charitable purposes or charitable purposes that do not benefit New Zealanders. The policy intent of the rules can therefore be undermined.

Key features

The exclusion from the deregistration tax in section HR 12(3)(a) has been narrowed to only apply if a deregistered charity's net assets are disposed of or transferred for charitable purposes to:

a tax charity (except for non-resident organisations that are tax charities under section CW 41(5)(c) of the ITA), or

a New Zealand resident person that derives exempt income under any of sections CW 38 to CW 52, CW 55BA or CW 64 of the ITA.

Assets transferred by a deregistered charity to an entity that is not a registered charity, or to a person that is not a New Zealand tax-exempt entity would be subject to the deregistration tax rules. This protects the integrity of the revenue base by ensuring that assets cannot be transferred overseas or to New Zealand entities that do not qualify for a tax exemption. Section HR 12(3)(a) still requires the disposal or transfer to be for charitable purposes.

A deregistered charity will no longer be required to dispose or transfer its net assets in accordance with its rules in order to be excluded from the deregistration tax. This ensures that a deregistered charity will not be subject to the deregistration tax if it transfers its assets to another tax charity or New Zealand tax-exempt entity for charitable purposes.

Effective date

The changes apply to charities that deregister on or after 1 April 2024.

Example 1: Transfer of assets to a New Zealand resident tax-exempt entity

Grey Warbler Group is a charity registered under the Charities Act 2005. The charity voluntarily deregisters on 30 March 2025 because it no longer wishes to publicly report on its financial activities. Following deregistration, the Group decides to transfer all the assets it built up while enjoying tax concessions to Kōwhai Community Housing, a New Zealand resident tax-exempt entity.

The legislative amendment ensures that the assets transferred by Grey Warbler Group to Kōwhai Community Housing are not subject to the deregistration tax. This is because Kōwhai Community Housing is a New Zealand resident tax-exempt entity, and the transfer of assets are for a charitable purpose. This is more likely to encourage Grey Warbler Group to choose to distribute its assets to New Zealand resident tax exempt entity.

Example 2: Transfer of assets overseas

Kingfisher Charitable Trust is a charity registered under the Charities Act 2005. The founders decide to deregister the charity from the Charities Register on 30 June 2024 and plan to wind up the trust. On deregistration, the trust has assets of $1.5m and no liabilities.

The deregistration tax calculation is determined one year after a charity is deregistered. Before 30 June 2025, the trust transfers assets worth $500,000 to Albatross Association, another charity registered under the Charities Act 2005. The trust transfers the remaining $1m assets to Stingray Charitable Trust, a charity established in the Cayman Islands.

Under the current rules, the Kingfisher Charitable Trust would have no deregistration tax liability as all its assets have been transferred to entities with charitable purposes within one year of deregistration.

The change ensures that the $1m assets transferred out of the New Zealand charitable sector to Stingray Charitable Trust in the Cayman Islands would be subject to the deregistration tax. The Kingfisher Charitable Trust will not be able to transfer the benefits of tax-exempt status that were conferred on those assets to an overseas charity where there is no oversight by New Zealand regulators and no entitlement to New Zealand tax concessions.

Charitable trust definition

Sections HC 13, HC 29, HC 31, HD 12, YA 1 and YB 8 of the Income Tax Act 2007

The amendments simplify the legislation by repealing the definition of a "charitable trust" in the trust rules and replacing references to a "charitable trust" with a "trust that is a tax charity".

Background

Section HC 13 of the Income Tax Act 2007 (ITA) provided that, in the trust rules, a trust is a "charitable trust" in an income year if:

- all income derived or accumulated by the trust in that, or any earlier, year is held for charitable purposes, and
- any income derived by the trustee in the income year is exempt income under either section CW 41(1) (Charities: non-business income) or CW 42(1) (Charities: business income) of the ITA.

This definition was inconsistent with the ordinary meaning of "charitable trust", as not all charitable trusts registered under the Charitable Trusts Act 1957 are eligible to derive exempt income under sections CW 41(1) or CW 42(1) of the ITA.

Effective date

The amendments apply from 29 March 2024.

Charitable entities and RWT-exempt status

Section 32E(1A) of the Tax Administration Act 1994

The amendment ensures that charities registered under the Charities Act 2005 are automatically exempt from resident-withholding tax (RWT).

Background

Since 1 April 2020, section 32E(1A) of the Tax Administration Act 1994 has provided automatic RWT-exempt status for charitable trusts registered under the Charities Act 2005. This was a simplification change intended to reduce unnecessary compliance costs for registered charities. However, the Charities Act 2005 registers "charitable entities", not just charitable trusts.

Key features

The amendment aligns the legislation with existing practice and ensures that all entities (for example, companies) registered under the Charities Act 2005 automatically have RWT-exempt status for the duration of their registration.

Effective date

The amendment applies from 1 April 2020.

Remedial amendments to the land rules

Unintended land tainting on a partition of land

Section CB 15E of the Income Tax Act 2007

New section CB 15E ensures that any income arising under section CB 10(2) or CB 15(1) when land is subdivided between co-owners is exempt to the extent to which the income on subdivision is exempt under section CW 3C.

Background

A partition of land between co-owners is not subject to income tax to the extent to which there is no substantive change in ownership under section CW 3C.

Sections CB 10(2) and CB 15(1) impose tax on land acquired from an associated person in certain circumstances. Absent this amendment, a taxpayer exempt under section CW 3C on a partition of land may be subject to tax under section CB 10(2) or CB 15(1), contrary to policy intent. For example, a taxpayer who had owned land on capital account and incorporated a company to subdivide the land into townhouses, keeping one for themselves, may be subject to tax on the disposal of the townhouse they retained if disposed of within 10 years, if the activity of the company amounts to the carrying on of a land business covered by section CB 10.

Effective date

The amendments are effective from 27 March 2021, the date on which section CW 3C was introduced.

Detailed analysis

Section CB 15E applies to a person for a disposal of land acquired from a co-owner on a partition or subdivision if the person:

- derives income from the disposal under section CB 10(2) or CB 15(1), and
- the person was not associated with a land developer when they originally acquired the land (ie, before it was partitioned or subdivided).

It will only apply to a person who has exempt income under section CW 3C. Refer to the TIB extract on section CW 3C below.

Under section CB 15E(2), if the person's end value proportion under section CW 3C is no more than 105% of their acquisition proportion, then the income the person derived under section CB 10(2) or CB 15(1) is fully exempt. In other words, if section CW 3C(1) applied to the land because the person's ownership proportion did not change, or only changed by 5% or less to fall within the safe-harbour, any income derived under section CB 10(2) or CB 15(1) will be fully exempt.

If section CB 15E(2) does not apply to the land because the person's ownership proportion changed by more than the safe harbour amount on the subdivision or partition such that section CW 3C(2) applied to the land, then the income the person derives under section CB 10(2) or CB 15(1) from disposing of the land is reduced by the amount calculated by the formula:

Amount derived x (acquisition proportion/end value proportion)

Amount derived is the amount the person derives from disposing of the land.

Acquisition proportion is the person's acquisition proportion under section CW 3C. This is the person's contribution to the cost of the land as a proportion of the total cost, and includes all costs to subdivide, develop, and build on the land.

End value proportion is the person's end value proportion under section CW 3C. This is the total value of the land the person receives on the completion of the partition or subdivision out of the total land value. As above, it includes land that the co-owner holds jointly with another person.

The formula ensures that the person only has income under section CB 10 or CB 11 to the extent they had income under section CW 3C. In other words, the disposal of the land is only taxed to the extent there was a change of ownership on the partition or subdivision of the land between the co-owners. It will only apply where the person's end value proportion is more than their acquisition proportion.

Example 1: Operation of section CB 15E

Daniel and Everly purchase land (50:50) for $1.5 million. They intend to build four townhouses on the land of equal lot size, keeping one each and selling the other two. They incorporate a look-through company, toastydog Ltd, for this purpose. The company's activity amounts to a development business for tax purposes. The development costs a further $2 million. The two townhouses they sold to third parties cost $900,000 to build, Everly's townhouse cost $400,000, and Daniel's 600k. Daniel therefore contributes $1.05 million to the development cost, and Everly $950,000.

Two of the townhouses are sold off the plans for $1 million each. Everly's townhouse is worth $900k and Daniel's is worth $1.3 million. Everly and Daniel, in their capacity as shareholders of toastydog Ltd, need to transfer their share in each other's townhouse to the other. Daniel lives in his townhouse for 7 years before selling it for $2 million. Because Daniel was associated with a developer (toastydog Ltd) at the point he acquired his townhouse, he is prima facie subject to tax under section CB 10 because he has sold his townhouse within 10 years of acquisition.

The calculation for Daniel is as follows:

Acquisition proportion = $1.8 million/$3.5 million =51.43%

End value proportion = $1.30 million/$2.2 million = 59.09%

This calculation for the end value proportion only includes the value of the land still held by the co-owners on completion of the subdivision. As the other two townhouses were sold off the plans, this only includes Daniel and Everly's townhouses.

Daniel's income under section CB 10 is $1 million (half of the $2 million sale price as Daniel only acquired half of the property when associated to the development company) – he already had a 50% interest in the land before the development. This is reduced under section CB 15E as follows:

Amount derived x (acquisition proportion/end value proportion)

$1 million x (0.5143/0.5909) = $870,367.24

$1 million - $870,367.24 = $129,632.76

Partitioning of land among co-owners

Section CW 3C of the Income Tax Act 2007

Section CW 3C of the Income Tax Act 2007 (the Act) has been amended to ensure that disposals of land between co-owners following a subdivision are not taxed to the extent that the post-subdivision allocation aligns with the original co-ownership shares.

Background

When co-owners subdivide land and keep a parcel each, each co-owner goes from owning a share in the whole of the undivided land to being the sole owner of the part of the land they get. While the share of the divided land they get may reflect the share they held as co-owner, they are considered to have disposed of their share in the parcel they did not keep, to the other co-owner. And likewise for each other co-owner. These disposals by each co-owner may be taxable events, as the land sale rules in the Act apply in certain situations to tax disposals of land (for example, if the disposal is within the bright-line period or if the land was acquired with the intention of disposal).

Section CW 3C was introduced by the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 to ensure that no income tax is imposed where there is no substantive change of ownership following a subdivision. It was intended that the exemption in section CW 3C would apply to the extent that the post-subdivision allocations aligns with the original co-ownership shares. There is also an exception for instances where there is a small difference in the allocations that each co-owner gets – up to 5% of the smallest co-owner's original holding. This 5% rule was to ensure minor differences in post subdivision allocations are ignored (for example, these could arise due to topography).

If the difference in what each co-owner gets on subdivision was greater than 5% of the smallest co-owner's original holding, the base rule applied. This meant that any income would be exempt only to the extent each co-owner's post-subdivision allocation aligned with their original co-ownership share. But there would be income (if a land sale rule applies) for any co-owner whose post subdivision allocation is less than their co-ownership share. The amount of any such income would reflect the extent to which the land a particular co-owner gets on the subdivision is less than what their co-ownership share was.

However, the provision was ineffective in achieving its intent in the following ways:

- The 5% rule did not apply on a "to the extent" basis, which meant if the 5% threshold was exceeded, the exemption did not apply at all.
- The 5% rule applied only to the co-owner who owned the smallest proportion of the land, not all co-owners.
- The provision did not apply if any of the land was disposed of to a third party. For example, if two siblings purchased land, subdivided and built two houses and one sibling buys one of the houses with their partner, the provision would not apply at all and both siblings would be taxed on their respective disposals.

The re-drafted section CW 3C is intended to address the above issues with the original provision.

Effective date

The amendments came into effect on and after 27 March 2021, the date on which section CW 3C was introduced.

Detailed analysis

Exempt income where no more than minor economic disposal of land

The new section CW 3C(1) provides that an amount that a co-owner of land receives from disposing of land to another co-owner on a subdivision is exempt income if the value of the land they receive on the subdivision, out of the total value of the land still held by the co-owners (whether alone or jointly or in common with another person), is no less than 95% of their contribution to the cost of the land as a proportion of total cost.

Put simply, the amount received from the other co-owner will be fully exempt if the ownership proportions have not changed by more than 5%. This 5% "safe harbour" recognises that there may be small variances in the value of the subdivided lots.

"Co-owner" is defined in section CW 3C(8) to include the person acting in a different capacity. The capacities included in the definition are:

- shareholder of a company
- trustee of a trust
- partner in a partnership
- owner of a look-through company.

This means that the person could acquire land in one capacity and then hold it in a different capacity after the subdivision or partition was complete and still qualify for relief under the section.

The wording "whether alone or jointly or in common with another person" in subsection (1) ensures that the section still applies if land post-subdivision is owned jointly by the co-owner and a third party.

Example 1: No more than minor disposal of land

Amy and Bill go 50:50 on a purchase of land for $1 million. They subdivide the land and construct 2 townhouses, costing $800,000 in total. Amy contributes $420,000 towards this cost as her townhouse is slightly bigger than Bill's. Bill contributes the remaining $380,000. After the development they subdivide the land. Amy's townhouse (lot A) is worth $1.1 million and Bill's townhouse (lot B) is worth $1 million.

Calculation for Amy:

First, consider section CW 3C(1):

The proportion of the value of the land Amy received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) is **52.38%** ($1.1 million / $2.1 million).

Amy's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **51.11%** ($920,000 / $1.8 million).

95% of Amy's contribution to the cost of the land, as a proportion of the total cost is **48.56%** (95% x 51.11%[39]).

The proportion of the value of the land Amy received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) (**52.38%**) is no less than 95% of Amy's contribution to the cost of the land, as a proportion of the total cost (**48.56%**).

As such, any amount Amy derives or is deemed to derive from disposing of land to Bill on the subdivision is exempt income.

Calculation for Bill:

First, consider section CW 3C(1):

The proportion of the value of the land Bill received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) is **47.62%** ($1 million / $2.1 million).

Bill's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **48.89%** ($880,000 / $1.8 million).

95% of Bill's contribution to the cost of the land, as a proportion of the total cost is **46.44%** (95% x 48.89%[40]).

The proportion of the value of the land Bill received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) (**47.62%**) is no less than 95% of Bill's contribution to the cost of the land, as a proportion of the total cost (**46.44%**).

As such, any amount Bill derives or is deemed to derive from disposing of land to Amy on the subdivision is exempt income.

[39] Being $920,000 / $1.8 million.

[40] Being $880,000/$1.8 million.

Example 2: Co-owner holding land jointly after subdivision

James and Will purchase land (50:50) for $1.5 million. They develop it into 8 townhouses which costs a further $2 million. At the end of the subdivision, they each have a 50% share in 8 lots of land (each worth $900,000). Six of the properties are then sold to third parties. James purchases one townhouse for $900,000. Will and his girlfriend, Nicole, purchase the other townhouse for $900,000 (each contributing 50% of the purchase price). To give effect to this transfer, James needs to sell his half share in the townhouse to be owned by Will and Nicole to them, and Will needs to sell his half share in James's townhouse to James.

Calculation for James:

James derives $225,000 from Will and $225,000 from Nicole (being James's 50% share of the $900,000 purchase price for Will and Nicole's townhouse).

First, consider section CW 3C(1):

The proportion of the value of the land James received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) is **50%** ($900,000 / $1.8 million).

James's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **50%** ($1.75 million / $3.5 million).

95% of James's contribution to the cost of the land, as a proportion of the total cost is **47.5%** (95% x 50%[41]).

The proportion of the value of the land James received on the subdivision, out of the total value of the land still held by people who were co-owners (whether alone or jointly or in common with another person) (**50%**) is no less than 95% of James's contribution to the cost of the land, as a proportion of the total cost (**47.5%**).

As such, the amount James derives from disposing of land to Will on the subdivision is exempt income.

The $225,000 James derives from Nicole is not exempt income under section CW 3C because it is not derived from disposing of land to someone who was another co-owner. Whether the amount James derives from Nicole is income depends on whether any taxing provisions apply (for example, the bright-line test or one of the other land sale rules).

Calculation for Will:

Will derives $450,000 from James (being Will's 50% share of the $900,000 purchase price for James's property). Will also derives $225,000 from Nicole (being Will's 50% share of the $450k Nicole contributes to the purchase price for Will & Nicole's townhouse).

First, consider section CW 3C(1):

The proportion of the value of the land Will received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person, is **50%** ($900,000 / $1.8 million).

Will's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **50%** ($1.75 million / $3.5 million).

95% of Will's contribution to the cost of the land, as a proportion of the total cost is **47.5%** (95% x 50%[42]).

The proportion of the value of the land Will received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person (50%) is no less than 95% of Will's contribution to the cost of the land, as a proportion of the total cost (47.5%).

As such, the amount Will derives from disposing of land to Will on the subdivision is exempt income.

The $200,000 Will derives from Nicole is not exempt income under section CW 3C because it is not derived from disposing of land to someone who was another co-owner. Whether the amount Will derives from Nicole is income depends on whether any taxing provisions apply (for example, the bright-line test or one of the other land sale rules).

[41] Being $1.75 million / $3.5 million.

[42] Being $1.75 million / $3.5 million.

Partially exempt income where more than minor economic disposal of land

If subsection (1) does not apply because the co-owner has made a more than minor disposal of land to another co-owner, the amount of income that is exempt is given by the formula:

Amount derived – (total land value x (acquisition proportion – end value proportion)

Amount derived is the amount that the co-owner receives from disposing of their interest in the land to another co-owner on a partition or subdivision.

Total land value is the total value of the land held by all persons who were co-owners at the end of the partition or subdivision. It includes land that the co-owner holds jointly with another person, for example, using the facts of example 1 above, if Bill owned his townhouse jointly with his girlfriend Juliette on the completion of the subdivision, the entire value of the townhouse would be included in the total land value, even though Juliette was not a part owner of the land prior to the subdivision.

Acquisition proportion is the person's contribution to the cost of the land as a proportion of the total cost. It includes all cost to subdivide, develop, and build on the land.

End value proportion is the total value of the land the person receives on the completion of the partition or subdivision out of the total land value. As above, it includes land that the co-owner holds jointly with another person.

The formula will only apply where the person has disposed of some of their land such that their acquisition proportion is less than their end value proportion by more than 5%, otherwise the safe-harbour in subsection (1) would apply. Put simply, the formula ensures that there is only income to the extent there has economically been a disposal of land.

Example 3: More than minor disposal of land between co-owners

Erica and Catherine go 50:50 on the purchase of land for $1 million. They develop 2 townhouses costing $1 million total. Erica contributes $700,000 to this cost and Catherine contributes $300,000, as Erica's townhouse is bigger. After the development, on partition of the land, Erica's townhouse (lot A) is worth $1.5 million and Catherine's townhouse is worth $1.2 million (lot B).

Calculation for Erica:

Erica derives $750,000 of income from Catherine (being the market value of the 50% share in lot A that she received from Catherine).

First, consider section CW 3C(1):

The proportion of the value of the land Erica received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person, is **55.56%** ($1.5 million / $2.7 million).

Erica's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **60%** ($1.2 million / $2 million).

95% of Erica's contribution to the cost of the land, as a proportion of the total cost is **57%** (95% x 60%[43]).

The proportion of the value of the land Erica received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person (**55.56%**) is less than 95% of Erica's contribution to the cost of the land, as a proportion of the total cost (**57%**).

As such, subsection (1) does not apply and subsection (2) applies instead.

Consider section CW 3C(2):

The extent to which the amount Erica derives from Catherine would be exempt under subsection (2) is calculated as follows:

Amount derived – (total land value x (acquisition proportion – end value proportion))

$750,000 – ($2.7 million x (0.6 – 0.5556)) = $750,000 – $119,880 = **$630,120 exempt income**.

Whether the remainder of the amount Erica derives from Catherine (**$119,880**) is income depends on whether any taxing provisions apply (for example, the bright-line test or one of the other land sale rules).

[43] Being $1.2 million / $2 million.

Calculation for Catherine:

Catherine derives $600,000 of income from Erica (being the market value of the 50% share in lot B that she received from Erica).

First, consider section CW 3C(1):

The proportion of the value of the land Catherine received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person, is **44.44%** ($1.2 million / $2.7 million).

Catherine's contribution to the cost of the land (including costs to subdivide, develop and build on the land) as a proportion of the total cost is **40%** ($800,000 / $2 million).

95% of Catherine's contribution to the cost of the land, as a proportion of the total cost is **38%** (95% x 40%[44]).

The proportion of the value of the land Catherine received on the subdivision, out of the total value of the land still held by people who were co-owners, whether alone or jointly or in common with another person (**44.44%**) is no less than 95% of Catherine's contribution to the cost of the land, as a proportion of the total cost (**38%**).

As such, the amount Catherine derives from disposing of land to Erica on the subdivision is exempt income.

[44] Being $800k / $2 million.

Land used by transitional housing providers

Sections DH 4 and DH 5 of the Income Tax Act 2007

Sections DH 4 and DH 5 have been amended to ensure that land used for transitional housing is excluded from the interest limitation rules. This enables land used by a transitional housing provider to provide social or temporary housing to claim interest deductions.

Background

Section DH 4(4) provided that the interest limitation rules do not apply to interest incurred by a person for land, to the extent the land is used by either a registered community housing provider, a government department or Kāinga Ora and its wholly owned subsidiaries for social housing, temporary accommodation or other accommodation for people in need.

It was always intended that this provision would also apply to land used by a transitional housing provider for one of the housing purposes listed in section DH 4(4). However, due to a drafting error, transitional housing providers were not included. This amendment rectifies this.

Effective date

The amendments are effective from 27 March 2021, the date sections DH 4 and DH 5 apply from.

Detailed analysis

Section DH 4(4) has been replaced. It now provides that the interest limitation rules do not apply to interest incurred by a person for land to the extent to which the land is used by an exempt housing provider for social or transitional housing. The only change is the introduction of the term "exempt housing provider" – the rest of the section replicates what was already there.

Section DH 5(5) defines an exempt housing provider. Paragraphs (a) to (c) replicate what used to be in section DH 4(4), the only change is the addition of paragraph (d). Paragraph (d) provides that a person contracted, directly or indirectly, by a Government Department to provide social or transitional housing is an exempt housing provider.

This covers a broad variety of transitional housing arrangements. The use of "directly or indirectly" ensures that a person can still obtain interest deductions when there is a middleman between them and the government agency.

This Act repeals the interest limitation rules from 1 April 2025, so this amendment will only apply from 27 March 2021 to 31 March 2025.

Amendments to rollover relief for the bright-line test

Sections CB 6AB(2B) and CB 6AC(2B) of the Income Tax Act 2007

Amendments to sections CB 6AB and CB 6AC of the Income Tax Act 2007 ensure that rollover relief applies under those provisions when residential land that was transferred to a family trust by a group of settlors is subsequently transferred back to the surviving settlors following the death of one of them, provided certain conditions are met.

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, if so, the amount of the gain that is taxable.

Section CB 6AB(2) provides rollover relief under the bright-line test in a scenario where the trustee of a "rollover trust" transfers residential land to a principal settlor (or a group of settlors that includes a principal settlor). One of the requirements for rollover relief under the section (in paragraph (a)) is that the transferees had previously transferred the land to the trust. Previously, this requirement was only satisfied in a scenario where there were multiple transferees if the land each transferee received from the trustee was in proportion to what they originally transferred to the trust. This proportionality requirement therefore prevented rollover relief in the situation where one of the settlors died and, following their death, **all** the land (including the deceased's share) was transferred from the trust to the surviving settlors.

Section CB 6AC(2) similarly provides rollover relief when the trustee of a "Māori rollover trust" transfers residential land to a settlor (or a group of settlors) in the situation where the settlor(s) had previously transferred the land to the trust. A similar proportionality requirement to the one described above for section CB 6AB(2) previously prevented rollover relief from applying under section CB 6AC(2) in "multiple transferee" scenarios where one of the settlors died and, following their death, **all** the land was transferred from the trust to the surviving settlors.

Effective date

The amendment came into force on 29 March 2024.

Given sections CB 6AB and CB 6AC will be replaced in their entirety by new sections FD 1 and FD 2 on 1 July 2024, the amendments will apply for a limited period. For transfers occurring on or after that date, the new rollover relief rules in sections FD 1 and FD 2 will apply. Section FD 1 will provide rollover relief for transfers of residential land between associated persons. Section FD 2 replicates the existing rules in section CB 6AC for Māori rollover trusts, including the modification to the proportionality requirement for transfers from trusts back to settlors that is the subject of this item.

Detailed analysis

Key terms

Section CB 6AB provides rollover relief under the bright-line test when residential land is transferred to or from a "rollover trust" on or after 1 April 2022, provided certain conditions are met. Several key terms are defined in the section.

"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)).

Section CB 6AC similarly provides rollover relief under the bright-line test when certain residential land is transferred to or from a "Māori rollover trust" on or after 1 April 2022, provided certain conditions are met.

"Māori rollover trust" is defined in section CB 6AC(4) to mean, at the time of a relevant transfer:

- all beneficiaries of the trust are members of the same iwi or hapū, or descendants of the same tīpuna, and
- the land in question is subject to Te Ture Whenua Māori Act 1993.

"Māori trustee" is defined in section CB 6AC(5) to mean a trustee of a trust that is either a Māori authority or eligible to elect to be a Māori authority.

Proportionality requirement when land is transferred back to settlors

Two separate tests determine whether rollover relief applies under the bright-line test in the situation where land is transferred from a rollover trust to a principal settlor of the trust, or to a group of settlors that includes a principal settlor.

The first test, contained in section CB 6AB(2)(a), applies if the transferees had originally transferred the land to the trustee, whether by settling the land on the trust or selling the land. Rollover relief applies under this test if 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 transferees:

- all transferees are beneficiaries of the trust
- at least one transferee is a principal settlor, and
- the trust is a rollover trust.

Modification of proportionality requirement

New section CB 6AB(2B) applies for the purposes of the proportionality requirement in section CB 6AB(2)(a) when a settlor who had previously transferred the land to the trustee dies. It provides that the proportionality requirement is met if the transferees receive at least the same proportion of the land back from the trustee as they had previously transferred.

This means that rollover relief may still apply when land is transferred from the trust back to the surviving settlors, following the death of one or more settlors who (along with the surviving settlors) originally transferred the land to the trust. As outlined above, each transferee receiving the land from the trustee must receive at least the same proportion of the land as they had originally transferred to the trustee (the land transferred from the trustee being the very same land that the transferees originally transferred to whoever was the trustee of the rollover trust at the time they made that original transfer).

Example 1: Land transferred back to surviving settlors

In August 1978, brothers Phil, Ian and Eddie each transfer a 1/3 interest in land they co-own to their family trust by settling the land on the trust. The only beneficiaries of the trust are Phil, Ian and Eddie and their spouses and children.

Following the death of Ian in late 2022, the trustee in February 2023 transfers 100 percent of the land back to Phil and Eddie. Phil receives the 1/3 interest that he originally transferred to the trust back from the trustee, while Eddie receives a 2/3 interest from the trustee (being his original 1/3 share, plus Ian's 1/3 share). The transfer by the trustee is made for nil consideration.

At the time the trustee transfers the land to Phil and Eddie:

- both Phil and Eddie are beneficiaries of the trust
- Eddie is a principal settlor of the trust (being the settlor whose settlements on the trust are the highest by market value as at February 2022), and
- the trust is a rollover trust, as all the beneficiaries are close family beneficiaries.

Full rollover relief applies to the transfer of the land from the trustee to Phil and Eddie. This means Phil and Eddie have a deemed bright-line start date of August 1978, being the trustee's bright-line start date (that is, when the land was originally transferred to the trust), with a total cost base in the land of nil (being the total cost of the interests in the land to the trustee).

If Phil and Eddie had instead purchased the land back from the trustee for more than nil consideration, only partial rollover relief would apply to the transfer of the land from the trustee to Phil and Eddie (see section FC 9C of the Income Tax Act 2007, and page 32 of *Special report: Rollover relief – bright-line test and interest limitation*, published on 22 May 2023). This means that Phil and Eddie would not have the benefit of the trustee's (nil) cost base in the land and would instead be deemed to have acquired the land for the amount of consideration they actually provided for it. However, this is of no consequence because Phil and Eddie would both still have a deemed bright-line start date of August 1978, meaning that a future disposal by them will not be subject to the bright-line test.

Modification of proportionality requirement for Māori rollover trusts

The proportionality requirement in section CB 6AC(2) for Māori rollover trusts has also been modified to cater for the situation where a settlor who had previously transferred the land to the trustee dies.

Section CB 6AC(2) applies in the situation where the land is transferred by a Māori trustee to a transferee or a group of transferees. Rollover relief applies under the section if:

- the transferees had previously transferred the land to the trust
- 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
  - all transferees are beneficiaries of the trust
  - the trust is a Māori rollover trust, and
  - all transferees are settlors of the trust.

Similar to section CB 6AB(2B), new section CB 6AC(2B) applies for the purposes of the proportionality requirement in section CB 6AC(2)(b) when a settlor who had previously transferred the land to the trustee dies. It provides that the proportionality requirement is met if the transferees receive at least the same proportion of the land back from the trustee as they had previously transferred.

Rollover relief and the main home exclusion

Section CB 16A(2B) and CZ 40(2C) of the Income Tax Act 2007

The 5- and 10-year bright-line test main home exclusions in sections CB 16A and CZ 40 have been amended to ensure that, where rollover relief applies, the use of the property by the transferor (for example, as a main home) is attributed to the transferee.

Background

The bright-line test taxes residential land acquired and sold within a specified timeframe. Rollover relief ensures that the bright-line test is not triggered in certain common situations where there is a legal transfer of residential land, but no change in economic ownership.

The rollover relief rules would be ineffective in ensuring the bright-line test is not triggered where there is no change in economic ownership if the transferor's use of the property as a main home was not attributed to the transferee.

Effective date

The amendments came into effect on 27 March 2021, the date the rollover relief rules were introduced.

Detailed analysis

Sections CB 16A and CZ 40 have been amended to provide that if a person was the transferee in a transaction to which the rollover relief rules in section CB 6AB applied, the transferor's use of the property is attributed to the person for the purposes of determining whether the main home exclusion applies. For example, the transferor's use of the property as a main home is attributed to the transferee.

The amendment to section CB 16A ensures this change applies to the 10-year bright-line test main home exclusion, and the amendment to section CZ 40 ensures it applies to the 5-year bright-line test main home exclusion.

Main home exclusion: construction period

Sections CB 16A(1B) and CZ 40 of the Income Tax Act 2007

Sections CB 16A and CZ 40 of the Income Tax Act 2007 have been amended to ensure that the period during which a main home is constructed is ignored for the purposes of determining whether the main home exclusion from the 5-year bright-line test applies.

Background

The bright-line test taxes land acquired and disposed of within a certain time period. For properties acquired on or after 29 March 2018 and before 27 March 2021, the bright-line period is 5 years. The bright-line period was changed to 10 years for properties acquired on or after 27 March 2021. The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024changes the bright-line period to 2 years for properties disposed of on or after 1 July 2024.

A person's main home is not taxed under the bright-line test. A person can qualify for the main home exclusion from the bright-line test provided the property is used as a main home for at least half of the bright-line period.

The rules could result in unfairness if the period during which a main home was constructed was not ignored. For example, a house that took two years to construct and was lived in as a main home for one year before being sold would not qualify for the main home exclusion despite only ever being used as a main home.

Effective date

The amendments apply to residential land acquired on or after 29 March 2018 and before 27 March 2021.

Detailed analysis

New subsection (1B) has been inserted into section CB 16A as it existed between 29 March 2018 and 26 March 2021 (inclusive). It provides that, for the purposes of determining whether residential land has been used for most of the bright-line period as a main home, the period in which the dwelling is constructed is ignored.

The same amendment has also been made in section CZ 40 by inserting new subsection (2B), however this amendment applies from 27 March 2021.

Both these sections needed to be amended because when the bright-line test was changed to 10 years the main home exclusion in section CB 16A was replaced from 27 March 2021 and the main home exclusion from the 5-year bright-line test was placed in section CZ 40 with application from 27 March 2021.

Example 1: Ignoring the construction period when determining if the main home exclusion applies

Amy purchased a new build townhouse off the plans on 1 June 2019. Construction was completed on 5 March 2020 and Amy moved in on 1 April 2020. Amy lived in the townhouse until 15 December 2020 when she moved overseas for a job offer she could not refuse. The townhouse was sold on 17 January 2021.

- The construction period of 1 June 2019 to 5 March 2020 is 279 days.
- The period Amy lived in the house from 1 April 2020 to 15 December 2020 is 259 days.
- The bright-line period of 1 June 2019 to 17 January 2021 is 597 days.
- The 279 days the property is constructed is ignored, so the calculation is as follows:

$$259/(597 - 279) = 81.45\%$$

The main home exclusion from the 5-year bright-line test applies because 81.45% is at least 50%, and Amy is not subject to tax on the sale of her home.

Remedial amendments to information-sharing provisions

Allowing death information to be shared with Kiwisaver scheme providers

Section 220B of the KiwiSaver Act 2006

The amendment will allow the Commissioner of Inland Revenue to electronically communicate information about deceased KiwiSaver members' estates to KiwiSaver providers.

Background

The accounts of deceased KiwiSaver members can become dormant, no longer receiving contributions while still incurring KiwiSaver provider fees.

In some cases, the scheme provider may not learn of the member's death or know the contact details of the deceased member's estate. In other circumstances, the executors or administrators may be unaware the deceased's KiwiSaver account exists.

In either case, the member's account will not be distributed to the member's intended heirs. This amendment will improve the flow of information from Inland Revenue to KiwiSaver scheme providers.

Effective date

The change came into effect on 1 April 2024.

Key features

The key change is that the amendment will allow the Commissioner of Inland Revenue to electronically provide KiwiSaver providers with information relating to the administration of a deceased member's estate.

Detailed analysis

Prior to this amendment, Inland Revenue was unable to offer KiwiSaver providers any information about the executors or administrators of the deceased member's estate. The amendment to section 220B of the KiwiSaver Act 2006 allows the Commissioner to electronically provide KiwiSaver providers with information relating to the administration of a deceased member's estate. This will assist them in contacting the executors or administrators of the deceased member's estate.

Information sharing with Health New Zealand

Schedule 7, part C, subpart 1, clause 23B(6)(f) to the Tax Administration Act 1994

Health New Zealand has been added to schedule 7 to the Tax Administration Act 1994 (TAA) bringing it within the definition of "government agency". The amendment enables disclosure of taxpayer information directly to Health New Zealand to support contact tracing practices.

Background

Information collected by Inland Revenue is held strictly confidential unless disclosure is permitted. These permitted disclosures balance Inland Revenue's responsibilities to respect and protect taxpayers' information while facilitating the delivery of government services, such as Working for Families.

In 2020, an information sharing provision was introduced to allow information to be shared between Inland Revenue and other "government agencies" for COVID-19 response purposes. This has facilitated information sharing between Inland Revenue and the Ministry of Health for contact tracing.

However, contact tracing has now been assumed by Health New Zealand, which was not a "government agency" as defined in clause 23B(6) of schedule 7 to the TAA. This means Inland Revenue was unable to directly disclose information to Health New Zealand despite the agency delivering a key COVID-19 response.

Effective date

This amendment takes effect on 29 March 2024.

Remedial amendments to the platform economy rules

Information reporting and exchange

Sections 3(1), 22(2) and 142K of the Tax Administration Act 1994

Several minor remedial amendments have been made to the Tax Administration Act 1994 to ensure that the new reporting rules work as intended.

Background

Amendments were included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 to give legislative effect in New Zealand to an information reporting and exchange framework developed by the OECD (the reporting rules).

The reporting rules came into force on 1 January 2024 and require platform operators to provide tax authorities with information about sellers and the income they earn from certain activities on digital platforms. This information is then exchanged between tax authorities that have implemented the rules.

Effective date

The amendments came into effect on 1 January 2024, consistent with the application date for the reporting rules in New Zealand.

Detailed analysis

Record-keeping requirements for reporting platform operators

Section 22 of the Tax Administration Act 1994 (TAA) requires platform operators to keep records for seven years following the end of the applicable tax year or income year for the purposes of the reporting rules.

This is problematic because information collected and reported under the reporting rules is done so on a calendar year basis, not on a tax year basis.

Amended section 22 requires a platform operator to retain records for seven years following the end of the relevant **calendar year**, instead of tax year or income year.

Definition of "civil penalty"

New civil penalties were included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 to support the introduction of the reporting rules. The penalties can apply to reporting platform operators (section 142J of the TAA) and sellers on digital platforms (section 142K of the TAA). These penalties were added to the definition of "civil penalty" in section 3(1) of the TAA to ensure all the rules in that Act that apply to civil penalties will apply to these new penalties.

Although the amendments to sections 142K and 142J apply from 1 January 2024, the definition of civil penalty in section 3(1) was amended to apply from the date of the Royal assent, being 31 March 2023.

An amendment has been made to the definition of civil penalty in section 3 of the TAA to ensure that the cross refences to sections 142K and 142J in the definition of civil penalty take effect from 1 January 2024 as intended.

Penalties – information to enable a platform operator to fulfill its reporting obligations

Section 142K(2)(c) of the TAA provides that sellers operating through digital platforms are liable for a penalty if they do not provide information that they are required to provide to a platform operator under the reporting rules.

This is problematic because the OECD reporting rules do not explicitly require sellers to provide information to platform operators, the rules merely require the operator to provide information in respect of sellers to the tax authority.

Amended section 142K clarifies that a seller is liable for a penalty if they do not provide information to a platform operator that the operator requires to fulfil its reporting obligations under the reporting rules.

Listing intermediaries

Section 60CB of the Goods and Services Tax Act 1985

The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 introduced new rules applying to "listing intermediaries" for the purposes of the GST rules for supplies of listed services (including taxable accommodation) that came into effect on 1 April 2024.

Background

Under the original GST rules for listed services enacted in March 2023, it was envisaged that in circumstances where an underlying supplier of taxable accommodation engaged the services of a property manager or agent, the property manager or agent would provide information about the underlying supplier to the operator of the electronic marketplace. This would have enabled the marketplace operator to apply the flat-rate credit scheme if the underlying supplier was not registered for GST. The rules as originally enacted did not adequately deal with the common scenario where a property manager or agent enters into a contractual arrangement with a marketplace operator to list taxable accommodation on behalf of underlying suppliers.

Where the property manager or agent has a contractual relationship with an operator of an electronic marketplace to list or advertise the services on the marketplace, the agent (referred to as a "listing intermediary") would generally be responsible for all requirements related to the flat-rate credit (instead of those obligations being on the marketplace operator). As explained below, they will also be treated as making a zero-rated supply of the accommodation provided by the underlying supplier to the marketplace operator, unless they are able to agree with the marketplace operator that they are liable for GST at the 15% rate on supplies of taxable accommodation.

Effective date

The new rules for listing intermediaries came into effect on 1 April 2024.

Detailed analysis

Listing intermediary definition

A "listing intermediary" is defined in section 60CB(8) of the Goods and Services Tax Act 1985 (GST Act) as a registered person who lists taxable accommodation on an electronic marketplace on behalf of an underlying supplier who makes those supplies through the marketplace.

The definition of "listing intermediary" requires that the person enters into an agreement with the marketplace operator to list or advertise the accommodation provided by the underlying supplier. A listing intermediary may also provide other services to underlying suppliers (such as property management services), but the listing intermediary definition does not require this.

An agent who lists taxable accommodation on an electronic marketplace on behalf of an underlying supplier but who does not have an agreement in their own name with the marketplace operator to list or advertise the services on the marketplace does not meet the definition of a "listing intermediary". Therefore, they are not subject to the requirements on listing intermediaries (namely, the various requirements related to the flat-rate credit, which would normally be the responsibility of the marketplace operator but become the responsibility of a listing intermediary when they are interposed between an underlying supplier of taxable accommodation and a marketplace operator). In this circumstance, the agent will instead provide information to the marketplace operator about the underlying supplier, such as the underlying supplier's GST registration status and bank account information.

Example 1: Property manager meets listing intermediary definition

Andraya uses the services of a property manager to manage her holiday home and advertise it on an electronic marketplace for short-stay accommodation. The property manager is registered for GST.

The property manager has an agreement in its own name with the operator of the electronic marketplace to list accommodation provided in multiple properties on the electronic marketplace. Aside from the addresses of the properties listed on the marketplace, the marketplace operator does not know anything about Andraya or any of the other owners of the properties listed on the marketplace by the property manager.

The property manager meets the definition of a listing intermediary.

Example 2: Person is not a listing intermediary

Willow has a holiday home in the Coromandel that she would like to rent out for the summer on Rent-A-Holiday-Home, a prominent electronic marketplace for short-stay accommodation. Willow is aware that her next-door neighbour, Callan, has an account on Rent-A-Holiday-Home that he sometimes uses to rent his own holiday home out for short-stay accommodation. Neither Willow nor Callan are registered for GST.

Willow is not a confident user of computers and smartphones, so she asks Callan if he can create an account on Rent-A-Holiday-Home for her and list the Coromandel holiday home on Rent-A-Holiday-Home as available for short-stay accommodation guests to book over the summer.

Callan creates an account on Rent-A-Holiday-Home for Willow and lists Willow's Coromandel holiday home as available to book over the summer. Even though the email address provided to Rent-A-Holiday-Home is Callan's secondary email address (rather than Willow's email address), the contract entered into with the marketplace operator to list the accommodation in the Coromandel holiday home is in Willow's name, not Callan's.

Callan is not a listing intermediary. Callan provides details of Willow's GST registration status (unregistered) and her bank account details to Rent-A-Holiday-Home so Rent-A-Holiday-Home can pay her the flat-rate credit.

Default rules for listing intermediaries – deeming of three separate supplies

Section 60CB(2) applies when a listing intermediary is interposed between an underlying supplier of taxable accommodation and an operator of an electronic marketplace. The effect of this is that the supply of the services is treated as three separate supplies:

- A supply from the underlying supplier of the services to the listing intermediary. This supply is zero-rated under section 11A(1)(jd) of the GST Act if the underlying supplier is a registered person.
- A supply from the listing intermediary to the marketplace operator, which is also zero-rated under section 11A(1)(jd). This zero-rated supply does not create a requirement for the listing intermediary to provide taxable supply information to the marketplace operator for the supply. It does however mean that the listing intermediary should include the value of this supply and all other zero-rated supplies that they make (or are deemed to make) in the "Zero-rated supplies" box in their GST return. The value of all such supplies also counts towards the person's total supplies for determining whether they exceed the GST registration threshold.
- A supply from the marketplace operator to the guest, which is subject to GST at the standard 15% rate. This means the default setting for output tax when a listing intermediary is interposed between the underlying supplier of the accommodation and an operator of an electronic marketplace is that the liability for output tax at the 15% rate remains with the marketplace operator (just as it would if the listing intermediary was not involved in the supply).

Application of flat-rate credit provisions

Section 60CB(5) provides that, under the provisions related to the flat-rate credit, the listing intermediary is treated as though they are the operator of the electronic marketplace through which the supply of listed services is made, and must meet all the requirements placed on the operator for the flat-rate credit under those provisions for that supply. This means that where a listing intermediary is interposed between an underlying supplier of taxable accommodation and an operator of an electronic marketplace, all requirements related to the flat-rate credit for that supply are imposed on the listing intermediary – including the requirement to deduct input tax for the flat-rate credit and to pass it on to the underlying supplier, and to provide a statement, at least monthly, to the underlying supplier showing the amount of flat-rate credit passed on.

Treatment of services supplied by listing intermediary directly to guests

In addition to listing or advertising taxable accommodation on an electronic marketplace on behalf of underlying suppliers, some listing intermediaries may provide property management services to these property owners. In this situation, it is not uncommon for the listing intermediary to structure its contracts so that services such as cleaning and linen hire are supplied to guests staying at the property (rather than being supplied to the property owner), for which the guests pay a fee. The fact that there is a separate fee for the listing intermediary's services on top of the price of the accommodation itself may not be apparent, because the marketplace may take and display just one bundled price for the package of services (being taxable accommodation and the listing intermediary's services).

Under the pre-1 April 2024 GST rules, the listing intermediary (if registered for GST) would have already been accounting for and paying GST to Inland Revenue on its services. However, if the fee charged for the listing intermediary's services is not known to the marketplace operator and cannot be distinguished from the price of the accommodation, having the marketplace operator account for output tax on the supply of accommodation and the listing intermediary account for output tax on the supply of its services would likely result in double taxation of the listing intermediary's services.

To address this issue, section 60CB(3) provides that when section 60CB(2) applies to a supply of listed services, a supply of other services by the listing intermediary to the guest through the electronic marketplace is treated as two separate supplies as follows:

- a supply from the listing intermediary to the operator of the electronic marketplace that is zero-rated under section 11A(1)(jd), and
- a supply by the marketplace operator that is subject to GST at the standard 15% rate.

The above rule only applies if section 60CB(2) applies. As discussed below, there may be situations where a listing intermediary is liable for output tax on a supply of taxable accommodation, in which case section 60CB(2) would not apply. In that situation, any services the listing intermediary supplies directly to guests through the electronic marketplace will retain their GST treatment under the normal GST rules, rather than being subject to the rule in section 60CB(3). This means, rather than being treated as making a zero-rated supply of those services to the marketplace operator (and the marketplace operator being treated as supplying those services to the guest), the listing intermediary's supply to the guest is a single standard-rated supply as per the pre-1 April 2024 rules.

If the listing intermediary is treated as making a zero-rated supply of the services to the marketplace operator, they are not required to provide taxable supply information to the marketplace operator for this supply.

Because the "other" services provided by the listing intermediary to the guest (that the listing intermediary is treated as supplying to the marketplace operator) are not "listed services", the provision of these services to the guest does not affect the calculation of the flat-rate credit that the listing intermediary is required to deduct input tax for in its GST return and then pass on to the underlying supplier of the accommodation. In other words, the amount of flat-rate credit required to be deducted and passed on is based only on the value of the accommodation provided by the underlying supplier, and does not include the value of the other services provided by the listing intermediary to the guest.

Example 3: Default rules for listing intermediaries

Gordon uses the services of a listing intermediary to manage his property and list it on several electronic marketplaces for short-stay accommodation. Gordon is not registered for GST. The listing intermediary is registered for GST for its property management activity.

Gordon has an agreement with the listing intermediary that his property will be rented out for no less than $100 per night.

Harriet uses an electronic marketplace to book accommodation in Gordon's property. Harriet pays a total of $150 plus GST for one night's stay in Gordon's property. This includes $100 for the accommodation, and $50 for services supplied to Harriet by the listing intermediary.

The marketplace operator accounts for GST on the supply. It provides Harriet with taxable supply information.

The listing intermediary is deemed to make a supply of the accommodation provided by Gordon to the operator of the electronic marketplace. It is also treated as making a supply of its own services (that it contractually supplies to Harriet) to the marketplace operator. Both deemed supplies are zero-rated, meaning the listing intermediary has output tax of zero for the $150 of services it is treated as supplying to the operator of the electronic marketplace. This is because the marketplace operator has accounted for output tax on these supplies at the standard GST rate of 15%.

The listing intermediary is responsible for calculating the flat-rate credit for Gordon. It calculates this based on the value of the accommodation of $100. It will be responsible for providing Gordon with a statement, at least monthly, showing the flat-rate credit that Gordon received from the listing intermediary.

When listing intermediary is treated as supplier of taxable accommodation

Provided certain conditions are met, a listing intermediary can agree with an operator of an electronic marketplace that they are liable for output tax on accommodation supplied through the electronic marketplace. The agreement between the listing intermediary and the marketplace operator must be recorded in a document.

To be entitled to seek such an agreement, the listing intermediary must:

- be a New Zealand tax resident
- list the accommodation provided by the underlying supplier on not just one, but multiple electronic marketplaces, and
- enable or facilitate the supply of the accommodation using an electronic system that can facilitate and manage guests' bookings automatically. For example, such an electronic system might include an application programming interface (API) that transmits data or information between the electronic marketplace and the listing intermediary's systems, or property management software that the listing intermediary uses to manage bookings taken via multiple electronic marketplaces.

The intention of the second and third requirements above is to limit the ability for a listing intermediary to obtain such an agreement with a marketplace operator to situations where the listing intermediary is in some ways similar to an operator of an electronic marketplace. The person might even be an operator of an electronic marketplace in certain scenarios, such as where they operate their own website or app through which guests can book taxable accommodation provided by an underlying supplier. In this situation where a person is both a listing intermediary for some supplies of taxable accommodation and a marketplace operator for other supplies (and would therefore be liable for output tax on those other supplies), the rules allow the person the option of accounting for and paying output tax on supplies for which they are a listing intermediary, subject to the marketplace operator's agreement with this arrangement.

Section 60CB(7) provides that the effect of such an agreement is that the listing intermediary is treated as though they are the marketplace operator for several key provisions in the GST Act related to listed services. This includes section 60C(2)(ab), which is the rule that treats taxable accommodation as supplied by the operator of the electronic marketplace through which the supply of services is made, provided those services are performed, provided or received in New Zealand.

In addition to being treated as the operator of the electronic marketplace for the purposes of section 60C(2)(ab) and the provisions related to the flat-rate credit, the listing intermediary is also treated by section 60CB(7) as though it is the operator of the electronic marketplace for:

- Section 25AAA – where a listing intermediary is interposed between an underlying supplier of taxable accommodation and an operator of an electronic marketplace, the listing intermediary must apply the rules for correcting over-deductions or under-deductions of input tax for the flat-rate credit when such inaccuracies are discovered.
- Section 60(1C) – the underlying supplier is treated as making a supply of listed services to the listing intermediary, which is zero-rated if the underlying supplier is a registered person, and the listing intermediary is treated as making a standard rated supply of the same services to the guest.
- Section 60C(3B) and (3C) – the act of a listing intermediary recovering or deducting an amount from a payment due to the underlying supplier and using this amount to satisfy its output tax liability for a supply it is treated as making does not give rise to any further GST implications.
- Sections 60C(2BB), (2BE), (2BF) and 60H – the various references to the "operator of the electronic marketplace" or "operator" throughout section 60H and in the rules for underlying supplier opt-outs should instead be read as referring to the listing intermediary. Under section 60H, this applies not just for the subsections related to the provision of information by underlying suppliers for the flat-rate credit, but also for the notification rule for unilateral opt-outs (section 60H(3)) where the underlying supplier is able to unilaterally opt out of the electronic marketplace rules because their total annual supplies are more than $500,000.
- Section 85E – where the listing intermediary is liable for output tax on supplies of taxable accommodation under section 60CB(7), it is eligible to apply the transitional rule for contracts for taxable accommodation entered into before 1 April 2024, provided certain conditions are met.

Where section 60CB(7) applies, the marketplace operator is relieved of all liability under the GST Act for the supply, except for the provision of taxable supply information as discussed below. This means the listing intermediary is liable to account for and pay output tax to Inland Revenue on supplies of taxable accommodation made on or after 1 April 2024.

Providing taxable supply information

Whenever a listing intermediary is interposed between an underlying supplier and an operator of an electronic marketplace in the supply of taxable accommodation to a guest, the marketplace operator is treated as the supplier of the services for the provision of taxable supply information (even if the listing intermediary is liable for output tax on the supply under section 60CB(7)). This means:

- the marketplace operator (not the listing intermediary) is required to issue taxable supply information to the guest under section 19NB in all circumstances, including when section 60CB(7) applies to treat the listing intermediary as making a supply of the services to the guest that is subject to the standard GST rate of 15%, and
- the "supplier's" details (such as name and GST registration number) the marketplace operator is required to include in the taxable supply information are their own, and not those of the listing intermediary or the underlying supplier of the accommodation.

Example 4: Listing intermediary is responsible for output tax

Sally uses the services of a listing intermediary to manage her property and list it on multiple electronic marketplaces to maximise her advertising exposure and therefore the number of nights on which the property is booked throughout the year. Sally is not registered for GST. The listing intermediary is registered for GST for its property management activity.

Iona uses one of the electronic marketplaces on which Sally's property is advertised to book the property for one night. Iona pays a total of $200 plus GST. This includes $120 for the accommodation and $80 for services supplied to Iona by the listing intermediary.

The listing intermediary has a written agreement with the operator of the electronic marketplace that the listing intermediary, rather than the marketplace operator, is liable for GST on any supplies of taxable accommodation that the intermediary lists on the electronic marketplace. This means the listing intermediary (not the electronic marketplace operator) is the supplier of the accommodation for GST purposes and has the responsibility for returning output tax on the supplies at the 15% GST rate.

The listing intermediary accounts for output tax on the total value of the services supplied to Iona of $200.

The listing intermediary is also responsible for calculating the flat-rate credit for Sally. It calculates this based on the value of the accommodation of $120. It is responsible for providing Sally with a statement, at least monthly, which shows the flat-rate credit that Sally received from the listing intermediary.

Even though the marketplace operator is not liable for output tax on the supply of accommodation, it is still responsible for providing taxable supply information to Iona. The marketplace operator includes its own name and GST registration number in the taxable supply information provided to Iona.

Opt-out rules for underlying suppliers

An underlying supplier who is eligible to opt out of the electronic marketplace rules (because more than 2,000 nights of accommodation they provide is listed on an electronic marketplace in a 12-month period, or because their taxable supplies in a 12-month period exceed $500,000) can still opt out or seek to opt out even if they use a listing intermediary to list the accommodation on the electronic marketplace. In this circumstance, the listing intermediary may need to notify the marketplace operator on the underlying supplier's behalf that the underlying supplier is opting out of the rules. If an opt-out agreement with the marketplace operator is required, the listing intermediary may need to liaise between the underlying supplier and the marketplace operator so the two parties can enter into an opt-out agreement.

Even if a listing intermediary has an agreement with the marketplace operator that they are liable for output tax on the supplies of accommodation that they list on the marketplace, an underlying supplier that the listing intermediary acts for who wishes to opt out of the rules to remain responsible for their own GST obligations may still be able to do so. In this situation, the underlying supplier would either notify the listing intermediary they are opting out (if they are opting out because their taxable supplies in a 12-month period exceed $500,000), or enter into an opt-out agreement with the listing intermediary (if they are seeking to opt out because they meet the "listing more than 2,000 nights of accommodation" criterion).

Transitional rule for accommodation

Section 85E of the Goods and Services Tax Act 1985

A transitional rule in section 85E of the Goods and Services Tax Act 1985 (GST Act) ensures listing intermediaries and operators of electronic marketplaces do not have to account for GST on contracts for taxable accommodation entered into before 1 April 2024, provided certain requirements are met.

Background

From 1 April 2024, operators of electronic marketplaces (and, in some cases, listing intermediaries) are required to account for GST on supplies of listed services, including taxable accommodation. Operators are liable to account for and pay GST on these supplies to Inland Revenue if an invoice is issued or a payment is received in respect of these services on or after 1 April 2024, as per the standard time of supply rule for GST.

A transitional issue may arise for operators of electronic marketplaces and listing intermediaries because of this timing rule. The problem may arise when an operator of an electronic marketplace takes an accommodation booking before 1 April 2024 for an underlying supplier who is not registered for GST. In this case, it is likely the price of the accommodation was set on the assumption of GST not applying. This means if neither a payment is received nor an invoice is issued for the supply until after the new GST rules for listed services are in effect, the supply will be deemed to have occurred when the new rules are in effect. In the absence of a transitional rule, the operator of the electronic marketplace (or, in some cases, a listing intermediary) would therefore have a GST liability for the supply, even though the price of the accommodation might not have been set with GST in mind.

Effective date

The transitional rule came into effect on 1 April 2024. It applies to contracts for taxable accommodation entered into before 1 April 2024 where the supplies are made on or after that date.

Detailed analysis

The transitional rule applies when:

- the supply is of taxable accommodation
- the supply is made through an electronic marketplace
- the supply is made under a contract entered into before 1 April 2024
- the time of supply for that supply takes place on or after 1 April 2024
- an operator of an electronic marketplace or a listing intermediary would be treated by section 60C(2)(ab) of the GST Act as making the supply in the course or furtherance of its taxable activity in the absence of the transitional rule
- the person who would be treated as making the supply chooses that the transitional rule applies, and
- if the underlying supplier of the services is a registered person (or, as discussed below, in some cases if a listing intermediary is interposed between the underlying supplier and the operator of the electronic marketplace), the person applying the transitional rule takes reasonable steps within a reasonable timeframe to notify the underlying supplier or listing intermediary of their decision to apply the transitional rule, and to provide the underlying supplier with sufficient information for them to correctly account for GST on the supply.

If the above conditions are met, section 85E(2) allows the marketplace operator or listing intermediary to treat the services as not having been supplied by them. The transitional rule would be applied by not including the relevant supplies in the "Total sales and income" box of the person's GST return, and by not deducting input tax for the flat-rate credit in respect of these supplies. The person does not need to notify Inland Revenue of their choice to apply the transitional rule, but they must keep evidence of their choice for a minimum period of seven years in accordance with the record keeping rules in the GST Act.

Supplies covered by the transitional rule

As outlined above, the transitional rule only applies if section 60C(2)(ab) would apply in its absence. Section 60C(2)(ab) provides that listed services are treated as supplied by the operator of the electronic marketplace through which the supply of services is made if those services are performed, provided, or received in New Zealand.

In some instances, a listing intermediary (rather than the operator of the electronic marketplace) may be treated as making the supply of listed services. Provided certain conditions are met, section 60CB(7) provides that a listing intermediary is treated as the marketplace operator for the purposes of section 60C(2)(ab). This means the transitional rule can only ever be applied if the services would otherwise be treated as supplied in New Zealand by either an operator of an electronic marketplace or a listing intermediary. For instance, it would not be necessary to have the transitional rule apply to supplies by GST-registered underlying suppliers who have opted out of the application of the electronic marketplace rule in section 60C(2)(ab) using one of the available opt-out provisions.

Who can choose to apply the transitional rule

Only the person who would be treated as the supplier of the services if section 60C(2)(ab) applied to the supply may choose to apply the transitional rule. In other words, the transitional rule can only ever be applied by an operator of an electronic marketplace or a listing intermediary, and only if that person would otherwise be treated as making the supply.

How the transitional rule applies

When such a person chooses to apply the transitional rule, the choice they are making is that section 60C(2)(ab) does not apply to the supply. This means the rules for electronic marketplaces in section 60C (and, if applicable, the rules for listing intermediaries in section 60CB) do not apply to treat the services as supplied by the person. Instead, the underlying supplier of the services is the supplier for GST purposes.

This means that:

- A person applying the transitional rule will not account for and pay output tax on the relevant supply to Inland Revenue. All requirements related to the flat-rate credit (which only apply if section 60C(2)(ab) applies) also do not apply. This means the person applying the transitional rule should not deduct input tax for the flat-rate credit for the supply and pass this this on to the underlying supplier.
- Any output tax liability on the supply remains with the underlying supplier as per the pre-1 April 2024 rules. The underlying supplier will only ever be liable to account for and pay output tax on the supply to Inland Revenue if they are a registered person making the supply in the course or furtherance of their taxable activity.

A decision by a marketplace operator or listing intermediary to apply the transitional rule does not change when the supply is deemed to occur. A GST-registered underlying supplier who is required to account for GST on the supply because of the transitional rule should therefore account for the output tax in their GST return for the taxable period in which time of supply occurred (being the earlier of when a payment was received or an invoice was issued for the supply).

Notification requirements

In situations where the transitional rule is applied for a supply and the underlying supplier of the accommodation is required to account for and pay GST on the supply to Inland Revenue, the underlying supplier would need to know they are liable for GST on the supply.

A marketplace operator or listing intermediary who wishes to apply the transitional rule will in some situations only be entitled to do so on the condition they take reasonable steps to notify the underlying supplier (or listing intermediary) of this decision. This notification must make it clear that the marketplace operator or listing intermediary is not liable for GST on the supply, and that this liability remains with the underlying supplier. Where this requirement applies, the notification must be made within a reasonable timeframe. The marketplace operator or listing intermediary should also take reasonable steps within a reasonable timeframe to ensure the underlying supplier has sufficient information to correctly account for GST on the supply to Inland Revenue.

Meaning of "reasonable steps"

There are two scenarios in which notifying the underlying supplier should be relatively straightforward:

- The first scenario is where an operator of an electronic marketplace would, in the absence of the transitional rule, be responsible for output tax on the supply, and there is no listing intermediary involved in the supply.
- The second scenario is where a listing intermediary would, in the absence of the transitional rule, be responsible for output tax on the supply. In other words, the listing intermediary and the operator of the electronic marketplace through which the supply is made have an agreement under section 60CB(6) that the listing intermediary is responsible for output tax on supplies of listed services.

In the above scenarios, the person applying the transitional rule must take reasonable steps to notify the underlying supplier only if the underlying supplier has told them they are GST-registered. As a result, some marketplace operators and listing intermediaries might only want to use the transitional rule for supplies where they are entitled to assume the underlying supplier is not a registered person. This approach is acceptable because the transitional rule is intended to be flexible enough to allow marketplace operators and listing intermediaries to apply it for all bookings taken before 1 April 2024 where time of supply occurs on or after that date, or only a subset of those bookings.

The person applying the transitional rule must ensure the information they provide is sufficient for the underlying supplier to correctly account for output tax on the relevant supplies. There is no requirement for any specific type of information to be provided, only that the information provided must simply be sufficient for this purpose. This is broad enough to include any information the marketplace operator or listing intermediary could share or provide that would enable the underlying supplier to identify the relevant supplies, so that the underlying supplier knows those supplies are the ones they need to account for in their GST return. For example, if the marketplace operator or listing intermediary will not be accounting for output tax on any of the underlying supplier's bookings taken before 1 April 2024, then they could make sure (in addition to telling the underlying supplier so) they provide the underlying supplier with the dates those bookings were made, or some other statement or notification that a specific booking was made before 1 April 2024.

Information that is sufficient for the underlying supplier to correctly account for output tax on the supply also includes the price paid by the recipient for the supply. This is the price inclusive of any commissions, mark-ups or fees due to the marketplace operator for their services.

There is a third possible scenario in which the underlying supplier might need to be notified that the person is applying the transitional rule. This scenario arises where a booking is made before 1 April 2024 for accommodation that was listed on the electronic marketplace by a listing intermediary and, in the absence of the transitional rule:

- the operator of the electronic marketplace would be liable for output tax on the supply, not the listing intermediary, and
- the listing intermediary would be responsible for all requirements in respect of the supply that relate to the flat-rate credit, if applicable.

This scenario (where the marketplace operator is responsible for output tax and the listing intermediary is responsible for all the requirements related to the flat-rate credit) is the default setting under the rules in section 60CB applying to listing intermediaries. In this default scenario, the marketplace operator (if applying the transitional rule) must take reasonable steps to notify the listing intermediary that they are applying the transitional rule and to provide the listing intermediary with information that is sufficient for GST-registered underlying suppliers to correctly account for output tax on the supplies. The listing intermediary in this scenario should pass the relevant information on to GST-registered underlying suppliers within a reasonable timeframe.

The marketplace operator in this scenario must take reasonable steps to provide the information to the listing intermediary regardless of whether the underlying supplier of the accommodation is a registered person. This is for two reasons:

1. In this situation, the marketplace operator is unlikely to know anything about the underlying supplier, including whether they are a registered person.
2. Even if the underlying supplier is not a registered person, the listing intermediary still needs the same information from the marketplace operator that, if the underlying supplier was GST-registered, would enable the underlying supplier to identify the supplies for which it should account for GST to Inland Revenue. In this case, the information will enable the listing intermediary to correctly identify for which supplies it should not deduct input tax for the flat-rate credit. Therefore, the "reasonable steps" requirement to notify the listing intermediary serves a dual purpose.

Meaning of "reasonable timeframe"

A marketplace operator or listing intermediary choosing to apply the transitional rule must take reasonable steps to provide the necessary information to GST-registered underlying suppliers and/or to listing intermediaries within a reasonable timeframe. This means the marketplace operator or listing intermediary should make their best endeavours to ensure the information is provided as soon as practicable to allow a GST-registered underlying supplier to account for output tax on the relevant supplies in the correct GST return, before that return is due to Inland Revenue. At the very latest, Inland Revenue would expect the necessary information to be provided in advance of the due date for the April 2024 GST returns (being 28 May 2024).

Example 5: Marketplace operator applies the transitional rule, underlying supplier not registered person

In January 2024, Ben books accommodation at a Whangarei bach for several days in December 2024/January 2025 through Marketplace Co, an operator of an electronic marketplace. Will, the underlying supplier of the accommodation, is not registered for GST because his supplies are below the registration threshold.

The payment terms allow Ben the option of paying for the accommodation in instalments. Ben pays the first instalment in April 2024. No invoice has been issued, so this first payment means time of supply occurs in April 2024 when the new GST rules applying to listed services are in effect.

Marketplace Co chooses to apply the transitional rule to this supply of accommodation, meaning that Marketplace Co would not account for GST on the supply. Marketplace Co applies the transitional rule by preparing and filing its GST return consistently with this position (that is, by not including the supply in the "Total sales and income" box in its GST return, and by not deducting input tax for the flat-rate credit). Because there is no listing intermediary involved in the supply and Will has not notified Marketplace Co that he is a registered person, Marketplace Co is not required to take reasonable steps to notify Will of the decision to apply the transitional rule.

Example 6: Reasonable steps requirement, no listing intermediary involved

In November 2023, Martin books accommodation at an Auckland bed and breakfast for one night in September 2024 through Marketplace Co. Graeme's Bed and Breakfast, the underlying supplier of the accommodation, is registered for GST but as of April 2024 has not opted out of the electronic marketplace rules.

The payment terms allow Martin to pay in full when he checks in at the bed and breakfast, which he will end up doing. As of April 2024, no invoice has been issued for the supply.

Marketplace Co intends to apply the transitional rule to all bookings made on its website before 1 April 2024 where time of supply will occur on or after 1 April 2024. This includes the booking made by Martin in November 2023.

In early April 2024, Marketplace Co provides communications to Graeme's Bed and Breakfast explaining that Marketplace Co will not be accounting for and paying GST on bookings taken before 1 April 2024 to Inland Revenue, and that GST on these bookings remains the legal responsibility of Graeme's Bed and Breakfast. The date on which Martin's booking was made is visible to Graeme's Bed and Breakfast via the Marketplace Co platform, so Graeme's Bed and Breakfast knows that it is required to include the supply in its GST return for the taxable period in which time of supply occurs (being when Martin pays upon checking in at the bed and breakfast if no invoice is issued before then).

Marketplace Co has taken reasonable steps within a reasonable timeframe to notify Graeme's Bed and Breakfast of the decision to apply the transitional rule and to ensure they have sufficient information to correctly account for GST on the supply. Marketplace Co is therefore entitled to apply the transitional rule for the supply.

Example 7: Marketplace operator takes reasonable steps to notify listing intermediary and underlying supplier

Jacob, a non-GST registered owner of a bach in Timaru, uses a listing intermediary to deal with the day-to-day management of his bach and to list it for short-term rental on the Marketplace Co website. In March 2024, a booking for a stay occurring at the bach for three nights in July 2024 is received through the Marketplace Co platform. Payment for the booking is not made until April 2024 and no invoice is issued before that, so time of supply is deemed to occur in April 2024.

In early April 2024, Marketplace Co provides communications to the listing intermediary explaining that Marketplace Co will not be accounting for and paying GST on bookings taken before 1 April 2024 to Inland Revenue, and that GST on these bookings remains the legal responsibility of the underlying suppliers of the accommodation. In these communications, Marketplace Co advises the listing intermediary that this information will need to be passed on to GST-registered underlying suppliers so they can comply with their GST obligations. Marketplace Co also advises the listing intermediary that other relevant information the GST-registered underlying suppliers will need to identify the bookings made before 1 April 2024 should be passed on to them, such as the dates the bookings were made (which is information that is accessible to the listing intermediary through the Marketplace Co platform).

Marketplace Co has taken reasonable steps within a reasonable timeframe to notify the listing intermediary of the decision to apply the transitional rule and to ensure that GST-registered underlying suppliers of accommodation listed on the platform by the listing intermediary have sufficient information to correctly account for GST on the supplies.

Because Jacob is not a registered person, the listing intermediary does not need to pass the information provided by Marketplace Co on to him. However, because Marketplace Co notified the listing intermediary that any GST liability for bookings taken before 1 April 2024 will remain with the underlying suppliers (instead of those supplies being subject to the new GST rules for listed services) and has provided sufficient information to the listing intermediary to enable these bookings to be identified, the listing intermediary knows it should not deduct input tax for the flat-rate credit on the supplies.

Flat-rate credit

Sections 3A(1)(d), 8C(4B), 20(3N) and 25AAA of the Goods and Services Tax Act 1985; section CX 1B of the Income Tax Act 2007

Remedial amendments have been made to the flat-rate credit scheme that applies for the purposes of the GST rules for supplies of listed services made through electronic marketplaces.

Background

The flat-rate credit is a credit available to underlying suppliers of listed services 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 through an electronic marketplace.

An operator of an electronic marketplace that is treated as supplying listed services (or, in some cases, a listing intermediary) is required to deduct input tax for the flat-rate credit if the underlying supplier of the services has not notified the marketplace operator or listing intermediary that they are registered for GST at the time of supply. The marketplace operator or listing intermediary is then required to pass on the flat-rate credit to the underlying supplier. They must also notify underlying suppliers, at least monthly, of the total amount of flat-rate credit that has been passed on.

Several legislative amendments have been made to ensure the flat-rate credit scheme operates as intended.

Effective date

The amendments came into effect on 1 April 2024.

Detailed analysis

Correction of over-deductions and under-deductions

New section 25AAA of the Goods and Services Tax Act 1985 (GST Act) applies when an operator of an electronic marketplace (or, if applicable, a listing intermediary) discovers that either too much, or too little, input tax has been deducted for the flat-rate credit. This might occur if, for instance, the supply of listed services is cancelled, or the consideration for the supply changes after input tax for the flat-rate credit has already been deducted for the supply. In such circumstances, the flat-rate credit may have already been passed on to the underlying supplier.

Section 25AAA sets out the process that marketplace operators and listing intermediaries must follow when an over-deduction or under-deduction of the flat-rate credit is discovered.

For over-deductions, the marketplace operator or listing intermediary must return an amount of output tax that is equal to the excess input tax deduction. If the marketplace operator or listing intermediary has already passed the flat-rate credit on to the underlying supplier at the time of discovering the inaccuracy, the amount of the excess credit may be offset against another amount of flat-rate credit required to be passed on to the underlying supplier.

The rules in section 25AAA for over-deductions do not apply if the marketplace operator or listing intermediary deducted input tax for the flat-rate credit for a supply by a GST-registered underlying supplier. If a GST-registered underlying supplier receives the flat-rate credit, they must account for this as an output tax adjustment in their GST return. Underlying suppliers are required to notify marketplace operators and listing intermediaries of their GST registration status, including any changes to their GST registration status, and marketplace operators and listing intermediaries should rely on this information when determining whether to apply the flat-rate credit scheme.

For under-deductions, the marketplace operator or listing intermediary must deduct further input tax for the flat-rate credit. It must then pass this on to the underlying supplier. If the marketplace operator or listing intermediary chooses, it can pass this additional amount on to the underlying supplier by offsetting it against other amounts owed by the underlying supplier to the marketplace operator or the listing intermediary (for example, commissions and other charges). In this situation, the amount that is offset must still be reflected in the monthly statement provided to the underlying supplier. The amount that is offset does not need to be shown separately on the statement from the other flat-rate credit amounts passed on for the relevant period – it is sufficient to include this amount in the total flat-rate credit passed on to the underlying supplier for that period.

The relevant adjustment of output tax or input tax to correct the inaccuracy must be made in the GST return for the taxable period in which the inaccuracy is discovered.

Example 8: Flat-rate credit adjustment when the supply of listed services is cancelled

An unregistered underlying supplier makes a supply of listed services through an electronic marketplace operated by a New Zealand-incorporated company that files its GST returns monthly. Time of supply for the listed services occurs in May 2024. The operator of the electronic marketplace calculates the flat-rate credit based on the value of the listed services and takes an input tax deduction for the flat-rate credit in its May 2024 GST return.

The supply is cancelled in October 2024 before the flat-rate credit is passed on to the underlying supplier (but after input tax has already been deducted for the flat-rate credit). The marketplace operator finds out about the cancellation (and therefore becomes aware that it has deducted too much input tax for the flat-rate credit for the cancelled supply) during that same month.

The marketplace operator returns an amount of output tax that is equal to the excess input tax deducted (in this case, the entire amount of the flat-rate credit that was first calculated for the supply) in its October 2024 GST return (October 2024 being the taxable period in which the marketplace operator became aware the supply was cancelled).

Minor remedial amendments to the flat-rate credit scheme

Several minor amendments have been made to ensure the flat-rate credit scheme operates as intended:

- The definition of "input tax" in section 3A of the GST Act has been amended to include an amount equal to the flat-rate credit that an operator of an electronic marketplace or a listing intermediary passes on under section 8C(3)(b)(ii) to an underlying supplier.
- New section 8C(4B) of the GST Act clarifies that the flat-rate credit is not consideration for a supply of any goods or services by the underlying supplier.
- Section 20(3N) of the GST Act has been amended to ensure the value of the flat-rate credit is not reduced by the amount of a discount provided by the operator of the electronic marketplace through which the supply of listed services was made.
- New section CX 1B of the Income Tax Act 2007 provides that the flat-rate credit is excluded income of the person receiving it, whether they are a GST-registered person or not.

Minor amendments

Sections 2(1), 9(9), 19NB, 20(4C), 60(1A)(b), 60C(2BC), (2BD), (2BF), (3B) and (3C) of the Goods and Services Tax Act 1985

The following remedial amendments have been made to the GST rules for supplies of listed services that came into effect on 1 April 2024:

- New section 19NB of the Goods and Services Tax Act 1985 (GST Act) provides when an operator of an electronic marketplace is treated as making a supply of listed services, the marketplace operator is always required to provide taxable supply information and supply correction information (where applicable) to the recipient. This applies without the need for the recipient to request the information and without regard to the recipient's GST registration status.
- New section 60C(3B) and (3C) of the GST Act clarifies that when an operator of an electronic marketplace or a listing intermediary collects an amount to cover its GST liability from a customer's payment due to an underlying supplier of listed services — or recovers this amount directly from the underlying supplier — the amount collected is not consideration for a supply.
- An amendment to section 60C(2BF)(a) provides that only non-individual underlying suppliers of listed services (accommodation hosts, drivers and deliverers) are able to unilaterally opt out of the electronic marketplace rules on the basis of exceeding more than $500,000 of taxable supplies in any 12-month period.
- A minor correction has been made to the wording of section 60(1A)(b). In the version of the provision as amended by the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023, it referred to an agent making a supply of distantly taxable goods or listed services to "a person resident in New Zealand". However, a supply of distantly taxable goods or listed services need not be made to a New Zealand resident for those respective GST regimes to apply. The amendment removes this incorrect reference.
- Recent changes to the definition of "electronic marketplace" in section 2(1) of the GST Act may have subtly (and inadvertently) changed the way in which the electronic marketplace rules would have applied as of 1 April 2024 in the distantly taxable goods context. Minor wording changes have been made to clarify the rules and reinstate the former position.
- Section 60C(2BC) enables the Commissioner to issue determinations setting out criteria an underlying supplier of listed services must meet if they wish to opt out of the electronic marketplace rules but do not meet the other statutory criteria for an opt-out. The application date for this provision has been brought forward from 1 April 2024 to 1 April 2023, thus retrospectively enabling the Commissioner of Inland Revenue to issue determinations before the listed services rules take effect.
- Technical drafting changes have been made to ensure the legislation aligns with the policy intent by requiring the Commissioner of Inland Revenue to have regard to the factors in both paragraphs of section 60C(2BD) and ensuring only those underlying suppliers who make taxable supplies of more than $500,000 can unilaterally opt out of the marketplace rules under section 60C(2BF).
- Consequential amendments that inserted references to "listed services" in certain sections of the GST Act were included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023, but some of these had no practical effect and have been removed. These former references to "listed services" were in the following provisions:
  - Section 9(9), which contains a special time of supply rule that is only relevant to operators of loyalty programmes.
  - Section 20(4C), which (along with section 20(4D)) contains special input tax deduction denial rules that apply for business-to-business supplies of remote services and distantly taxable goods that were incorrectly treated as zero-rated. These rules have no application for listed services (no business-to-business exclusion applies to listed services).
- The provision that treated a supply of listed services between two marketplace operators as a zero-rated supply has also been repealed. This provision was intended to deal with the situation where there was more than one marketplace operator involved in a supply of listed services for the purposes of enabling the flat-rate credit scheme to operate where the marketplace operator responsible for returning output tax had no relationship with the underlying supplier of the services. This situation is now addressed by the rules for listing intermediaries.

Effective date

The amendment bringing forward the application date of section 60C(2BC) applies on and after 1 April 2023.

New section 60C(3B) and (3C) applies on and after:

- 1 October 2016 for supplies of remote services
- 1 December 2019 for supplies of distantly taxable goods
- 1 April 2024 for supplies of listed services.

All the other amendments came into effect on 1 April 2024.

Remedial amendments to the financial arrangements rules

Transitional residents holding domestic financial arrangements

Sections EW 37 and EW 41 of the Income Tax Act 2007

A deemed acquisition has been created for financial arrangements with a New Zealand source held by a non-resident when they become a New Zealand transitional resident and therefore become subject to the financial arrangements rules.

Background

The financial arrangements rules spread income and expenditure over the term of an arrangement and require a base price adjustment when the arrangement matures. However, the financial arrangements rules do not apply to non-residents (section EW 9(2) of the Income Tax Act 2007). To ensure the base price adjustment only includes gains and losses when the person is a New Zealand resident, there is a deemed acquisition of the arrangement when the person becomes a New Zealand resident. This deemed acquisition is currently provided for in sections EW 37 and EW 41.

This deemed acquisition was amended in 2006 to include the transitional residence rules. The transitional residence rules were intended to encourage immigration to New Zealand by allowing qualifying residents to exclude their offshore assets from the New Zealand tax base for the first four years. The consequence of these rules is that, when a financial arrangement does not have a New Zealand source, a person will only have a deemed acquisition of the arrangement once the person's transitional residence period expires rather than when they became a New Zealand resident.

However, the changes made for the transitional residence rules did not consider that immigrating transitional residents may hold financial arrangements with a New Zealand source. Such arrangements are always subject to New Zealand tax, even when held by a non-resident – however, they are not taxed under the financial arrangements rules unless they are held by a New Zealand resident, so accrued gains and losses are not included.

The deemed acquisition rules previously did not cover a person who becomes a transitional resident while holding New Zealand-sourced financial arrangements. Although the person was taxed correctly during the life of that arrangement, the base price adjustment incorrectly included gains and losses in the period before the person became a New Zealand resident.

This issue particularly arose for certain immigrants who are required to hold New Zealand assets (such as New Zealand government bonds) to meet their visa requirements and acquire these before moving to New Zealand.

Key features

An additional paragraph has been added to each of sections EW 37(1) and EW 41(1). This paragraph creates a deemed acquisition of a New Zealand-sourced financial arrangement if that arrangement was held by a non-resident when they become a transitional resident. This deemed acquisition will only affect the tax position of the person once that arrangement matures by excluding from the base price adjustment any accrued gains and losses that arose before the person became a transitional resident.

Effective date

The amendments are effective for financial arrangements if a base price adjustment is required to be completed after 29 March 2024.

Detailed analysis

The same paragraph has been added to each of sections EW 37(1) and EW 41(1). These sections have the equivalent effect, except that section EW 37 applies to accrued obligations (eg, borrowing from another person so there is an obligation to make payment) and section EW 41 applies to accrued entitlements (eg, lending to another person so there is an entitlement to receive repayment).

New paragraph (ab) will apply when the following three requirements are met:

- The person becomes party to the arrangement after 1 April 2008. This date is chosen to align with the start of the Income Tax Act 2007.
- The person becomes a transitional resident after becoming a party to the arrangement. This ensures the deemed acquisition applies to arrangements held when the person becomes a transitional resident.

- The person must calculate and allocate income or expenditure under the arrangement for an income year under the financial arrangements rules.

The third requirement, in subparagraph (ab)(iii), is the most important and intentionally applies similar language to that in existing section EW 9(1), which covers the application of the financial arrangements rules to residents. This requirement is designed to ensure that financial arrangements with a New Zealand source are only captured once a non-resident becomes a resident (including a transitional resident). It will not apply to a foreign-sourced financial arrangement held by a person becoming a transitional resident. This is because such an arrangement is treated, under section HR 8, as if the transitional resident were non-resident, in which case section EW 9(1) does not apply.

Foreign-sourced arrangements of a person becoming a transitional resident have been excluded from new paragraph (ab) as these already have a deemed acquisition under section EW 37(1)(d) or EW 41(1)(d) once the person ceases to be a transitional resident.

Likewise, arrangements of a person becoming a New Zealand resident who is not a transitional resident are excluded from new paragraph (ab) whether those arrangements are New Zealand or foreign sourced, as these already have a deemed acquisition under section EW 37(1)(b) or EW 41(1)(b).

Operation of the financial arrangements entry rules when the borrower is insolvent

Section EW 46C of the Income Tax Act 2007

Section EW 46C of the Income Tax Act 2007, which is intended to be a taxpayer favourable section that treats a remitted debt within a group as being repaid in full so that debt remission income does not arise, has been amended so that deemed repayment is reduced by the amount of an impairment that occurred before the creditor migrated to New Zealand.

Background

Transfers of value between members of a wholly-owned group are generally not intended to have tax consequences. Furthermore, when debt owed by a company to its shareholders is forgiven pro rata, this is equivalent to a capital contribution. Section EW 46C supports this by deeming qualifying debt as being repaid in full so that no debt remission income arises for the borrower. There is also no deduction for the lender.

When a person migrates to New Zealand with an outstanding financial arrangement there is a deemed acquisition under either section EW 37 or EW 41. The purpose of this is so that only gains and losses arising after the person becomes a tax resident are subject to the financial arrangements rules. When a creditor migrates to New Zealand the deemed acquisition price under section EW 41 will be reduced to the extent that the debt is impaired.

However, under sections EW 41 and EW 46C, as they were before amendment, when a creditor migrated to New Zealand with an impaired debt that was subsequently remitted, section EW 46C treated the debt as being repaid in full. The consequence of this was even where the creditor did not receive any payment, the base price adjustment would create taxable income for the creditor because the amount deemed to be received (the face value of the debt) would be larger than the amount deemed to be paid (the market value of the impaired debt at the time the creditor became New Zealand resident).

Key features

Where a creditor has a deemed acquisition under section EW 41, due to entering into the financial arrangements rules with an accrued entitlement, any subsequent deemed repayment under section EW 46C is reduced by any impairment at the time of the deemed acquisition.

Effective date

The amendment applies in relation to any debt remitted on or after 29 March 2024.

Detailed analysis

The majority of deemed repayments to a creditor under section EW 46C will continue to be calculated under section EW 46C(5). However, where section EW 46C(5B) applies, because the creditor has a deemed acquisition under section EW 41, the deemed repayment will now be calculated under section EW 46C(5C).

The calculation under section EW 46C(5C) will be the lower of two amounts:

(a) the amount of the debt – that is, the same amount that would be calculated under section EW 46C(5) if that section applied, or

(b) the amount of the debt reduced by any impairment at the time section EW 41(2) applied.

Therefore, if the debt was not impaired at the time the arrangement entered the financial arrangements rules, the amount in paragraphs (a) and (b) will be identical and the outcome is unchanged.

The amendment applies only where the arrangement had a deemed acquisition under section EW 41. No equivalent amendment has been made for section EW 37 as this section covers accrued obligations and the value of these obligations are not expected to reduce due to an impairment based on the credit quality of the debtor.

In section EW 46C(5C)(b), the amount of the impairment must be calculated under generally accepted accounting practice. Because the debt is within a wholly-owned group and is likely not to appear in the consolidated financial statements of the group, it is not necessary for the impairment to be shown in published financial statements. However, the impairment would need to be sufficiently documented within relevant accounting records and applying generally accepted accounting practice to substantiate the timing and size of the impairment.

This amendment will only apply where the debt is remitted within a wholly-owned group covered by section EW 46C(1)(a) or (b). The amendment will not apply to the extent the debt is proportional to shareholding within a less than wholly-owned group, partnerships or look through companies covered by EW 46C(1)(c) to (e). This is because of the complexity of applying an equivalent amendment in these situations and the limited likelihood of such a situation arising.

Debt -equity swaps on convertible notes

Section EW 46D of the Income Tax Act 2007

Section EW 46D treats shares issued by an insolvent debtor as issued for their market value when the proceeds of that share issue are used to repay debt owed to the person subscribing for the shares. This section has been amended so that it will not apply to shares issued under a convertible note that was issued when the borrower was solvent.

Background

Under section EW 46D, shares issued by an insolvent debtor are treated as issued for their market value when the proceeds of that share issue are used to repay outstanding debt owed to the person subscribing for the shares. Section EW 46D only applies when a number of criteria are met including, in section EW 46D(1)(d), that the debtor does not satisfy the solvency test in the Companies Act 1993 immediately before either or both of the arrangement is entered into and/or the issue of the shares.

Under the second limb of this solvency test as enacted, the valuation rule could apply where a convertible note was issued by a solvent borrower but that note converted to debt after the borrower became insolvent, however this was not what parliament intended.

Key features

Shares issued pursuant to a conversion of convertible notes issued by a solvent borrower have been excluded from section EW 46D.

Effective date

The amendment is effective from 1 April 2023, the original application date for section EW 46D.

Detailed analysis

New section EW 46D(1)(cb) has been inserted to exclude, from section EW 46D, shares issued on conversion of a debt instrument that was convertible into shares when issued by a solvent borrower.

Other remedial amendments

Double tax agreement source rule

Section YD 4(17D) of the Income Tax Act 2007

The amendment will ensure that the double tax agreement (DTA) source rule in section YD 4(17D) of the Income Tax Act 2007 does not apply to fees for technical, management or similar services or certain payments attributable to a permanent establishment in a third state.

Background

New Zealand taxes income on the basis of both residence and source. While New Zealand residents are generally taxed on their worldwide income, non-residents are only taxed on New Zealand-sourced income. In broad terms, income is treated as having a source in New Zealand when its connection with New Zealand is strong enough for New Zealand to exert taxing rights over that income. However, the point when a connection will be "strong enough" is not always clear and may involve judgement calls that appear arbitrary.

The DTA source rule in section YD 4(17D) deems an item of income to have a source in New Zealand if New Zealand has a right to tax that income under a DTA. There are several exceptions to the DTA source rule.

Before the introduction of section YD 4(17D), an item of income would only have a source in New Zealand if it was included in a specific domestic source rule.

The rule was introduced with other anti-Base Erosion and Profit Shifting (BEPS) measures to reduce risks of double non-taxation. It applies for income years beginning on or after 1 July 2018.

The problem with the DTA source rule is that it can deem income to be sourced in New Zealand in unintended circumstances where the income's connection with New Zealand is tenuous, and where New Zealand did not anticipate collecting tax on that income. Where such overreaches have been identified, amendments have been made to ensure those amounts are not caught by the DTA source rule (for example, income falling under section YD 4(15) to (17)).

The amendment will similarly address the following two cases of overreach resulting from the DTA source rule:

- fees for technical, management or similar services provided by a non-resident and performed outside New Zealand, and
- certain payments made to another contracting state but attributable under a DTA to a permanent establishment (PE) in a third state.

Effective date

The amendment is effective for income years commencing on or after 1 July 2018.

Detailed analysis

Overview

Fees for technical, management or similar services

Income from personal services is usually treated as sourced in New Zealand under section YD 4(3) or (4) if the service is performed in New Zealand.

Under the DTA source rule, fees for technical, management or similar services provided by a non-resident to a New Zealand customer (payer) can be deemed to be sourced in New Zealand even if the services are performed overseas. However, it is unusual for personal services income to be treated as sourced in New Zealand when the services are neither performed in New Zealand nor attributable to a New Zealand PE.

This result occurs under New Zealand's DTAs with India, Fiji and Malaysia only because of special provisions in those DTAs that treat fees for technical, management or similar services in the same way as royalties. Such a provision does not exist in New Zealand's negotiating model and is not in our other DTAs.

Further, it is difficult for taxpayers to understand and comply with the law, and for Inland Revenue to enforce the rules, when different source rules apply depending on which DTA applies. This may also disincentivise taxpayers from acquiring services from providers in particular countries, and so distort their economic decision-making.

The amendment will ensure fees for technical, management and similar services that are treated as royalties in a DTA are excluded from the DTA source rule.

Certain payments attributable to a third state PE

As DTAs are bilateral in nature, issues can arise when arrangements involve three states. A technical issue arises when a New Zealand resident pays interest and royalties for its PE in a third state to a recipient in the other DTA country.

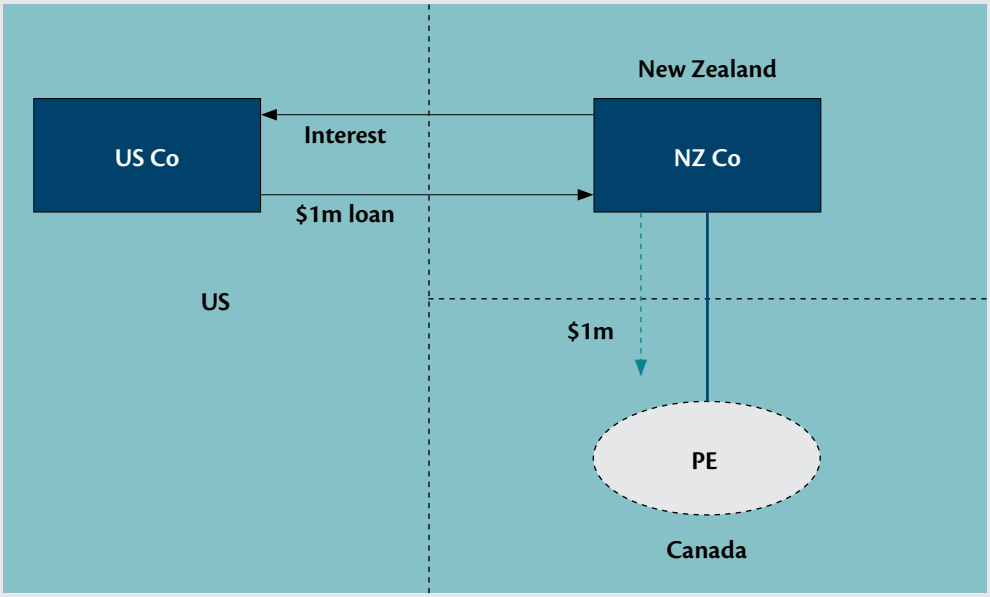
New Zealand's domestic source rules exclude payments made, or borrowed funds used, in connection with or for the purposes of a business carried on through a fixed establishment outside New Zealand (see sections YD 4(9)(a) and YD 4(11)(b)(i)). This ensures the payment does not have a New Zealand source when it is attributable to a PE in another state. However, the DTA source rule inadvertently overrides these domestic source rule exclusions. This can result in the same income being sourced and taxed in both New Zealand and in the PE state.

The DTA between New Zealand and the recipient's state creates a source in New Zealand but does not provide relief when that income is attributable to a PE in a third state, under a DTA between New Zealand and that third state.

The following example illustrates the overreach in this scenario.

Example 1: Overtaxation of income attributable to a PE in a third state

In this example, a New Zealand company borrows $1 million from a US company to fund its PE activity in Canada. The New Zealand company pays interest to the US company on the $1 million loan.



Under the New Zealand/US DTA[45], interest is deemed to have a source in the payer's state (in this case New Zealand), regardless of the fact that in this case, the interest is attributable to a PE in a third state.

As a result, the interest payment will be treated as sourced in both New Zealand (under the DTA source rule) and likely Canada (under Canadian tax law) and taxable on that basis. It will also be taxable in the US on the residence basis, with relief provided to the US Co under the New Zealand/US DTA and potentially US tax law.

If the PE had been located in the US, this issue would not arise as the New Zealand/US DTA would provide tax relief and treat the income as sourced in the US instead of in New Zealand. This is because the DTA addresses the scenario when there is a PE in a contracting state but not when the PE is in a third state.

If not for the DTA source rule, New Zealand's domestic rules would not treat the interest as being sourced in New Zealand, since it relates to a fixed establishment outside New Zealand (a fixed establishment being similar to a PE). This would prevent the interest having a deemed source in both New Zealand and Canada, the PE state.

The amendment excludes interest and royalty payments attributable to a PE outside New Zealand from the DTA source rule.

[45] And most of our DTAs, with the exception of our DTA with Australia.

10% income interest test for access to the attributable FIF income method

Sections EX 35 and EX 46 of the Income Tax Act 2007.

Amendments to the foreign investment fund (FIF) rules have expanded access to the attributable FIF income (AFI) method in periods where a person acquires or disposes of a FIF interest. The relevant period for the 10% income interest test has changed to the period of ownership within the accounting period, rather than the entire accounting period.

Background

There are several different methods potentially available to a person in calculating the FIF income or loss from their FIF interests. Previously, to use the AFI method a person was required to, at all times in the accounting period, have an average income interest in the FIF of 10% or more. Where there are variations in the income interest during the accounting period, a weighted average calculation is performed.

However, this 10% income interest test did not work as intended. An acquisition or disposal could result in an average income interest below 10% for the entire accounting period, despite the actual interest held during the period of ownership being 10% or more. As a result, a taxpayer may not have had access to the AFI method for that period only, and instead had to apply a less favourable FIF calculation method.

The amendment to section EX 46 changes the relevant period for the 10% income interest test to be the period of ownership within the accounting period, rather than the entire accounting period.

Section EX 35 was amended in 2016 with the same effect. The cross reference to section EX 50(4) in section EX 35 has also been amended to provide additional certainty and be consistent with the section EX 46 changes.

Effective date

The amendments are effective from 1 July 2011, to align with the start date from which the AFI method became available to taxpayers.

Clarify meaning of "building" for depreciation purposes

Section YA 1 of the Income Tax Act 2007

A new definition of "building" has been inserted into Income Tax Act 2007 to clarify that, for the purposes of the depreciation rules, a "building" includes a part of a building owned under a unit title.

Background

A recently published Interpretation Statement IS 22/04: Claiming depreciation on buildings, defines "building" for the purposes of the depreciation rules. The interpretation arguably leads to the conclusion that a part of a building owned under a unit title is not a "building" in its own right and therefore not depreciable. This is not the policy intent.

Given this Act repeals building depreciation from 1 April 2024, this amendment only applies from 1 April 2020 to 31 March 2024.

Effective date

The amendments are effective from 1 April 2020, the date building depreciation was reintroduced.

Detailed analysis

The definition of building in section YA 1 provides that in subpart EE (which are the depreciation rules) a building includes a part of a building, to the extent to which is it a unit in a unit title development under the Unit Titles Act 2010.

Correcting extra pay inaccuracy on termination

Section RD 17 of the Income Tax Act 2007

An amendment has been made to the taxation of extra pay on termination of employment.

Background

Special rules apply to the taxation of extra pay received by an employee who also receives income from which PAYE is deducted. Under section RD 17 of the Income Tax Act 2007 (ITA) which governs the taxation of extra pay, the amount of tax on extra pay is determined by the sum of:

- the amount of the extra pay, and
- the annualised value of all PAYE income payments made to the employee in the period that starts four weeks before the date of the payment of the extra pay and ends on the date of that payment.

Once these two values are added together, the marginal rate which is to be applied to the amount of extra pay is determined using the rates contained within schedule 2, part B, table 1 of the ITA. While this generally produces the correct result, it could result in over or under-taxation when an extra payment was made to an employee at termination of employment.

Effective date

The amendment will come into effect on 1 April 2025.

Key features

New subsection (1BA) introduces a special rule into section RD 17 designed to reduce the taxation inaccuracies which can occur when extra pay is received on the termination of an employee's employment.

This special rule requires employers to determine the marginal tax rate for extra pay on termination of employment by adding the extra pay to the annualised value of the last two pay periods. The existing, "four week" rule will continue to apply in other cases.

Detailed analysis

The existing approach will be appropriate in most cases, but created challenges where the amount of PAYE income payments received in the preceding four weeks was not representative of a typical PAYE pay cycle.

Special rule: Extra pay on termination of employment

New subsection (1BA) introduces a special rule into section RD 17 which governs the taxation of extra pay on termination of an employee's employment. Where this occurs, the taxation of extra pay is based on the sum of:

- the amount of the extra pay, and
- the annualised value of the PAYE income payments for the last two pay periods before the PAYE income payment for the extra pay.

This special rule requires an employer to "look back" and annualise the PAYE income payments for the last two preceding pay periods rather than any payments received over the last four weeks. Because of the way in which the term "pay period" is defined in section YA 1 of the ITA, any pay periods for which no amount is payable can be ignored for the purposes of annualising PAYE income payments over the last two pay periods.

Example 1: Pierre's salary

Pierre owns "Pierre's Pastries" an upmarket bakery in Auckland famed for the quality of its pastries and croissants. He has two employees, Connor and Larissa.

Unfortunately, Connor decides to leave Pierre's employment and work for a rival bakery nearby.

Connor is paid weekly and his income can vary. Connor's last PAYE period includes the amount of $1,000 in extra pay and will be paid in the period ending 21 April. Connor's salary information is below:

Period end	Status	PAYE income payment (excluding extra pays)
21 April	At work	$500.00
14 April	At work	$650.00
7 April	At work	$550.00

To determine the amount of tax that applies to the extra pay, Pierre knows he must annualise the two most recent periods for which payment was made.

Pierre ignores the period ending 21 April because that is the period including the extra pay and is expressly excluded by section RD 17(1BA). The two most recent pay periods for which Connor is paid are 14 April and 7 April. Pierre performs the annualisation calculation as follows:

- **Step 1:** Pierre adds together the amounts received for the pay periods ended 7 April and 14 April (ie, $550 +$650 = $1,200)
- **Step 2:** Because the sum of the two pay periods represents two weeks' PAYE income payments, Pierre divides the number of weeks in the year by two to determine the number of fortnights in a year (ie, 52/2 = 26).
- **Step 3:** Pierre annualises the amount of Connor's PAYE by multiplying the number of fortnights in the year by the amount determined in Step 1 (ie, $1,200 x 26 = $31,200).
- **Step 4:** Finally, Pierre adds the amount of extra pay to the amount determined in Step 3 (i.e. $31,200 + $1,000 = $32,200).
- **Step 5:** Having completed this calculation, Pierre proceeds to apply the appropriate marginal tax rate (based on the total of $30,600) to the amount of the extra pay as required by section RD 17 and pays the resulting amount to Connor.

Example 2: Kelvin's salary

For the last three years, Kelvin has worked at "Will's Café", a Wellington café owned by his employer, Will. However, Kelvin decides he wants to travel overseas for six months on a working holiday. He gives notice to his employer, who arranges his final salary payment.

Kelvin is paid weekly and his income can vary from one week to the next. Kelvin's last PAYE payment includes the amount of $2,000 in extra pay and will be paid in the period ending 26 May.

Will has the following recent salary information available:

Period end	Status	PAYE income payment (excluding extra pays)
26 May	At work	$550.00
19 May	Unpaid leave	$0.00
12 May	At work	$500.00
5 May	At work	$600.00

To determine the amount of tax that applies to the extra pay, Will knows he must annualise the two most recent periods for which payment was made.

Will ignores the period ending 26 May because that is the period including the extra pay and is expressly excluded by section RD 17(1BA). He ignores the period ending 19 May because Kelvin is unpaid for that pay period. The two most recent pay periods for which Kelvin is paid are 12 May and 5 May. Will performs the annualisation calculation as follows:

- **Step 1:** Will adds together the amounts received for the pay periods ended 5 May and 12 May (ie, $600 +$500 = $1,100)
- **Step 2:** Because the sum of the two pay periods represents two weeks' PAYE income payments, Will divides the number of weeks in the year by two to determine the number of fortnights in a year (ie, 52/2 = 26).
- **Step 3:** Will annualises the amount of Kelvin's PAYE by multiplying the number of fortnights in the year by the amount determined in Step 1 (ie, $1,100 x 26 = $28,600).
- **Step 4:** Finally, Will adds the amount of extra pay to the amount determined in Step 3 (ie, $28,600 + $2,000 = $30,600).
- **Step 5:** Having completed this calculation, Will proceeds to apply the appropriate marginal tax rate (based on the total of $30,600) to the amount of the extra pay as required by section RD 17 and pays the resulting amount to Kelvin.

In some cases, the employee may not have two prior pay periods to draw upon. In such cases, the employee could choose to notify their employer of their tax code pursuant to section RD 10 of the ITA based on their expected taxable income for the income year. Further information on the taxation of extra pay can be found in IR335: *Employer's Guide: Information to help you with your responsibilities as an employer* (April 2024)

Foreign sourced amounts earned by resident trustees

Section HC 26(1) of the Income Tax Act 2007

The amendment reverses a change made in 2023 to ensure that changes to foreign trust disclosure requirements do not limit the exemption in section HC 26.

Background

Section 78(1) of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 replaced "New Zealand resident trustee" with "resident trustee of a foreign trust" in the opening words of section HC 26 of the Income Tax Act 2007.

This change was made as part of a range of amendments that expanded the foreign trust disclosure rules to apply to trusts that were not foreign trusts but that also utilised the exemption in section HC 26.

The change to section HC 26(1) unintentionally meant that this would no longer apply where a settlor is a transitional resident (despite transitional residents being expressly referred to in section HC 26(1)(a)). The intention of the changes was to update the foreign trust disclosure requirements, not narrow the application of section HC 26.

Key features

The change from "New Zealand resident trustee" to "resident trustee of a foreign trust" in section HC 26(1) is reversed to ensure that the application of section HC 26 is not narrowed.

Effective date

The amendment applies from 1 April 2023.

Provisional tax – technical amendments

Section RC 6 Income Tax Act 2007

The amendment restores the reference to the year preceding the prior year in section RC 6(5) to ensure that provision works as intended.

Background

There are special rules in the Income Tax Act 2007 (ITA) that deal with a situation where a taxpayer calculates their provisional tax liability with reference to the prior year and a reassessment of that prior year is subsequently made that changes that instalment amount after they have paid it.

However, section RC 6(5) is currently limited to situations where the prior year (current year (CY) – 1) is reassessed. This creates an issue where a taxpayer is using the year preceding the prior year (CY – 2) to calculate their provisional tax liability and that year is subject to a reassessment. In that case, the taxpayer may be exposed to use of money interest and penalties where they have no knowledge of the actual liability.

The treatment of the CY – 2 year is inconsistent with the treatment of the CY – 1 year and the policy intent. There is no policy reason why the two years (CY – 1 and CY – 2) should be treated differently. It appears this was a drafting error at the time the ITA was rewritten.

Key features

The amendment restores the wording of section RC 5(6) before the rewrite of the Income Tax Act.

Effective date

The amendment is effective from 1 April 2008.

Portfolio investment entity (PIE) – technical amendments

Sections BC 7(5), and HM 60 of the Income Tax Act 2007

The amendments clarify the wording in several provisions that deal with the calculation of investor tax liabilities for investments in portfolio investment entities (PIEs).

Background

There are a number of links between provisions that deal with the calculation of tax liabilities for investments in PIEs that have become de-linked. These amendments reestablish those links.

Key features

The amendments:

- Reword section HM 60(4) of the Income Tax Act 2007 (ITA) to reflect the relationship between sections CX 56 and HM 60.
- Remove the reference to section 28B of the Tax Administration Act 1994 in section HM 60(1) of the ITA would be removed. Section HM 60(1) deals with the notified investor rate. Section 28B deals with the tax file number.
- Amend section BC 7(5) of the ITA to refer to "natural person investors who are resident in New Zealand" to be consistent with section HM 36B.

Effective date

The amendments take effect on 29 March 2024.

Resident withholding tax and custodians

Section RE 14C of the Income Tax Act 2007

The amendment clarifies the wording dealing with the receipt of a non-cash dividend by an intermediary to ensure that provision works as intended.

Key features

The amendments correct two wording issues:

- the rules refer to the custodian "deriving" the dividend, when legally the custodian has no shareholding in the underlying company, and
- the ultimate shareholder is referred to as the "shareholder in the company", which can be read as the custodial company rather than the underlying foreign company.

Effective date

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

Time to make a look-through company election

Section HB 13(3)(b) of the Income Tax Act 2007

Amendments have been made to section HB 13(3)(b) of the Income Tax Act 2007 to confirm current practices and provide more consistency with other elections made by taxpayers.

Background

Previously a new company could become a look-through company by making an election to the Commissioner **before** the last day for filing the return of income of the company per section HB 13(3)(b).

This created confusion for taxpayers because this does not align with the general rules for other elections, which permit elections to be filed **on** the last day to file a tax return. Inland Revenue has also been permitting elections to be filled on the last day for the tax return to be filed. The amendment confirms that approach.

Key features

The amendment changes the last day to make an election to the Commissioner to become a look-through company to be **on** the last day for the tax return to be filed, rather than **before** the last day for the tax return to be filed.

This amendment will retrospectively apply from its inception date to provide certainty to taxpayers who have relied on Inland Revenue's practice since the introduction of the look-through company election process.

Effective date

The changes apply for the 2011–12 and later income years.

Setting the early payment discount rate

Section RC 38(4)(a) of the Income Tax Act 2007

Amendments have been made to section RC 38(4)(a) of the Income Tax Act 2007 to better align the Early Payment Discount (EPD) rate with the policy intent.

Background

The EPD incentivises voluntary payment of taxes by businesses in their first year of paying tax. The applicable EPD rate is calculated using the Commissioner's paying rate (the credit use of money interest (UOMI) rate) plus 200 basis points, unless otherwise set by the Governor-General.

The recent economic environment has resulted in the UOMI rate changing more often than anticipated, creating uncertainty for taxpayers as to what EPD rate will apply to their total tax payable. The risk of under or over payment of tax undermines the ability of the EPD to incentivise voluntary payment.

Key features

The amendments:

- provide one EPD rate applicable throughout a tax year, based on the credit UOMI rate on the last day of the prior tax year, and
- provide a transitional rule to apply for the 2022–23 and 2023–24 income years. For each of those years, the highest credit UOMI rate during those tax years will be used as a base to calculate one applicable EPD rate.

Effective date

The amendments take effect for the 2024–25 and later income years.

The transitional rule takes effect for the 2022–23 and 2023–24 income years.

Deducting expenditure related to mitigating environment hazards

Section DB 46 of the Income Tax Act 2007

Section DB 37 of the Income Tax Act 2004

The amendments ensure that expenditure to avoid, remedy, or mitigate environmental hazards is deductible as intended.

Background

The policy intent of section DB 46 of the Income Tax Act 2007 (and the comparable provision in the Income Tax Act 2004, section DB 37) is to allow deductions for expenditure that involves avoiding, remedying, or mitigating the effects of the discharge of environmental contaminants or the making of noise. Depending on the type of expenditure, it is either immediately deductible (such as expenditure related to monitoring the discharge of a contaminant) or deductible over time to match the expected life of the underlying asset (such as a resource consent). The full list of allowable and excluded expenditures is provided in schedule 19 of the 2007 Act.

Several technical drafting errors were recently identified in the provisions and associated definitions. Specifically, the provisions relied on terms used in the depreciation provisions, which was not technically appropriate for this type of expenditure as it is not depreciable property. Also, several further drafting errors were made during the 2007 rewrite of the provision and its definitions.

Amendments to both the 2004 and 2007 Acts have, therefore, been made to ensure that the policy intent of deducting expenditure related to mitigating environmental hazards is achievable in practice.

Key features

The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 contains amendments that have modified the various depreciation-based references in section DB 46 and its predecessor, section DB 37, to terms that are more appropriate for expenditure related to mitigating environmental hazards. For example, the terms 'diminishing value method' and 'straight-line method' have been modified to "diminishing value equivalent method" and "straight-line equivalent method", both of which are now respectively defined in sections DB 46 (11) and (12) (see also DB 37(11) and (12). The opportunity has also been taken to add a definition of "adjusted value" (see sections DB 46(9) and DB 37(9)), to clarify what is meant by that term when a person chooses to use the straight-line equivalent method.

A further amendment has rectified the errors in the definition of "diminished value" in the Income Tax Act 2007. The revised definition is set out in section DO 9B which now expresses the definition in a formula whose terms explicitly include references to section DB 46 expenditure and are consistent with the previous formula in section DB 37 of the Income Tax Act 2004. For section DB 46 expenditure the relevant diminished value becomes:

amount of expenditure + income derived – deductions allowed

where :

amount of expenditure is of a type described in section DB 46;

income derived is the total amount of income derived under section CB 28(8) (Environmental restoration accounts) in relation to the expenditure; and

deductions allowed is the total amount allowed as a deduction for the DB 46 expenditure to any person in the current income year and any earlier income years under the Act or an earlier Act.

Effective date

The amendments to the Income Tax Act 2004 apply to income years starting on and from 10 June 2005. The amendments to the Income Tax Act 2007 apply for the 2008–09 and later income years. In both cases, however, they do not apply to past tax positions taken up to 29 March 2024. This preserves past tax positions taken that were based on the previous wording of the provisions.

Disability support payments remedial

Section CW 52B of the Income Tax Act 2007

Section CW 52B has been amended to refer to direct funding disability support payments made by the Ministry for Disabled People or the Ministry of Health, with application from July 2022, to ensure these payments remain exempt from income tax.

Background

Section CW 52B provides that where a person receives a direct funding disability support payment, the payment is not subject to income tax. This section previously referred to payments made by the Ministry of Health or District Health Boards. It was updated in July 2022 as a consequential change under health reform legislation (the Pae Ora (Healthy Futures) Act 2022) to refer to payments made by Health New Zealand or the Māori Health Authority.

However, the health reform legislation incorrectly removed a reference to the Ministry of Health and failed to reflect that the Ministry for Disabled People was established in July 2022 and began administering some of the direct funding disability support payments.

Effective date

The remedial amendment comes into force on 1 July 2022. This ensures the income tax exemption applies as intended to the relevant direct funding disability support payments made by the Ministry of Disability People or the Ministry of Health.

Clarifying that the child support time-bar does not apply to temporary exemptions

Section 87A of the Child Support Act 1991

The amendment clarifies that under the Child Support Act 1991 the Commissioner of Inland Revenue (the Commissioner) is able to grant, end or overturn a temporary exemption in a period that would otherwise be time barred.

Background

The Child Support Amendment Act 2021 (the Amendment Act) introduced a four-year time bar to reassessments of child support. Beyond the four-year period, reassessments will not occur, subject to specified exceptions. This was intended to provide more certainty for parents and reduce administration costs, while balancing equity concerns through specified exceptions.

Temporary exemptions from paying child support are available to liable persons when certain criteria are met. They are granted on the grounds that a person has limited income and limited capacity to earn income. These exemptions apply to liable persons who are:

- in prison, hospital or a treatment facility for at least 13 weeks
- suffering a long-term illness or injury for at least 13 weeks and unable to do paid work because of the illness or injury, or
- under 16 years old.

It was intended that these exemptions could be applied to adjusted in periods that would otherwise be time barred, which would be consistent with the victims of sex offences exemption, but the Amendment Act did not achieve this outcome. The amendment in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 clarifies that the Commissioner is able to grant, end or overturn a temporary exemption in a period that would otherwise be time barred, preventing issues for liable persons who continuously qualify for temporary exemptions for periods more than four years ago.

Effective date

The amendment is effective on 26 October 2021 to align with the effective date of the relevant amendments in the Amendment Act.

Emergency event payments for Working for Families purposes

Section 91AAS of the Tax Administration Act 1994

The amendment removes references to the 12-month limitation in section 91AAS of the Tax Administration Act 1994. This section allows the Commissioner of Inland Revenue (the Commissioner) to determine an event to be an emergency event for the purpose of exempting payments being made to relieve the adverse impacts of that event, from family scheme income.

Background

Under current law, payments aimed at relieving the adverse effects of an event are exempt from family scheme income, provided the event is declared an emergency event by the Commissioner. However, to be exempt income for the purposes of Working for Families, these payments must be received within the period of the Commissioner's emergency event determination, which can be set for a maximum period of 12 months from the first day of the event. This creates inflexibility that impacts the Government's ability to distribute payments aimed at emergency event relief. Additionally, it impacts the Working for Families entitlements of emergency relief payment recipients. This issue arose in relation to payments being made to relieve the adverse impacts of the January 2023 floods and Cyclone Gabrielle.

To ensure that legislation is suited to current and future contexts, and to give the Government flexibility in the way it responds to emergency events, the Tax Administration Act 1994 has been amended to remove references to a 12-month maximum period.

These changes ensure that payments for emergency event relief do not constitute family scheme income by allowing the Commissioner to set an emergency event determination under section 91AAS for a period that is longer than 12 months since the occurrence of the emergency event.

Effective date

The amendment has effect from 1 September 2023 to align with the current end date of the emergency event set by the Commissioner in relation to the January 2023 floods and Cyclone Gabrielle.

Cross-border workers: obligations undertaken by nominated persons

Section 24HB of the Tax Administration Act 1994

Amendments have been made to section 24HB of the Tax Administration Act 1994 to correct overreach and better align with the policy intent.

Background

As originally drafted, section 24HB enables a non-resident contractor to enter into an arrangement with a person resident in New Zealand in relation to their tax affairs or social policy entitlements, or both.

Concerns have been raised regarding the implementation of section 24HB. In particular, the joint and several liability condition may overreach and cause unintended consequences. In addition, existing provisions already enable non-resident contractors to enter into an arrangement with a nominated person, agent or intermediary making this provision somewhat redundant.

However, the provision does confirm operational practice with regards to accepting the reporting and payment of employment-related taxes (pay-as-you-earn, fringe benefit tax and employer's superannuation contribution tax) in some circumstances. These circumstances arise where a New Zealand resident undertakes employment-related tax compliance activities on behalf of a non-resident contractor.

Key features

The amendments narrow the section's application to employment-related taxes only to reflect operational practice. The joint and several liability condition is correspondingly amended. It applies to arrangements in relation to employment-related taxes and, where such an arrangement exists, an application for an exemption on the basis of the compliance history of another party to the arrangement.

Effective date

The amendments take effect on 1 April 2024.

Clarifying that individuals earning "non-reportable income" can change balance dates

Sections 22H(4), 38(1) and (1C) of the Tax Administration Act 1994

Amendments have been made to clarify that individuals earning non-reportable income may request a change of balance date and return income to a late balance date.

Background

Taxpayers can make a request to the Commissioner of Inland Revenue (the Commissioner) to change their balance date under section 38 of the Tax Administration Act 1994 (TAA). However, a restriction in section 38(1C) of the TAA prevented individuals whose "final account" for a tax year was treated as an assessment from being able to request a balance date change. Both individuals only earning "reportable income" (income that is taxed at source by a payer, such as salary or wages or dividends) and individuals also earning non-reportable income (income that is not taxed at source, such as business income) would have a final account under the individuals' income information reporting rules in subpart 3B of Part 3 of the TAA.

In addition, section 22H(4) of the TAA required individuals to provide income information required as part of the process of finalising their account for a tax year to the Commissioner by 7 July in the following tax year (this is consistent with the standard due date for income tax returns). An individual wanting to return income to a late balance date may have been unable to comply with the 7 July due date because it would be very close to or before the end of the income year they would be providing the information in relation to. This issue did not arise for non-individuals with a late balance date because under section 37(1)(b) of the TAA their income tax return is due by the seventh of the month that is the fourth month after the end of their income year.

The outcomes described above were unintended consequences of 1 April 2019 amendments relating to simplifying individuals' end-of-year income tax obligations. Prior to the 2019 amendments, the law did not allow individuals only earning income taxed at source by a payer to request a balance date change. However, individuals also earning income that was not taxed at source were able to request a change of balance date and return income to a late balance date.

Key features

- The amendments reverse the unintended effects of the 2019 amendments.
- The amendments to section 38 of the TAA clarify that individuals earning income that is not reportable income (ie, income not taxed at source) can request a change of balance date under that section.
- The amendments to section 22H(4)(a) adjust the due date for the provision of information under that section for individuals with a late balance date so that it aligns with the due date in section 37(1)(b) of the TAA.

Effective date

The amendments take effect on 1 April 2019 for the 2018–19 and later income years. This addresses the unintended effects as at the date the previous legislation applied from.

Requirement to file annual Māori authority credit account return

Section 69B of the Tax Administration Act 1994

Amendments have been made to section 69B of the Tax Administration Act 1994 to align the treatment of Māori authority credit accounts (MACA) with imputation credit accounts (ICA) and reduce unnecessary compliance costs.

Background

To reduce compliance costs for taxpayers, a 2022 amendment removed the requirement for a member of a consolidated tax group or consolidated imputation group to file a return for their ICA if it has a nil balance at all times during the relevant tax year.

Section 69B similarly requires a Māori authority to file an annual IR8J return for their MACA, which raised the question of whether the exemption for ICA filing requirements should also be extended to MACA returns.

Key features

This amendment exempts a Māori authority that is a member of a consolidated Māori authority group from filing a return for their MACA if the account balance is nil at all times during the relevant tax year.

This amendment will retrospectively apply to align with the amendment made to ICA filing requirements.

Effective date

The amendments are effective for the 2020–21 and later tax years.

Empowering assessment provisions for discretionary penalties

Sections 3 (definition of "civil penalty"), 89C, 94A, 94BB, 94BC, 94BD, 94BCB of the Tax Administration Act 1994

The amendments enable the Commissioner to make assessments of several different discretionary penalties.

Background

Part 9 of the Tax Administration Act 1994 (TAA) sets out various penalties that taxpayers and other persons could be liable for when they do not comply with the requirements of the TAA (or any Inland Revenue Act) or requirements of the Commissioner of Inland Revenue (the Commissioner).

Some penalties in Part 9 apply automatically on the occurrence or non-occurrence of an event (for example, the non-payment of tax by the due date). These penalties are not assessed by the Commissioner and are instead imposed by the operation of law. Part 9 also includes penalties that are discretionary in nature, meaning the Commissioner can impose the penalty but does not have to. These discretionary penalties are given effect to by an "assessment" that the Commissioner must make.

Several penalties in Part 9 of the TAA did not have provisions empowering the Commissioner to make an assessment of them. This raised the question of whether the Commissioner could give effect to them. To address this question and ensure consistency with other similar civil penalties, new provisions have been inserted into the TAA to ensure the Commissioner can make an assessment of the penalties.

Key features

The key features of the amendments are:

- new provisions enabling the Commissioner to make an assessment of four discretionary penalties for which there was no corresponding assessment provision
- changes to ensure the Commissioner is not required to issue a notice of proposed adjustment (NOPA) before making an assessment of the penalties, and
- consequential amendments to the definition of "civil penalty" and other provisions of the TAA to ensure the penalties operate and apply consistently with other civil penalties.

Effective date

The amendments came into effect on 29 March 2024, except for the provision empowering the Commissioner to assess penalties related to the applied global anti-base erosion rules, which comes into effect on 1 January 2025.

Detailed analysis

New sections 94BB, 94BC, 94BD and 94BCB of the TAA enable the Commissioner to make an assessment of the following penalties for:

- ultimate owners of large multinational groups that do not meet country-by-country reporting requirements, and that would be liable for a penalty under section 139AAB of the TAA
- members of large multinational groups that do not provide information required of them by the Commissioner, and that would be liable for a penalty under section 139AB of the TAA
- trustees of "foreign exemption trusts", who do not register with Inland Revenue, or provide information to the Commissioner when required, and who would be liable for a penalty under section 139AC of the TAA, and
- taxpayers who fail to register or provide information for the purposes of the applied global anti-base erosion rules, and who would be liable for a penalty under section 139ABB of the TAA.

These new sections enable the Commissioner to make an assessment of the penalty that is payable by the person, and the person is then liable to pay that penalty unless they establish in proceedings challenging the penalty that the penalty is not chargeable, or the penalty is excessive. Once the Commissioner has made an assessment of the penalty payable by the person, a notice of assessment should be issued which sets out the amount of the penalty and the due date for payment. Generally, the due date for the penalty will be set out in the provision in Part 9 that contains the penalty and will be no less than 30 days after the date of the notice of assessment. In some circumstances, the Commissioner can set a later due date.

Before making an assessment, the Commissioner is generally required to issue a NOPA. Exceptions to this general requirement are set out in section 89C of the TAA. One of these exceptions provides that the Commissioner is not required to issue a NOPA before making an assessment of a discretionary penalty. Section 89C has been amended to provide that the Commissioner does not need to issue a NOPA before making an assessment of any of the penalties referred to above.

Consequential amendments

Section 94A of the TAA enables the Commissioner to make an assessment of civil penalties including shortfall penalties. For the avoidance of doubt, this section excludes from its scope the four penalties added to the TAA by the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024 (the amending Act). This is because the assessment of these four penalties will be made under their own empowering provision.

The definition of "civil penalty" in section 3(1) has been amended to include a reference to the four penalties added by the amending Act. This ensures the rules in the TAA that apply to civil penalties also apply to these penalties (for example, the application of use-of-money interest if the penalty is not paid by the due date).

Revoking ultra vires clause in Regulation

Regulation 13 of the Tax Administration (Regular Collection of Bulk Data) Regulations 2022

Regulation 13 of the Tax Administration (Regular Collection of Bulk Data) Regulations 2022 is revoked because it is ultra vires.

Background

The Tax Administration (Regular Collection of Bulk Data) Regulations 2022 enable Inland Revenue to collect datasets from payment service providers (PSPs) on a regular basis. The datasets consist of aggregate data of merchant sales and are used to detect non-compliance including hidden economy activities. The datasets are used for risk analysis and to ensure compliance through education, marketing and targeted campaigns including investigation of high-risk cases. Macro analysis of this information is also used in research and to inform policy.

When the regulations were drafted, PSPs were concerned with Inland Revenue's ability to criminally prosecute a PSP for late information filing, even if it was due to extenuating circumstances. Regulation 13 was therefore introduced to provide PSPs with a criminal defence if they took reasonable steps to provide the information by the due date.

Following enactment, the Regulations Review Committee reviewed the regulations and raised concerns that regulation 13 potentially amended the application of primary legislation, when it had not been expressly empowered to do so by the legislation under which it was made. Officials subsequently reviewed the regulation and concluded that it was ultra vires and should be revoked.

Effective date

Regulation 13 is revoked from 29 March 2024.

Maintenance items

The amendments in Table 1 are minor technical maintenance items and correct any of the following:

- ambiguities
- compilation issues
- cross-references
- drafting consistency, including reader's aids – for example, the defined terms lists
- grammar
- effective dates
- consequential amendments arising from substantive rewrite amendments, and
- inconsistent use of terminology and definitions.

Effective date

The amendments take effect on the dates outlined in the table.

Table 1: Maintenance amendments

Act	Section	Amendment	Effective Date
Income Tax Act 2007	CB 6A(7)	Correcting terminology	27 March 2021
	CB 6AB(5)(a)	Correcting effective date	27 March 2021
	CB 6AC(4)(a)	Correcting effective date	27 March 2021
	CB 6AB(2)	Clarifying that a taxpayer need only meet one of two tests for rollover relief	1 April 2023
	CB 6AB	Correcting application provision	1 April 2022
	CB 6AC	Correcting application provision	1 April 2022
	CB 6AE	Correcting application provision	1 April 2022
	CX 19D	Aligning with requirements of the Legislation Act 2019	1 April 2008
	FC 2(3)	Correcting cross-reference	29 March 2024 (day after date of Royal assent)
	FC 9B(b)	Correcting terminology	1 April 2022
	FC 9B(e)	Correcting terminology	1 April 2022
	HF 1(2)(f)	Correcting cross-reference	1 April 2008
	HG 4(4)	Correcting terminology	1 April 2008
	MB 7(3)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	MB 7(4)(a)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	MB 7(7)(a)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	MB 7(8)(a)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	MB 7 (list of defined terms)	Removing defined term	29 March 2024 (day after date of Royal assent)
	MK 2	Removing defined term	1 April 2008
	YA 1 (accommodation)	Correcting cross-reference	8 January 2023
	YA 1 (council-controlled organisation)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	YA 1 (residential land)	Correcting terminology	27 March 2021
	YA 1 (reportable income)	Inserting defined term	1 April 2022
	Schedule 35	Removing deregistered company	20 October 2022
	Schedule 35	Updating company name	9 March 2023

Act	Section	Amendment	Effective Date
Tax Administration Act 1994	3(1) (civil penalty)	Correcting effective date	1 January 2024
	3(1) (individual, qualifying individual), 22D	Correcting cross-references	1 April 2019
	59BA(3)	Clarifying exemption for foreign trust	1 April 2021, 1 April 2023
	79	Correcting cross-reference	7 December 2020
	80	Correcting cross-reference	7 December 2020
	120KBB(1)(a)	Removing example	30 March 2022
	227F	Correcting cross-references	18 March 2019
Goods and Services Tax Act 1985	10(15C)	Correcting cross-reference	29 March 2024 (day after date of Royal assent)
	11A(1)(r)	Correcting terminology	29 March 2024 (day after date of Royal assent)
	19N(7)(a)	Correcting cross-reference	1 April 2023
	20(3J)(a)(iv)	Correcting cross-reference	1 April 2023
	20(3LB), (3LC)	Clarifying relationship between provisions	30 March 2022
	20(3LB)	Correcting cross-reference	30 March 2022
	25(4)	Correcting terminology	30 March 2022, 1 April 2023
Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022	227(8)	Correcting cross-reference	30 March 2022
Taxation (Annual Rates for 2023–2023, Platform Economy, and Remedial Matters) Act 2023	152(4)	Correcting terminology	31 March 2024

Order revocations

The Act revokes the following Orders, which are spent:

- COVID-19 Resurgence Support Payments Scheme (March 2021) Order 2021
- COVID-19 Resurgence Support Payments Scheme (July 2021) Order 2021
- COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021
- COVID-19 Support Payments Scheme (Omicron Outbreak) Order 2022

Effective date

The revocations took effect on 29 March 2024.

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

DET 24/01: Amortisation Rates for Listed Horticultural Plants

Issued: 3 April 2024

Application

This Determination sets out the amortisation rates (based on diminishing values) for listed horticultural plants as determined by the Commissioner of Inland Revenue and listed in the schedule to this Determination. The Determination is made under section 91AAB of the Tax Administration Act 1994.

The Determination applies from the 1 April 2023 and subsequent income years. Its application may be supplemented or changed by supplementary Determinations pursuant to subsection 91AAB(4) of the Tax Administration Act 1994.

Discussion

In this Determination, unless the context otherwise requires, expressions used have the same meanings as those in ss DO 5 to DO 9, YA 1, schedule 20 of the Income Tax Act 2007 and s 91AAB of the Tax Administration Act 1994 in respect of an income year starting on or after 1 April 2023 and subsequent income years.

Determination

Under section 91AAB of the Tax Administration Act 1994:

(a) for the purposes of section 91AAB(1)(a), the types of horticultural plant, tree, vine, bush, cane, or similar plant, as set out in the schedule to this Determination, shall be listed horticultural plants; and

(b) for the purposes of section 91AAB(1)(b), for the 2024 income year and subsequent income years, a banded rate set out in schedule 12, column 1 of the Income Tax Act 2007 is to be used to calculate the diminishing value for each type of listed horticultural plant shall be at the election of the taxpayer either:

  (i) the amortisation rates as set out in column 2 of the schedule to this Determination; or

  (ii) 10%.

Schedule to Determination DET 24/01

Amortisation rates for listed horticultural plants

Column 1 Listed horticultural plant	Column 2 Diminishing value amortisation rate (%)	Column 3 Estimated useful life of horticultural plant (years)
Berry fruit		
Blueberry	12	13
Blackcurrant	18	8
Rubus		
Raspberry	26	5
Blackberry	15	10
Boysenberry	15	10
Loganberry	15	10

Column 1 Listed horticultural plant	Column 2 Diminishing value amortisation rate (%)	Column 3 Estimated useful life of horticultural plant (years)
Other Rubus	15	10
Citrus		
Grapefruit	7.5	18
Lemon	7.5	20
Lime	7.5	20
Mandarin	6	25
Orange	6	25
Tangelo	6	25
Grapes		
Table grapes	7.5	20
Nuts		
Chestnut	7.5	20
Hazelnut	6	26
Walnut	4	30
Pip fruit		
Apple	9.5	15
European pear	7.5	20
Nashi Asian pear	9.5	15
Summer fruit		
Apricot	9.5	15
Cherry	7.5	20
Plum	9.5	15
Nectarine	12	12
Peach	12	12
Vegetables		
Asparagus	22	6
Other		
Avocado	7.5	20
Feijoa	7.5	18
Hop	15	10
Kiwifruit	7.5	20
Olives < 500 trees per hectare	7.5	20
Olives > 500 trees per hectare	9.5	15
Passionfruit	33	4
Persimmon	6	25
Tamarillo	33	4

This Determination is signed on the 3rd day of April 2024.

Matthew Evans
Technical Lead
Technical Standards, Legal Services

Commentary on Determination DET 24/01

Introduction

This commentary does not form part of the Determination. It is intended to help in the understanding and application of the Determination.

This Determination sets out the diminishing value amortisation rates (depreciation like deductions) that the Commissioner has determined for each horticultural plant that is listed in the schedule to this Determination.

A 10% amortisation rate applies to most other horticultural plants that are not included in the schedule to this Determination.

Estimated useful life

The main element the Commissioner has considered to establish the amortisation rate for each listed horticultural plant is its estimated useful life. Where appropriate, the following have been considered in arriving at the amortisation rates of listed horticultural plants.

- The main purpose for which a listed horticultural plant has been cultivated; and
- The way a listed horticultural plant is cultivated and managed.

The estimated useful life of a listed horticultural plant commences on the day of planting and continues until the plant might reasonably be expected to cease to be useful to a person in deriving income or carrying on a horticultural business.

The main factor that has been considered in calculating the estimated useful life of a listed horticultural plant is that it has passed its commercial "use-by" date. This, in essence, is due to the plant's age and the fact that it can no longer deliver an economic crop.

Other factors that have a significant impact on the estimated useful life of a listed horticultural plant have been considered. This includes such things as natural and incidental damage, decay, disease, and exhaustion.

Inland Revenue has not considered any element where a specific deduction is provided for in the legislation. This includes replacement plantings, or where a listed horticultural plant has ceased to exist or be used to derive income.

Crop management techniques, such as regeneration, topworking and reworking where trees are potentially cut back to their stumps, have also been considered in determining the estimated useful life of listed horticultural plants. Where the process of topworking or reworking involves grafting a new variety on to the old root system, it is considered that a new plant has been established.

The estimated useful life of each listed horticultural plant has been established by Inland Revenue following extensive consultation with grower organisations and industry experts.

Amortisation rates

The process adopted in arriving at the amortisation rates of listed horticultural plants commenced with the establishment of an appropriate estimated useful life for each listed plant. This data is then translated into a comparable band for setting a diminishing value depreciation rate, as provided in column 1 of Schedule 12.

The amortisation rates listed in the schedule to this Determination have been established for the widest possible application. Where the estimated useful lives of the various species of a plant variety do not materially differ, only one amortisation rate has been established for that variety.

Additions of new amortisation rates/changes to existing amortisation rates

Where a horticultural plant has not been determined by the Commissioner as a listed horticultural plant, taxpayers may apply in writing to the Commissioner for a specific horticultural plant or category of horticultural plants to be so determined.

Changes may be made to the Determination from time to time by the Commissioner on receipt of written applications from grower organisations. Changes may include adding further horticultural plants to those already listed, adjusting the estimated useful life of a horticultural plant, or removing a plant that is no longer commercially grown. Changes may be effective for the current or future income years. They will not apply to previous income years.

Changes to this Determination will be made by the Commissioner issuing supplementary Determinations under subsection 91AAB(4) of the Tax Administration Act 1994.

Applications for changes must include the following information:

- The nature of the change to the Determination being sought. This may be a new amortisation rate, change an existing amortisation rate or remove an existing amortisation rate.
- Applicant's details. This includes full name, IRD number (if applicable), address, contact details i.e. email address or phone number and the contact person for enquiries.
- Horticultural plant information. This includes:
  a) description of the horticultural plant;
  b) the income year the change is requested to apply from (changes may be effective for the current or future income years), they will not be made to previous income years;
  c) the reasons for the request to change the Determination (adding further horticultural plants to those already listed, adjusting the estimated useful life of a horticultural plant due to a change, or removing a plant that is no longer commercially grown);
  d) the Applicant's detailed assessment of the plant's estimated useful life (this is to include any evidence to support that assessment);
  e) a detailed assessment by an independent industry expert of the plant's estimated useful life (this is to include any evidence to support that assessment).

The application process for a horticultural plant to be determined as a listed horticultural plant or to change the amortisation rate for an existing listed horticultural plant is summarised in the flowchart attached as Appendix.

Applications for changes to the Determination should be sent by email to: TechnicalStandards@ird.govt.nz; or

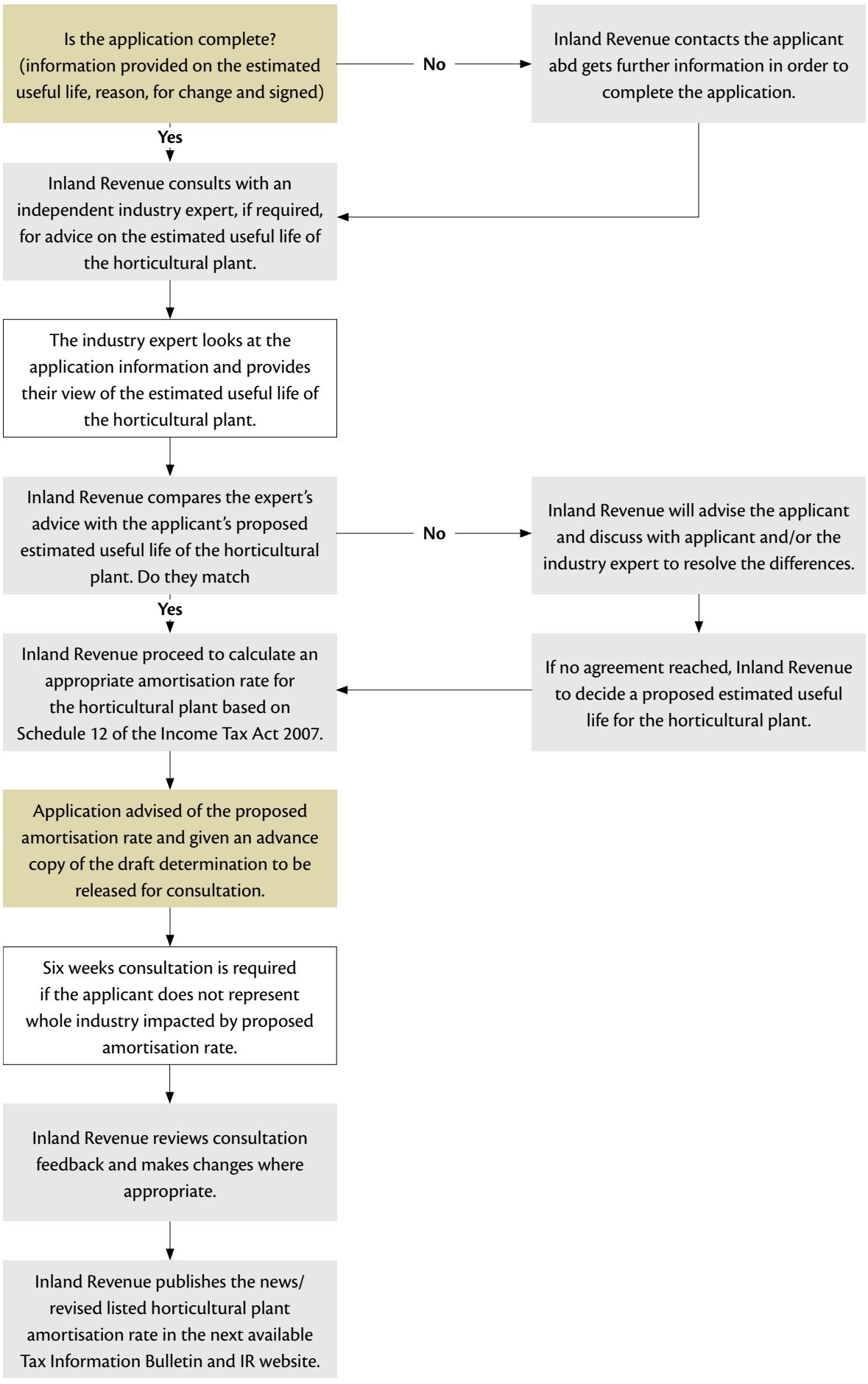
By post to:

The Technical Lead
Technical Standards – Legal Services
Inland Revenue
P O Box 2198
Wellington

In considering applications for change to the listed horticultural plant Determination, the Commissioner will continue to consult with relevant grower organisations and industry experts.

The Commissioner will discuss any change that is to be made to the listed horticultural plant Determination with the applicant before it is finalised.

Appendix


Is the application complete? (information provided on the estimated useful life, reason, for change and signed)
No
Inland Revenue contacts the applicant abd gets further information in order to complete the application.
Yes
Inland Revenue consults with an independent industry expert, if required, for advice on the estimated useful life of the horticultural plant.
The industry expert looks at the application information and provides their view of the estimated useful life of the horticultural plant.
Inland Revenue compares the expert's advice with the applicant's proposed estimated useful life of the horticultural plant. Do they match
No
Inland Revenue will advise the applicant and discuss with applicant and/or the industry expert to resolve the differences.
Yes
Inland Revenue proceed to calculate an appropriate amortisation rate for the horticultural plant based on Schedule 12 of the Income Tax Act 2007.
If no agreement reached, Inland Revenue to decide a proposed estimated useful life for the horticultural plant.
Application advised of the proposed amortisation rate and given an advance copy of the draft determination to be released for consultation.
Six weeks consultation is required if the applicant does not represent whole industry impacted by proposed amortisation rate.
Inland Revenue reviews consultation feedback and makes changes where appropriate.
Inland Revenue publishes the news/ revised listed horticultural plant amortisation rate in the next available Tax Information Bulletin and IR website.

FDR 2024/01: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (Wellington Management Funds (Ireland) PLC - Wellington Global Impact Bond Fund NZD Class)

Any investment by a New Zealand resident investor in shares in the Wellington Global Impact Bond Fund – NZD Share Class to which none of the exemptions in sections EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate ("FDR") method to calculate foreign investment fund income for the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the New Zealand Dollar (NZD) denominated class of the Wellington Global Impact Bond Fund ("the Fund") are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply. The Fund is part of the Wellington Management Funds (Ireland) PLC ("WMFI") and incorporated under the laws of Ireland.

WMFI is structured as an umbrella fund with segregated liability between sub-funds. These sub-funds do not have a separate legal personality.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the NZD denominated class of the Fund ("the NZD Share Class") each year.

The Fund invests in a broadly diversified portfolio of eligible intermediate term domestic and global fixed interest and money market securities. The Fund has various shares classes denominated in different currencies, including USD, AUD, GBP, EUR and NZD that provide holders of those classes of shares with an interest in the pool of investments held by the Fund. The NZD class of shares of the Fund is denominated in New Zealand dollars. The Fund has foreign currency hedging arrangements in place which effectively provide investors in the NZD class of the Fund with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the FDR method for interests in the NZD Share class but would apply if the Fund represented a separate foreign company and the NZD Share Class was the only class of share on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement including any interposed entities or financial arrangements in ascertaining whether an investment in a FIF provides the New Zealand resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in the NZD Share Class of the Fund, and holds an attributing interest in the FIF, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination. It applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
  - is incorporated in Ireland and issues multiple classes of shares; and
  - is known at the date of this determination as Wellington Management Funds (Ireland) PLC; and
  - is structured as an umbrella fund with segregated liability between sub-funds.

- The attributing interest consists of the New Zealand dollar denominated class of shares issued in the Wellington Global Impact Bond Fund, a sub-fund of Wellington Management Funds (Ireland) PLC. This class of shares provides an interest in the underlying assets of the Fund that predominantly (i.e. 80% or more by value at a time in the income year) consist of financial arrangements such as international fixed interest securities; and
- The investment assets attributable to the New Zealand dollar denominated class of share are subject to foreign currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating to the extent possible any exchange rate risk for New Zealand investors where this removes 80% to 125% of foreign currency risk for the assets.

Conditions

It is a condition of this determination that the investment in the Fund is part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is economically equivalent to a debt instrument denominated in New Zealand dollars.

In addition, it is a condition of this determination that an investor will not be excluded from using the FDR method to calculate FIF income from an interest where the absolute notional value of the Fund's investment in global fixed income securities (directly or indirectly via derivatives) plus the fair value of the related hedges plus cash and cash equivalents (together referred to as "the numerator") is 80% or less than the combined total of the numerator plus the absolute nominal value of other derivatives (together referred to as "the denominator") for a continuous period of 45 days. For the purposes of calculating the numerator and denominator hedging to NZD is excluded. Should this occur the determination will cease to apply from the first day of the quarter immediately following the expiry of the 45 day period.

Interpretation

In this determination, unless the context otherwise requires -

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007.

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007.

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007.

"New Zealand resident" means a person that is resident in New Zealand for the purposes of the Income Tax Act 2007.

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007.

"The Fund" means the Wellington Global Impact Bond Fund, a sub-fund of Wellington Management Funds (Ireland) PLC.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2024-2025 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this 2nd April 2024.

Iain McConville
Technical Specialist

DEP111: Tax Depreciation Rate for horticulture LED grow light systems

Issued: 5 April 2024

This determination sets a depreciation rate for horticulture LED grow light systems used for indoor farming operations.

Note to Determination DEP111:

The Commissioner has been asked to consider a depreciation rate for horticulture LED grow light systems, for use by indoor farm operations.

Horticulture LED grow light systems are a lighting solution designed exclusively for agricultural purposes. The horticulture grow light system incorporates advanced LED technology and has been proven to significantly enhance the growth rate of plants, for example strawberries. This asset is designed for use in indoor horticultural operations, to enable year-round cultivation of plant crops independent of seasonal limitations.

Determination DEP111: Tax Depreciation Rates General Determination Number 111

This determination may be cited as "Determination DEP111 Tax Depreciation Rates General Determination Number DEP111: Horticulture LED grow light systems for use in indoor farming operations.

Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the table below:

This determination applies for the 2023 and subsequent income years.

Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination will apply to the kind of items of depreciable property listed in the table below by adding into the "Agriculture, horticulture and aquaculture" industry category, the estimated useful life, and general diminishing value and straight-line depreciation rates for the asset class listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Horticulture LED grow light systems	5	40	30

Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

This determination is signed on the 5th day of April 2024.

Matthew Evans
Technical Lead
Technical Standards, Legal Services

CFC 2024/01: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance (American Samoa) Limited	American Samoa

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Sarah Bourke
Group Lead – Significant Enterprises

CFC 2024/02: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
Tower Insurance (Cook Islands) Limited	Cook Islands

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Jessica Griffin
Group Lead – Customer Compliance

CFC 2024/03: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(b) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of the members of a group of CFCs, if the members satisfy subsection (3). Pursuant to section 91AAQ(1)(b) and (7), Tower Limited has made an application to extend an earlier determination in respect of the members of the group of CFCs set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	*Jurisdiction*
National Insurance Company (Holdings) Limited	Fiji
Tower Insurance (Fiji) Limited	Fiji
Southern Pacific Insurance Company (Fiji)) Limited	Fiji

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Jessica Griffin
Group Lead – Customer Compliance

CFC 2024/04: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance Limited	Samoa

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Sarah Bourke
Group Lead – Significant Enterprises

CFC 2024/05: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
National Pacific Insurance (Tonga) Limited	Tonga

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Sarah Bourke
Group Lead – Significant Enterprises

CFC 2024/06: Non-attributing active insurance CFC status Tower Limited

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because an attributable CFC amount includes the CFC's income from an insurance business or from being an insurer under s EX 20B(3)(f) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), Tower Limited has made an application to extend an earlier determination in respect of the CFC set out below. Tower Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	***Jurisdiction***
Tower Insurance (Vanuatu) Limited	Vanuatu

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2024 and 2025 income years.

This determination is signed by me this 26th day of March 2024.

Sarah Bourke
Group Lead – Significant Enterprises

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 24/02: GST – Grouping for companies

Issued | Tukuna: 22 March 2024

This interpretation statement explains how the GST grouping rules apply to companies. All legislative references are to the Goods and Services Tax Act 1985 (GSTA) unless otherwise stated.

Summary | Whakarāpopoto

1. The GST grouping rules allow a group of related companies to be treated as a single company, if they meet certain eligibility requirements.[1] The rules help to reduce distortions that might otherwise arise between a single entity, a branch structure and a group structure. The GST grouping rules also help to reduce compliance costs.
2. This interpretation statement explains how the GST grouping rules apply to companies.
   - The representative member is treated as carrying on all group members' activities, as a registered person.
   - Taxable supplies made by group members to persons outside the GST group are treated as taxable supplies made by the representative member, as a registered person.
   - Taxable supplies made to group members from persons outside the GST group are treated as taxable supplies made to the representative member.
   - Taxable supplies between group members are mainly disregarded.
   - Non-taxable supplies made by or to group members are treated as made by or to the representative member. Intra-group non-taxable supplies are not disregarded.
   - The representative member claims all input tax deductions.
   - The representative member makes all input tax adjustments where there is a change in the use of goods or services acquired by group members.
3. Occasionally, these rules can have significant implications for the treatment of a supply. For example, if an unregistered company is part of a GST group and it makes supplies to persons outside the GST group, those supplies are treated as made by the representative member, as a registered person. Therefore, the supplies become taxable supplies (provided they would be taxable supplies if made by a registered person) and GST must be charged. Similarly, if a non-resident company is part of a GST group and the representative member is a New Zealand resident, supplies made by that non-resident company are treated as made by the representative member. As a result, the GST grouping rules can change the place of a supply.
4. This interpretation statement contains examples that illustrate how the GST grouping rules apply. It also discusses some of the specific compliance and administrative rules that apply to GST groups.

[1] A related interpretation statement, IS 24/03: GST – Who can group register? explains the eligibility requirements for companies and other entities that want to form a GST group.

5. While this interpretation statement focuses on the GST grouping rules as they apply to companies, the same principles may apply to other entities that are eligible to form a GST group.
6. This interpretation statement is organised into five parts:
   - Part 1 discusses the purpose of the GST grouping rules.
   - Part 2 summarises the eligibility requirements for GST group registration.
   - Part 3 explains the main consequences of GST group registration. It includes examples illustrating how the rules apply.
   - Part 4 contains further examples that concern more complicated transactions.
   - Part 5 discusses some compliance and administrative rules for GST groups.

Part 1: Purpose of the GST grouping rules

7. The purpose of the GST grouping rules is to treat a group of related companies as a single company for GST purposes. Under this approach, the legal structure of the GST group is disregarded and members of the group act as a single company, carried on by the representative member.
8. This approach is intended to reduce distortions that might arise between a single entity, a branch structure and a group structure. For example, by disregarding intra-group taxable supplies, a group of companies is treated like a single company that makes taxable supplies between different departments or branches. In the case of a single company, the supply is a "self-supply" and is disregarded. The GST grouping rules ensure that this supply is also disregarded for a group of companies.
9. The GST grouping rules also simplify administration and reduce compliance costs. For example, the representative member is responsible for filing a single consolidated GST return on behalf of all companies in the GST group.[2] This reduces compliance costs for group members who do not file separate GST returns.
10. Previously, there was some uncertainty about how the GST grouping rules interacted with other parts of the GSTA.[3] The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 amended the GSTA to clarify that where a GST group exists, the GST grouping rules are applied before the other provisions in the GSTA.

Part 2: Eligibility requirements

11. This part summarises the eligibility requirements for GST group registration for companies. For a detailed discussion of the eligibility requirements for both companies and non-companies, see **IS 24/03: GST: Who can group register?**
12. Two or more companies[4] are eligible to be a GST group if, under s IC 3 of the Income Tax Act 2007, they:
    - are a group of companies;
    - are part of a group of companies;
    - would be a group of companies but one or more of the companies is a muti-rate portfolio investment entity, a listed portfolio investment entity or a look-through company (s 55(1)(a)).
13. In addition, the companies must meet **either** or **both** of the following requirements:
    - Be GST-registered.
    - In a 12-month period, the companies, as the eligibility group[5] make at least 75% taxable supplies (as a percentage by value of their taxable and other supplies) to persons outside the eligibility group. For this purpose, "taxable supplies" includes supplies that would be taxable supplies if made by a registered person (s 55(1)(b)).

[2] Consequently, a company can only be a member of one GST group at a time.

[3] This uncertainty was discussed in GST policy issues - an officials' issues paper, (Policy and Strategy, Inland Revenue, February 2020) and in IRRUIP 13: Consequences of GST group registration (April 2019).

[4] "Company" means any body corporate incorporated in New Zealand or elsewhere. "Company" does not include a local authority or a public authority (s 2 of the GSTA).

[5] The GSTA uses the term "eligibility group" to differentiate between the group of companies before grouping (the "eligibility group") and once the group is formed (the "GST group").

- Under s IC 3 of the Income Tax Act 2007, companies can group if they have common voting interests that total at least 66%. Where a market value circumstance exists for a company that is part of a group of companies, the companies can group if they have common market value interests that total at least 66%.[6]

14. For income tax purposes, a look-through company cannot be a member of a "group of companies", and multi-rate PIEs and listed PIEs require 100% common ownership to be members of a "group of companies". However, for GST grouping purposes, these restrictions are ignored. Look-through companies, multi-rate PIEs and listed PIEs are eligible to be members of GST groups under s 55(1) if they meet the 66% common voting interests test and, if applicable, the 66% common market value interests test.

Unregistered companies

15. A company that is not GST-registered may join a GST group, provided the eligibility group collectively makes at least 75% taxable supplies (as a percentage by value of their taxable and other supplies) to persons outside the eligibility group. A company may be unregistered because it:
    - does not carry on a taxable activity (for example, a holding company);
    - carries on a taxable activity but does not, or does not intend to, make taxable supplies in New Zealand of more than $60,000 in a 12-month period;
    - is non-resident and does not carry on a taxable activity in New Zealand; or
    - is non-resident and carries on a taxable activity in New Zealand but does not, or does not intend to, make taxable supplies in New Zealand of more than $60,000 in a 12-month period.
16. An unregistered company cannot be the representative member of a GST group (s 55(3)(b)).

Non-resident companies

17. In certain circumstances, a non-resident company may join a GST group:
    - A non-resident company registered for GST in New Zealand under s 51 is eligible to join a GST group. The non-resident company may join a GST group with resident or non-resident companies.
    - A non-resident company registered for GST in New Zealand under s 54B may only join a GST group with other non-resident companies (s 55(1B)).
    - A non-resident, unregistered company may join a GST group, provided the eligibility group collectively makes at least 75% taxable supplies[7] (as a percentage by value of their taxable and other supplies) to persons outside the eligibility group. The non-resident company may join a GST group with resident or non-resident companies.
18. Part 5 of this interpretation statement explains how to apply to be a GST group (from [9595]).

Part 3: Consequences of GST grouping

19. This part explains the main consequences of GST grouping for companies.
    - The representative member is treated as carrying on all group members' activities, as a registered person (from [21]).
    - Taxable supplies made by group members to persons outside the GST group are treated as taxable supplies made by the representative member, as a registered person (from [29]).
    - Taxable supplies made to group members from persons outside the GST group are treated as taxable supplies made to the representative member (from [30]).
    - Taxable supplies between group members are mainly disregarded (from [34]).
    - Non-taxable supplies made by or to group members are treated as made by or to the representative member. Intra-group non-taxable supplies are not disregarded (from [41]).
    - The representative member claims all input tax deductions (from [45]).
    - The representative member makes all input tax adjustments where there is a change in the use of goods or services that were acquired by group members (from [5757]).

[6] IS 22/07: Company losses – ownership continuity, sharing and measurement, explains the meaning of "market value circumstance" from [135].

[7] Or the supplies would be taxable supplies if made by a registered person (s 55(1)(b)(ii)).

The representative member carries on all activities

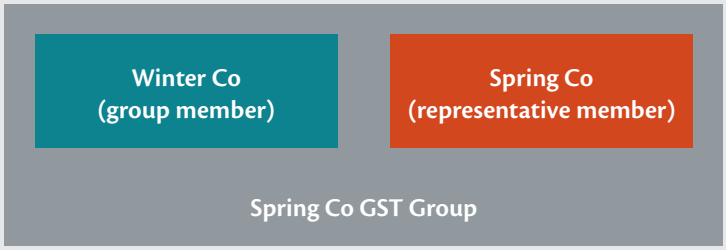
20. Once members are grouped, the representative member is treated as carrying on all the separate activities of group members, as a registered person (s 55(1AD)).

Group members' activities are not merged

21. Group members' activities are not merged so that they lose their distinctiveness. The GSTA treats the group members as if they were a single company "operating separately each activity that each member would operate in the absence of [the grouping rules]..." (s 55(1AB)(a)(i)).
22. This approach is consistent with how a single company carries on the activities of its different departments or branches or how a registered person can carry on more than one taxable activity under one GST registration. For example, in *Case R38* (1994) 16 NZTC 6,212 (TRA), the Taxation Review Authority accepted that a registered person could carry on several taxable activities under one GST registration. In this case, the taxpayer had multiple taxable activities: solicitor, deer farming and grazing, and land investment. (See also *Case P4* (1994) 14 NZTC 4,024 (TRA).)
23. These consequences apply unless the GSTA expressly provides otherwise (s 55(1AC)).
24. Example | Tauira 1 illustrates that group members' activities are treated as separately carried on by the representative member.

Example | Tauira 1 – Group members' activities are not merged

Spring Co GST Group consists of two New Zealand–resident companies: Winter Co and Spring Co. Winter Co sells torches. Spring Co sells light bulbs. Both are GST-registered, and Spring Co is the representative member.



Spring Co, as representative member, is treated as carrying on the taxable activity of Winter Co (s 55(1AD)).

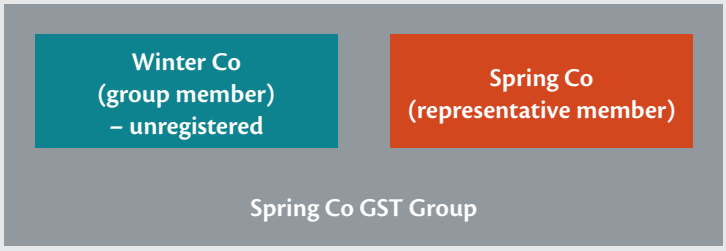
This means the companies in Spring Co GST Group are treated as a single taxable company for GST purposes. However, the taxable activities of Spring Co and Winter Co are not merged into one taxable activity. Spring Co is treated as carrying on both taxable activities – selling torches and selling light bulbs.

Grouping may change the nature of a group member's activity

25. An unregistered company can join a GST group. However, once grouped, its activity is treated as carried on by the representative member **as a registered person**. This has implications for the GST treatment of supplies made by that unregistered company while part of the GST group (discussed at [33]). The unregistered company does not need to separately register for GST while in the GST group.
26. Example | Tauira 2 illustrates how grouping may change the nature of a group member's activity.

Example | Tauira 2 – Grouping may change the nature of a group member's activity

The facts are the same as in Example | Tauira 1, except Winter Co is not registered for GST. This is because in the last 12 months, Winter Co has not made taxable supplies of more than $60,000 and it does not expect to exceed this threshold in the next 12 months.



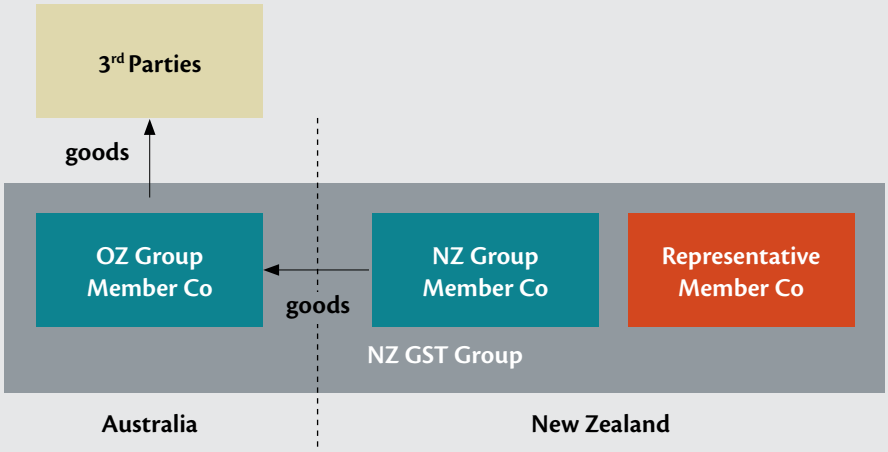
Under s 55(1AD), Spring Co, as representative member, is treated as carrying on the activity of Winter Co, as a registered person. As a result, Winter Co's activity is treated as carried on by a registered person, and therefore any supplies of torches that Winter Co makes outside the group are taxable supplies and GST must be charged.

Grouping may change the place of supply

27. A non-resident company may join a GST group. However, once grouped, its activity is treated as carried on by the representative member. If the representative member is a New Zealand–resident company, the non–resident company's activity is treated as carried on by the New Zealand–resident representative member. Example | Tauira 3 illustrates how grouping may change the place of supply.

Example | Tauira 3 – Grouping may change the place of supply

There are three companies in NZ GST Group. Two are New Zealand–resident companies (NZ Group Member Co and Representative Member Co) and one is an Australian-resident company (OZ Group Member Co).



NZ Group Member Co makes a supply of goods to OZ Group Member Co. OZ Group Member Co then supplies those goods to third parties in Australia.

Supplies of goods made by OZ Group Member to third parties in Australia, are treated as made by Representative Member Co to the third parties in Australia. As Representative Member Co is resident in New Zealand the supply is subject to GST under s 8(2). However, as the goods have been exported to Australia, they are zero-rated under s 11(1)(c). Representative Member Co must account for GST on this supply in the group GST return, although no GST is payable on the supply of goods as it is a zero-rated supply. Example | Tauira 10 considers this arrangement in more detail.

The representative member makes and receives all taxable supplies

28. Taxable supplies (standard-rated and zero-rated supplies) made by a group member to a person outside the GST group are treated as taxable supplies made by the representative member, as a registered person (s 55(1AE)).
29. Similarly, taxable supplies to a group member from a person outside the GST group are treated as taxable supplies received by the representative member, as a registered person (s 55(1AG)).

30. These consequences apply unless the supply is a supply of imported services that is treated as made in New Zealand under s 8(4B); or the GSTA expressly provides otherwise (s 55(1AC)). Supplies of imported services subject to s 8(4B), are discussed from [75].
31. Example | Tauira 4 illustrates that taxable supplies made by a group member to a person outside the GST group are treated as made by the representative member.

Example | Tauira 4 - Taxable supplies made by a group member to a person outside the GST group

The facts are the same as in Example | Tauira 1.

Winter Co, a GST-registered company, makes a taxable supply of goods to 3rd Party Co. That supply is treated as a taxable supply made by Spring Co, as the representative member (s 55(1AE)).

Spring Co must account for GST on this supply in the group GST return.

Supplies by an unregistered group member to persons outside the GST group

32. If an unregistered company joins a GST group and makes a supply of goods or services to a person outside the GST group, the supply is treated as made by the representative member, as a registered person. If the supply would be a taxable supply if made by a registered person, the grouping rules treat that supply as a taxable supply made by the representative member. Consequently, GST must be charged on this supply and the relevant taxable supply information must be retained. This is illustrated in Example | Tauira 5. Taxable supply information is discussed in more detail from [113].

Example | Tauira 5 – Supply by an unregistered group member to a person outside the GST group

The facts are the same as in Example | Tauira 4, except Winter Co is not registered for GST. Winter Co makes a supply of goods to 3rd Party Co. The supply is treated as a taxable supply made by Spring Co, as the GST-registered representative member (ss 55(1AE)(a) and 55(1AF)).

GST must be charged on this supply and taxable supply information must be retained. Spring Co must account for GST on this supply in the group GST return, even though Winter Co is not separately registered for GST.

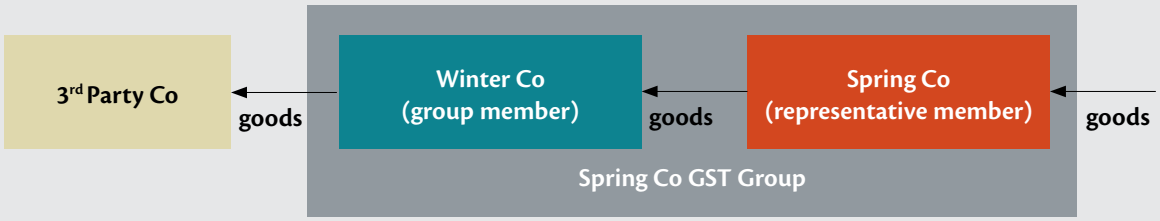
Taxable supplies between group members are mainly disregarded

33. Taxable supplies between group members are mainly disregarded when calculating tax payable by the GST group (s 55(1AE)(b)). This means output tax is not charged on an intra-group taxable supply and input tax cannot be claimed.
34. Disregarding an intra-group taxable supply does not prevent the GST group from claiming input tax on the original supply of the goods or services into the GST group. The representative member can still claim an input tax deduction on the original taxable supply of those goods or services by a third party into the GST group, to the extent to which the goods or services are used or intended to be used to make taxable supplies outside the GST group (s 20(3C)).
35. However, not all intra-group taxable supplies are disregarded. If the supply is a supply of imported services that is treated as made in New Zealand under s 8(4B), the supply cannot be disregarded. In addition, an intra-group taxable supply will not be disregarded if the GSTA expressly provides that the supply cannot be disregarded (s 55(1AC)) or if the GSTA requires otherwise (s 55(1AE)).

36. The group member and representative member must retain sufficient records relating to the disregarded supply, should the Commissioner need to verify any information (s 75).
37. This outcome is consistent with the purpose of the GST grouping rules, which is to treat a group of companies as a single company. If the GST group were a single company, an intra-group supply would be a "self-supply" and would not be subject to GST.
38. Example | Tauira 6 concerns a disregarded intra-group taxable supply.

Example | Tauira 6 – Disregarded intra-group taxable supply

Spring Co agrees to sell light bulbs to Winter Co for $1,000 plus GST. Winter Co intends to use those light bulbs in the torches it produces to make taxable supplies to third parties outside the GST group. The supply of light bulbs from Spring Co to Winter Co is taxable supply of goods and, if the companies were not grouped, Spring Co would need to charge $150 of output tax on this supply.



However, Spring Co and Winter Co are in the same GST group. This means taxable supplies between group members are disregarded. As the supply is disregarded, no output tax is charged on Spring Co's supply of the light bulbs to Winter Co.

However, disregarding the supply between Spring Co and Winter Co does not affect the GST group's ability to claim input tax on the goods Spring Co acquires from outside the group to make the supply to Winter Co. Spring Co (as the representative member) may claim a full input tax deduction on that supply because the GST group intends to use those goods to make taxable supplies to third parties outside the GST group.

39. Part 4 of this interpretation statement contains detailed examples illustrating how cross-border intra-group taxable supplies are treated.

The representative member makes and receives all non-taxable supplies

40. Non-taxable supplies are exempt supplies, supplies where the supplier is not GST-registered and supplies where the supply is not subject to GST.
41. Non-taxable supplies made by a group member are treated as made by the representative member (s 55(1AF)). Similarly, non-taxable supplies made to a group member are treated as made to the representative member, as a registered person (s 55(1AG)). Intra-group non-taxable supplies are not disregarded.
42. These consequences apply, unless the supply is a supply of imported services that s 8(4B) treats as made in New Zealand, or the GSTA expressly provides otherwise (s 55(1AC)).
43. The following examples illustrate how these rules apply:
    - Example | Tauira 7 illustrates an exempt supply of services by a group member to a third party.
    - Example | Tauira 8 illustrates an intra-group exempt supply of services.
    - Example | Tauira 9 illustrates a non-taxable supply of goods by an unregistered group member to a third party.
    - Example | Tauira 10 illustrates a non-taxable supply of goods by a non-resident group member to a non-resident third party.

Example | Tauira 7 – Exempt supply of services by a group member to a third party

Winter Co supplies financial services to 3rd Party Co. The supply is an exempt supply, so Winter Co does not charge GST on this supply.

Section 55(1AF) treats the supply of financial services as made by Spring Co, as the representative member of the GST group. The supply remains an exempt supply.

Example | Tauira 8 - Intra-group exempt supply

Frost Co has joined Spring Co GST Group. Winter Co makes an exempt supply of financial services to Frost Co. The supply is an exempt supply, so Winter Co does not charge GST on this supply.

The exempt supply of financial services is treated as made by Spring Co, as the representative member (ss 55(1AF)). The supply is also treated as received by Spring Co, as the representative member (s 55(1AG)). The supply remains an exempt supply.

Example | Tauira 9 – Non-taxable supply of goods by an unregistered group member to a third party

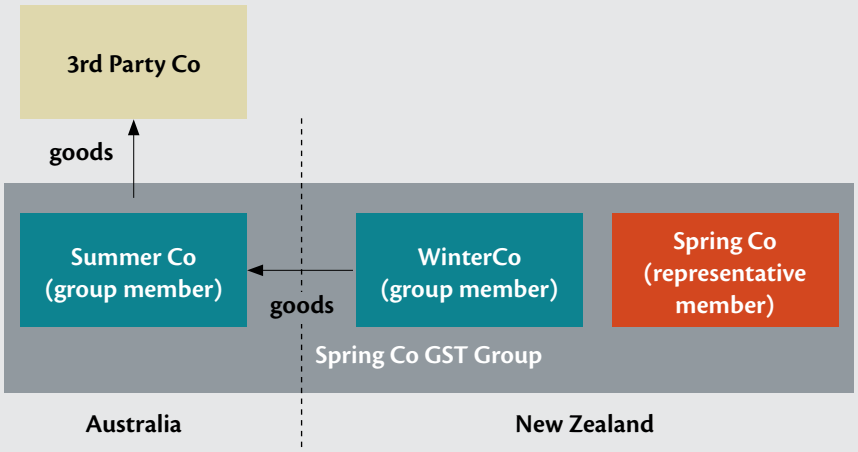
Seasons Co has joined Spring Co GST Group. Seasons Co is not registered for GST as it has not made supplies of more than $60,000 in the last 12 months and does not expect to do so in the next 12 months. Seasons Co makes a non-taxable supply of goods to 3rd Party Co.

The non-taxable supply of goods by Seasons Co is treated as made by Spring Co, as representative member (ss 55(1AE)(a) and 55(1AF)). As Spring Co is GST-registered, and as the supply would be a taxable supply if made by a registered person, the supply changes from a non-taxable supply to a taxable supply. Output tax must be charged, and taxable supply information must be retained.

Example | Tauira 10 – Non-taxable supply of goods by a non-resident group member to a non-resident third party

Summer Co (an Australian-resident company) has joined Spring Co GST Group. Summer Co is eligible to join the group because it is registered for GST under s 51 and satisfies the requirements of s 55(1).

Winter Co makes a supply of goods to Summer Co. Summer Co then makes a supply of goods to 3rd Party Co. 3rd Party Co is an Australian-resident company and not part of Spring Co GST Group.



There are two supplies – the supply from Winter Co to Summer Co and the supply from Summer Co to 3rd Party Co. The first supply is an intra-group taxable supply and is disregarded (s 55(1AE)(b)).

The second supply made by Summer Co to 3rd Party Co is treated as made by Spring Co (s 55(1AF)). Because Spring Co is resident in New Zealand, the supply is subject to GST under s 8(2). However, as the goods have been exported to Australia, it is likely they will be zero-rated under s 11(1)(c). Spring Co needs to include the supply in the group GST return, although no GST is payable as it is a zero-rated supply.

The representative member claims all input tax deductions

44. A consequence of treating the representative member as making and receiving all taxable supplies from outside the GST group is that the representative member is treated as paying all tax paid by any member of the GST group on those supplies (s 55(1AL)(b)).
45. Because the GST grouping rules treat the GST group as a single taxable company, input tax deductions are calculated as if the GST group was a single company.
46. Example | Tauira 6 at [39] illustrates how an intra-group taxable supply is disregarded. In that example, goods that Spring Co acquired from outside the GST group are used to make an intra-group taxable supply to Winter Co (a group member). Winter Co then uses those goods to make taxable supplies to third parties outside the GST group. Spring Co, as the representative member, can claim an input tax deduction on the supply of goods coming into the GST group, because Winter Co intends to use the goods to make taxable supplies to third parties.
47. To determine the extent to which goods or services are used for making taxable supplies, a GST group must estimate how it intends to use them. A full input tax deduction is allowed for goods or services that are intended to be used solely for making taxable supplies.
48. In Example | Tauira 6, an input tax deduction would not be available if Winter Co intended to use the goods to make exempt supplies. This is because under s 20(3C) input tax may be deducted only to the extent to which the goods and services are used for or are intended to be used in making taxable supplies.
49. Input tax deductions are calculated under s 20(3H). The formula is:

    Full input tax deduction × percentage intended use

50. "Full input tax deduction" means the total amount of input tax on the supply. "Percentage intended use" means the extent to which the person intends to use the goods or services for making taxable supplies, estimated at the time of acquisition and expressed as a percentage (s 20(3I)).

51. When goods or services are acquired from outside the GST group, there will often be a clear intention as to the extent to which the goods or services are to be used to make taxable supplies. For example, a GST group that makes furniture might acquire timber to make tables. As the sale of tables is a taxable supply, the timber acquired is intended to be fully used to make taxable supplies. However, in other situations, it may be more difficult to estimate the intended use of the goods or services. This typically occurs when goods or services comprising of "overheads" are acquired. For example, it might be difficult to determine the extent to which electricity acquired to power a company's office building is used to make taxable supplies, where that company makes both taxable and exempt supplies.
52. To determine the "percentage intended use", the Commissioner's approach is to directly attribute those goods or services to making either taxable supplies or exempt supplies, where there is a clear intention of the extent to which the goods or services will be used. Where direct attribution is not possible, the extent to which the goods or services will be used to make taxable supplies compared to non-taxable supplies is estimated by apportioning on a reasonable basis.

Input tax deductions where goods or services are used to make taxable supplies

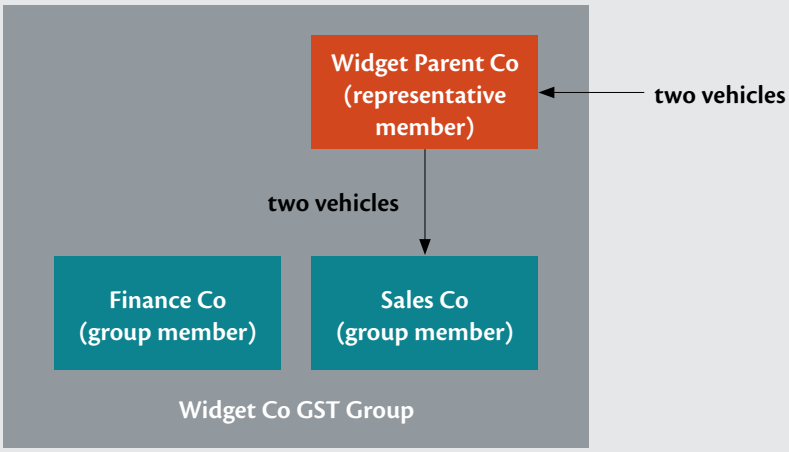
53. Example | Tauira 11 demonstrates how to calculate an input tax deduction where the goods or services acquired from outside the GST group are directly attributable to a taxable supply.

Example | Tauira 11 – Input tax deductions where goods or services are used to make taxable supplies

Widget Parent Co is the representative member of the Widget Co GST Group. Sales Co makes taxable supplies of widgets to third parties. Finance Co makes exempt supplies of financial services to third parties.

Widget Parent Co purchases two vehicles. The vehicles cost $23,000 each, including GST. Widget Parent Co supplies both vehicles to Sales Co for business use. The supply is an intra-group taxable supply and is disregarded.

Sales Co intends to use the vehicles in its business.



Widget Parent Co can claim a full input tax deduction of $6,000 in the group GST return on the purchase of the vehicles because the vehicles are intended to be wholly used by Sales Co to make taxable supplies.

Input tax deductions where goods or services are used to make taxable and exempt supplies

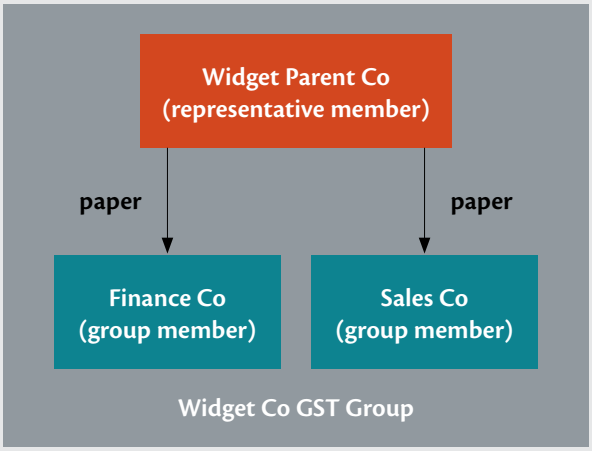
54. Where a supply of goods or services from outside the GST group cannot be directly attributed to a taxable supply, the GST group must apportion the input tax based on the GST group's estimate of the extent to which those goods or services are intended to be used to make taxable supplies (s 20(3G)). The GST group must choose a determination method that provides a fair and reasonable result.
55. Example | Tauira 12 illustrates how to calculate an input tax deduction where the goods or services acquired from outside the GST group cannot be directly attributed to a taxable supply.

Example | Tauira 12 – Input tax deductions where goods or services are used to make both taxable and exempt supplies

The facts are the same as in Example | Tauira 11.

Widget Parent Co purchases a pallet of photocopy paper from outside the GST group. Widget Parent Co supplies Sales Co and Finance Co with paper as required. These supplies are disregarded intra-group taxable supplies.

Widget Parent Co (as the representative member) wants to know if it can claim back the input tax on the purchase of the paper in the group GST return. Widget Parent Co has no record itemising how much paper Finance Co and Sales Co each used.



To determine the "percentage intended use" of the paper, it is not possible or realistic, given the nature of Widget GST Group's business, to directly attribute the paper to the making of taxable and exempt supplies. This means the extent to which the paper is intended to be used to make taxable supplies must be determined in another way. This generally involves determining the extent to which the paper is intended to be used to make taxable supplies based on the levels of supplies made by the group or some other reasonable basis and apportioning the input tax accordingly.

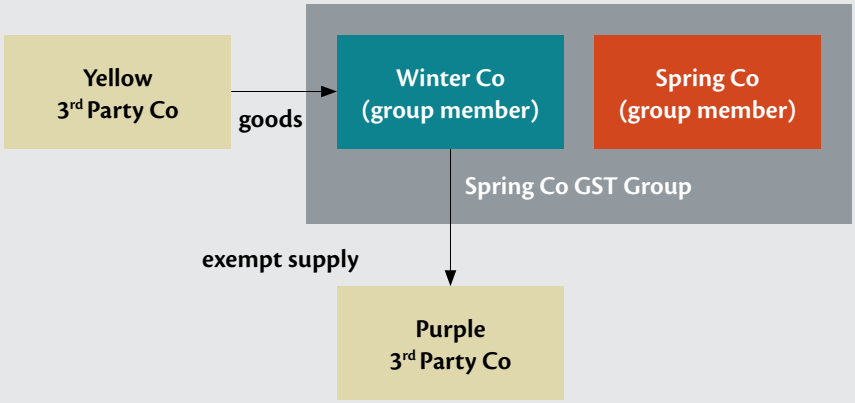
Therefore, the levels of taxable versus non-taxable supplies made outside the GST group would need to be measured in an appropriate way. This might be by using a turnover method or a profit-based method or another method that more fairly reflects the proportion of taxable supplies to total supplies. The method used would need to consider the nature of the businesses carried on by the GST group and the contribution of each group member. The "percentage intended use" would then be applied to determine the amount of input tax that could be claimed.

The representative member makes all change-in-use adjustments

56. Where a company acquires goods or services with the intention of making taxable supplies, but the actual use of those goods or services later changes, an input tax adjustment may be required (ss 21 and 21A).
57. The grouping rules contain a specific provision for dealing with adjustments where the goods or services were acquired before a company joined a GST group. For example, if a company acquires goods or services before joining a GST group, and that company intends to use those goods or services to make taxable supplies, s 55(1AH) treats the initial acquisition of the goods or services as made by the representative member. The grouping rules already treat any later application of those goods or services as made by the representative member, so in this way it is the same "person" acquiring the goods or services and subsequently applying them for a different purpose. This rule ensures the representative member can make any adjustments where there has been a change in use.
58. These consequences apply, unless the supply is a supply of imported services that s 8(4B) treats as made in New Zealand; or the GSTA expressly provides otherwise (s 55(1AC)).
59. Example | Tauira 13 illustrates how to make a change-in-use adjustment where a company acquires goods to make taxable supplies before grouping and those goods are subsequently applied to make an exempt supply once the GST group is formed.

Example | Tauira 13 – Change-in-use adjustment for goods acquired pre-grouping

Before Spring Co GST Group is formed, Winter Co acquires goods from Yellow 3rd Party Co with the intention of using those goods to make taxable supplies. Winter Co deducted input tax on this supply. After Spring Co GST Group is formed, Winter Co uses the goods to make an exempt supply to Purple 3rd Party Co.



If Winter Co was not part of Spring Co GST Group, it would need to make an adjustment for the change in use of the goods. As part of a GST group, an adjustment still needs to be made. This adjustment is made by Spring Co as the representative member.

Spring Co makes this adjustment because s 55(1AH) treats the initial acquisition of the goods by Winter Co (pre-grouping) to have been made by Spring Co. Spring Co is also treated as making the exempt supply to Purple 3rd Party Co, made in fact, by Winter Co.

60. Example | Tauira 14 illustrates how to make a change-in-use adjustment where the intended use of the goods differs from the actual use.

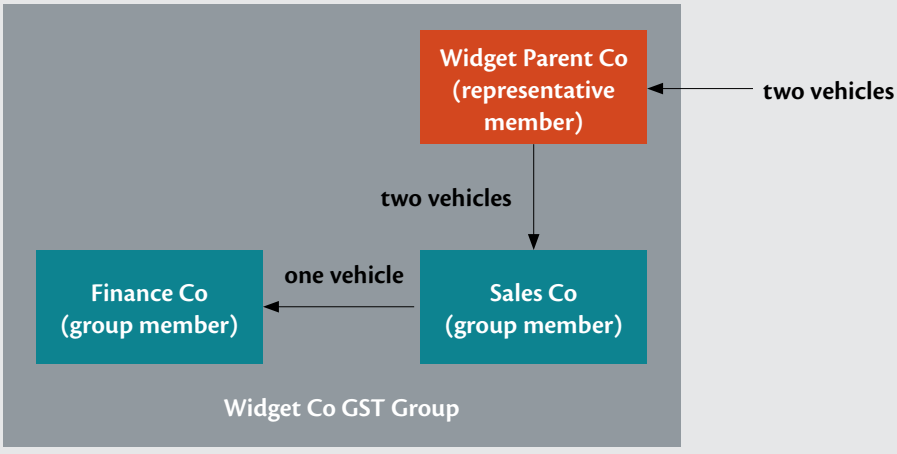
Example | Tauira 14 – Change-in-use adjustment where intended use differs from actual use

The facts are the same as in Example | Tauira 11.

Widget Parent Co purchases two vehicles. The vehicles cost $23,000 each, including GST. Widget Parent Co supplies the vehicles to Sales Co for business use. The supply is an intra-group taxable supply and so is disregarded.

Sales Co intends to use the vehicles in its business and it does so for the first year. In the following year, Sales Co sells one vehicle to Finance Co for $20,000. The supply is an intra-group taxable supply and so is disregarded. No output tax is charged on this supply. Finance Co uses the vehicle 100% to make exempt supplies.

Widget Co GST Group wants to know whether it needs to make a change-in-use adjustment.



In Example | Tauira 11, Widget Parent Co claimed a full input tax deduction in the group GST return on the purchase of the vehicles, because Sales Co intended to use both vehicles wholly to make taxable supplies.

In this example, an adjustment needs to be made to account for the permanent change in use of one of the vehicles (s 21A).

As the change in use (from 100% taxable to 100% exempt) is permanent and is not expected to change in future, s 21FB applies. The amount of the adjustment is calculated under s 21FB(2).

Section 21FB(2) provides that the Widget Co GST Group's adjustment for the adjustment period in which the change occurred is an amount calculated using the formula:

Full input tax deduction × new intended use percentage – previous net deductions

"Full input tax deduction" is the total amount of input tax on the supply, which is $3,000. The "new intended use percentage" is 0%, as the vehicle is to be used 100% to make exempt supplies. "Previous net deductions" is $3,000. Therefore, the formula gives a result of -$3,000. As the amount is negative, Widget Parent Co must treat the $3,000 as a positive amount of output tax and attribute it to the relevant adjustment period under s 20(4) (s 21FB(4)(b)).

Therefore, $3,000 is the amount Widget Parent Co must return when filing the group GST return.

Part 4: Further examples

61. The examples in this part concern more complicated transactions.
    - Cross-border intra-group taxable supplies (from [63]).
    - Financial services supplied to or between group members under the business-to-business regime (from [80]).
    - GST on capital-raising costs (from [87]).
    - Sale of a business by a GST group (from [90]).

Cross-border intra-group taxable supplies

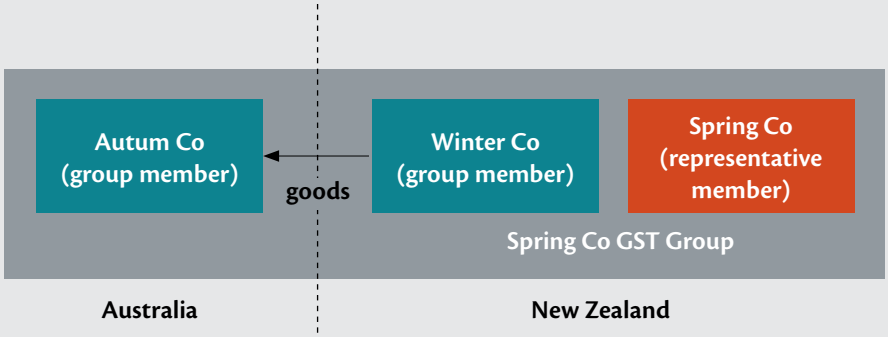
Exported goods

62. A supply of goods is zero-rated where the supplier enters the goods for export under the Customs and Excise Act 2018 (s 11(1)(d) of the GSTA). To be eligible for zero-rating, the goods must be entered for export within 28 days from the time of supply; otherwise, the supply is standard-rated (s 11(4)).
63. It may not always be possible to export goods within 28 days of the time of supply. In these circumstances, a supplier may apply to the Commissioner for an extension of time, provided they meet certain conditions (s 11(5)).
64. However, where the supplier and the recipient are part of the same GST group, it does not matter whether the supplier enters the goods for export within 28 days or not. The supply is an intra-group taxable supply and is disregarded (s 55(1AE)(b)). This outcome is consistent with branch treatment. If a New Zealand–resident company sends goods to its branch in Australia to sell to the Australian market, there is no supply when the goods are sent overseas so there are no GST consequences. When the goods are eventually sold in Australia, they may be zero-rated under either para (c) or para (j) of s 11(1) on the basis that the goods have been exported or that they are outside New Zealand at the time of supply and delivered to a recipient also outside New Zealand.
65. Example | Tauira 15 illustrates how the GST grouping rules apply when a New Zealand–resident company makes a taxable supply of goods to a non-resident company in the same GST group.

Example | Tauira 15 – Cross-border intra-group taxable supply of exported goods

Autumn Co has joined Spring Co GST Group. Autumn Co is an Australian-resident company that sells industrial torches to the New Zealand and Australian markets. It is eligible to be a part of Spring Co GST Group because it is registered for GST in New Zealand under s 51.

Winter Co sells a crate of torch lenses to Autumn Co. Before grouping, the goods would have been zero-rated as Winter Co entered them for export within 28 days of the time of supply. As the companies are now grouped, Spring Co GST Group would like to know how it should treat this supply.



The taxable supply of torch lenses between Winter Co and Autumn Co is an intra-group taxable supply and is disregarded (s 55(1)(AE)(b)).

If Winter Co had failed to enter the goods for export with 28 days, the outcome would be the same. The supply is an intra-group taxable supply and is disregarded. Therefore, Spring Co (as representative member) would not need to seek an extension of time under s 11(5) in relation to this supply.

Exported services

66. A supply of exported services is zero-rated where the services are supplied to a person who is not resident in New Zealand and who is outside New Zealand when the services are performed (s 11A(1)(k)).[8]

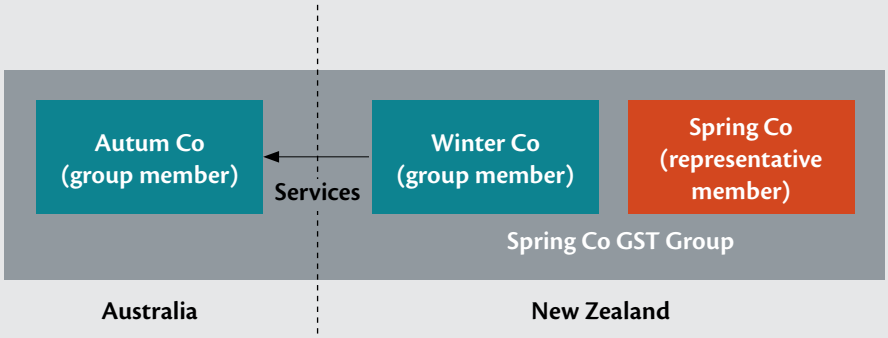
67. If a New Zealand–resident company makes a taxable supply of services to a non-resident company in the same GST group, the supply of exported services is disregarded. This outcome is consistent with branch treatment because supplies of services between branches are ignored for GST purposes.

68. Some exported services must be standard-rated. For example, exported services that are supplied directly in connection with land in New Zealand and are intended to enable a change in ownership of that land (s 11A(1)(k)(i)). However, if the companies supplying and receiving the services are part of the same GST group, this supply is disregarded. Example | Tauira 16 illustrates the GST treatment of a cross-border intra-group taxable supply of exported services.

[8] Provided those services are not supplied directly in connection with land, improvements to land or movable personal property situated in New Zealand; or if the services relate to the acceptance of an obligation to stop carrying on a taxable activity in New Zealand.

Example | Tauira 16 – Cross-border intra-group taxable supply of exported services

Winter Co makes a supply of exported services to Autumn Co. Spring Co GST Group would like to know how this supply should be treated for GST purposes.



If the companies were not grouped, the supply of services from Winter Co to Autumn Co would be a zero-rated supply under s 11A(1)(k). However, because Winter Co and Autumn Co are part of the same GST group and because the supply is a taxable supply of services between group members, the supply is disregarded (s 55(1AE)(b)).

If the supply between Winter Co and Autumn Co was a supply of conveyancing services provided to Autumn Co in relation to the sale of land that Autumn Co owned in New Zealand, the outcome would be the same. The supply is still an intra-group taxable supply of exported services and is disregarded instead of zero-rated under s 11A(1)(k)(i).

Imported goods

69. GST is levied on goods[9] imported into New Zealand at the rate of 15% (s 12). The New Zealand Customs Service collects this tax. GST is levied on imported goods by reference to their value (which includes the value of the goods, any freight costs and customs duty, if applicable). It is not levied on goods because a supply took place.

70. In addition, GST may be charged on the cross-border supply of goods if the goods are in New Zealand at the time of supply, or the goods are distantly taxable goods (s 8(3)). In these circumstances, GST is charged on the supply at the rate of 15%. However, if the goods are supplied for the purposes of carrying on the recipient's taxable activity, the goods are treated as supplied outside New Zealand, unless the supplier chooses to treat the supply as made in New Zealand (s 8(4)).

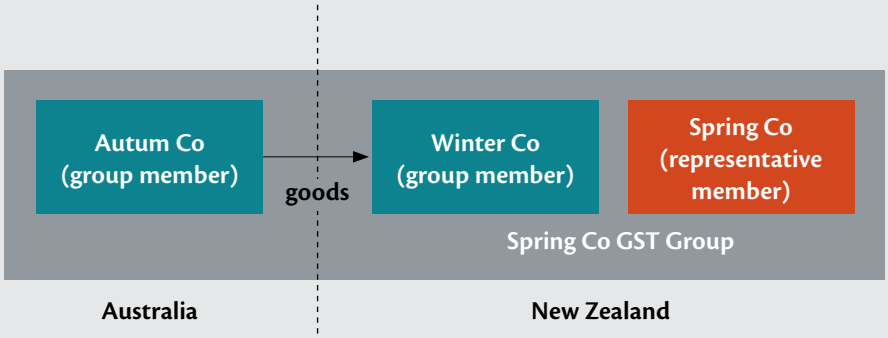
71. Where a GST group makes a cross-border intra-group supply of imported goods and the representative member is resident in New Zealand, the supply is treated as made in New Zealand by a New Zealand–resident, registered supplier. This is because the representative member is treated as carrying on the taxable activity of the non-resident company and under s 8(2) goods are treated as supplied in New Zealand if the supplier is resident in New Zealand. This is the case whether the goods are in New Zealand at the time of supply or not. As this is an intra-group taxable supply of goods, the supply is disregarded. Disregarding the supply ensures that there is consistent treatment between branches and companies. A cross-border transfer of goods between branches would also be disregarded for GST purposes. Customs duty may still apply.

72. Example | Tauira 17 illustrates the GST treatment of a cross-border intra-group taxable supply of imported goods.

[9] Except for fine metal and distantly taxable goods (goods valued at $1,000 or less (excluding GST)).

Example | Tauira 17 – Cross-border intra-group taxable supply of imported goods

Autumn Co makes an intra-group supply of goods to Winter Co. The goods are not in New Zealand at the time of supply. Spring Co GST Group want to know how to treat this supply for GST purposes.



GST of 15% is levied on the goods when they are imported into New Zealand (s 12(1)). Customs duty may also apply.

Under the GST grouping rules, Autumn Co's activity is treated as carried on by Spring Co, as a registered person (s 55(1AD)). Because Spring Co is a New Zealand resident, the supply is considered to take place in New Zealand and is a taxable supply, subject to GST at the rate of 15% (s 8(2)). However, because the supply is a taxable supply between two group members, it is disregarded under s 55(1AE)(b). This is the position, even if the goods are not in New Zealand at the time of supply.

Spring Co can claim back the GST levied under s 12, if the goods are acquired as part of Spring Co's taxable activity.

Imported services

73. Certain supplies of imported services may be subject to GST. If the requirements of s 8(4B) are met, a supply of imported services may be treated as made in New Zealand and therefore subject to GST. This is known as the "reverse charge". However, if the supply of imported services does not meet the requirements of s 8(4B), the supply may still be subject to GST if it is a supply of remote services under s 8(3)(c). The application of the GST grouping rules to the reverse charge and to remote services is discussed below.

Reverse charge

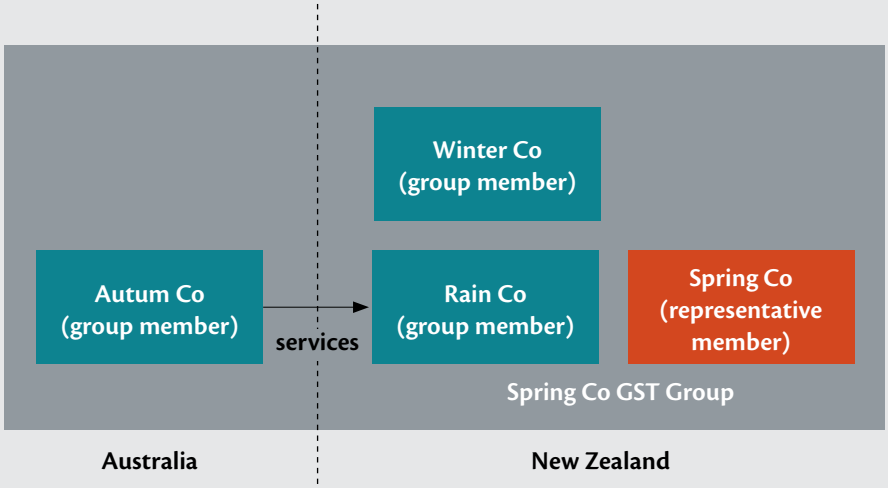
74. The reverse charge applies where a non-resident supplies services into New Zealand.[10] The reverse charge treats the supply of imported services as made in New Zealand by the recipient of the supply (s 5B). Therefore, the supply becomes subject to GST.

75. The reverse charge overrides the GST grouping rules. Therefore, if the reverse charge applies and a supply of imported services is treated as made in New Zealand, s 55(1AC)(a) provides that subss (1AD) to (1AI) of s 55 do not apply. The effect of s 55(1AC)(a) is that the single taxable company disappears, and each company in the GST group is recognised as a separate company. This means the intra-group taxable supply of imported services cannot be disregarded and must be included in the group GST return. Example | Tauira 18 illustrates this situation.

[10] The reverse charge also applies to a supply of goods, but only where the goods are imported by the recipient in a consignment with a total value of $1,000 or less, and the recipient does not pay GST to the New Zealand Customs Service or to the supplier (s 8(4B)(bb)). However, s 55(1AC)(a) only applies to a supply of services and not a supply of goods under s 8(4B).

Example | Tauira 18 – Cross-border intra-group taxable supply of imported services subject to the reverse charge

Autumn Co provides software services to Rain Co, a New-Zealand–resident subsidiary of Winter Co and a member of Spring Co GST Group. Rain Co is a financial services company. Spring Co GST Group would like to know how this supply should be treated for GST purposes.



The supply satisfies s 8(4B), so it is a taxable supply treated as taking place in New Zealand:

- the services are supplied by a non-resident supplier (Autumn Co) to a recipient in New Zealand (Rain Co);
- the recipient does not intend to use the services more than 95% in their taxable activity to make taxable supplies (Rain Co is a financial services company so makes mainly exempt supplies); and
- the supply of services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of their taxable activity.

Under s 55(1AC)(a), the intra-group taxable supply of imported services is not disregarded and must be included in the Spring Co GST group return. The Spring Co GST Group disappears for the purpose of this transaction, and each company in the group is recognised as a separate company.

Remote services

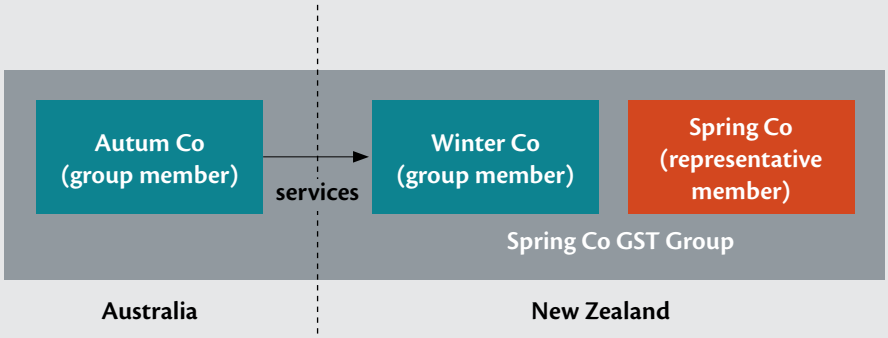
76. "Remote services" are services where, at the time of performance of the service, no necessary connection exists between the physical location of the recipient and the place where the services are physically performed (s 2). Remote services include services such as the supply of digital content and the online supply of games and publishing services.

77. If the recipient of the supply of imported services does not satisfy s 8(4B), for example, if the recipient intends to use the services 95% or more in their taxable activity, the reverse charge will not apply. However, if the supply is a supply of remote services, the supply is treated as being supplied in New Zealand under s 8(3)(c) and will still be a taxable supply, provided s 8(4D) does not apply (where remote services are supplied to a GST-registered company for the purpose of carrying on their taxable activity).

78. However, where there is a cross-border intra-group taxable supply of remote services and the representative member is resident in New Zealand, the supply is treated as made in New Zealand by a New Zealand–resident supplier. This is because the representative member is treated as carrying on the taxable activity of the non-resident company (discussed at [28]), and under s 8(2) the services are considered to be supplied in New Zealand if the supplier is resident in New Zealand. The supply is therefore an intra-group taxable supply and is disregarded. Unlike the reverse charge, the remote services rule does not override the GST grouping rules. Example | Tauira 19 illustrates this situation.

Example | Tauira 19 – Cross-border intra-group taxable supply of remote services

Autumn Co provides software to Winter Co. The supply does not satisfy s 8(4B) because Winter Co intends to use the services 95% or more in its taxable activity to make taxable supplies. Therefore, the reverse charge does not apply. Spring Co GST Group wants to know how to treat this supply for GST purposes.



Autumn Co's activity is treated as carried on by Spring Co, as a registered person (s 55(1AD)). Because Spring Co is a New Zealand resident, the supply is treated as taking place in New Zealand and is a taxable supply (s 8(2)). However, because the supply is a taxable supply between two group members, it is disregarded under s 55(1AE)(b).

Business-to-business supplies of financial services

79. Companies that elect into the business-to-business regime can zero-rate supplies of financial services to GST-registered financial services suppliers (s 20F).

80. Zero-rating is permitted if the level of taxable supplies the recipient makes in a 12month period is equal to or exceeds 75% of their total taxable supplies for the period (s 11A(1)(q)).

81. Zero-rating is also permitted even if the level of taxable supplies does not meet the 75% threshold, provided the recipient is part of a group that meets the threshold in a 12-month period, or a period acceptable to the Commissioner (s 11A(1)(r)). Section 11A(1)(r) applies only to recipients that are a group of companies under s IA 6 of the Income Tax Act 2007, rather than specifically to GST groups (although there may be overlap). If a GST group includes other entities, such as a partnership, then s 11A(1)(r) does not apply.

82. Business-to-business elections may be made by the representative member on behalf of the GST group. Paragraph [130] contains more information on GST group elections.

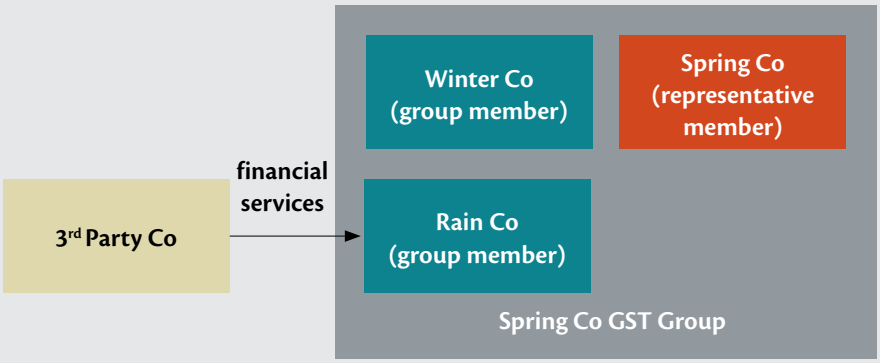
Business-to-business supplies of financial services to a GST group

83. Example | Tauira 20 illustrates how the business-to-business regime applies when financial services are supplied to a GST group.

Example | Tauira 20 – Financial services supplied to a GST group

3rd Party Co is a financial services provider that has elected into the business–to-business regime under s 20F. It wants to supply financial services to Rain Co.

Rain Co is registered for GST but does not, on its own, meet the 75% threshold required under s 11A(1)(q). However, Rain Co is part of Spring Co GST Group, which does meet the 75% threshold. Spring Co GST Group is also a group of companies under s IA 6 of the Income Tax Act 2007.



The "registered person" in s 11A(1)(r) is the GST group collectively. Therefore, under s 11A(1)(r) the supply can be zero-rated even if Rain Co does not meet the 75% threshold, because Rain Co is part of Spring Co GST Group, which meets the threshold in a 12-month period.

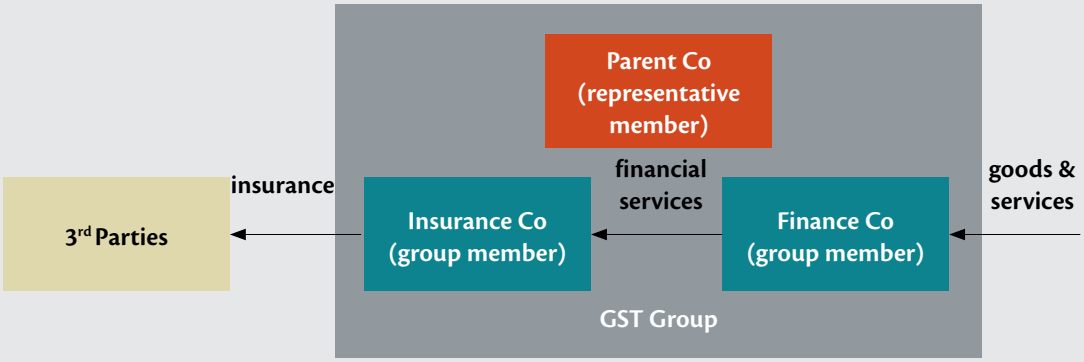
Business-to-business supplies between group members

84. A financial services supplier (known as the "first supplier") can deduct input tax where it supplies financial services to another financial services supplier (known as the "direct supplier") under the business-to-business regime (s 20C). The amount of that deduction is determined by the ratio of taxable to non-taxable supplies made by the direct supplier.

85. Where the first supplier and the direct supplier are members of the same GST group, the representative member is treated as both the first supplier and the direct supplier. This is because any exempt supply made by a member of the group is treated as made by the representative member and any supplies made to a member of group are treated as received by the representative member. Therefore, the representative member can deduct a portion of the input tax paid on goods and services acquired from outside the group using an appropriate method. This is illustrated in Example | Tauira 21.

Example | Tauira 21 – Business-to-business supplies between group members

Finance Co supplies financial services to Insurance Co. Insurance Co then supplies general insurance (40%) and life insurance (60%) to third parties based on the value of supplies made. Both companies have elected into the business-to-business regime under s 20F.



GST Group wants to know whether Parent Co, as the representative member, can deduct input tax on the supply of financial services that Finance Co made to Insurance Co.

Because the group is treated as a single company, all goods and services acquired by Finance Co that are used to make supplies of financial services to Insurance Co are deemed to be acquired by Parent Co as representative member. Similarly, all supplies made by Insurance Co outside of the GST group are deemed to be made by Parent Co as representative member. Therefore, Parent Co can deduct a portion of the input tax paid on goods and services acquired from outside the group using an appropriate method, which in this case may be the 60:40 split between life and general insurance made by Insurance Co. This means Parent Co can claim an input tax deduction of 40% of the input tax paid as those goods and services are used to make taxable supplies. This is on the same basis as in Example | Tauira 12, and does not require using s 20C.

GST on capital-raising costs – section 20H

86. Section 20H permits an input tax deduction on capital-raising costs where the registered person uses the capital raised to fund their taxable activity. The provision applies only to taxpayers who principally make taxable supplies and have not elected into the business-to-business regime.

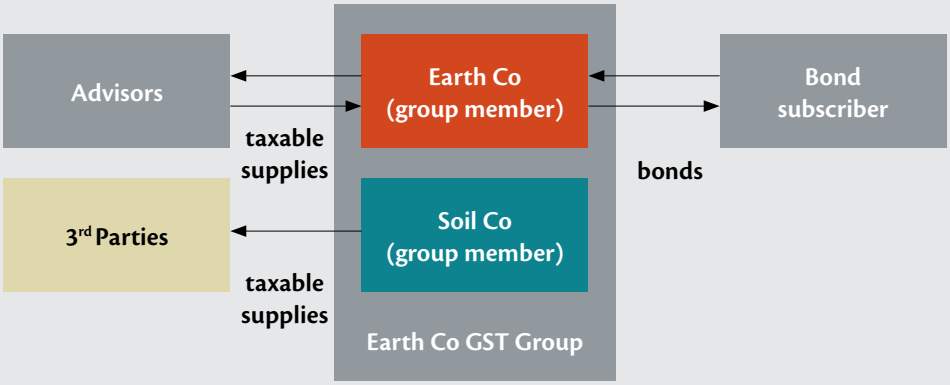
87. In a grouping context, where a parent or holding company raises finance for the benefit of the GST group, a question arises as to whether a s 20H deduction is available. This is because, in these circumstances, the parent or holding company might not principally make taxable supplies.

88. However, under the GST grouping rules, the "registered person" is interpreted as the GST group as a whole. If the GST group as a whole principally makes taxable supplies, a s 20H deduction can be claimed. Example | Tauira 22 illustrates this scenario.

Example | Tauira 22 – GST and capital raising costs

Earth Co and Soil Co are members of Earth Co GST Group. Soil Co is the operating company and carries on the taxable activity of earthworks. Earth Co is the holding company and representative member. Earth Co does not make many taxable supplies and effectively operates in a holding and financing role.

Earth Co GST Group needs to raise capital to finance the purchase of new machinery. Earth Co issues a bond and incurs legal and advisory fees.



Earth Co GST Group wants to know whether it can claim a deduction under s 20H for these capital-raising costs. As Earth Co is grouped with Soil Co (which makes taxable supplies), a full s 20H input tax deduction is available. This is because Earth Co, as the representative member, is treated as making Soil Co's taxable supplies and issuing the bonds.

Therefore, by treating the group as if it were a single company, Earth Co can claim the s 20H input tax deduction for its capital-raising costs because the group as a whole principally makes taxable supplies.

This outcome is consistent with the single taxable company approach. It also aligns group treatment with the treatment that occurs under a branch structure.

Sale of a business by a GST group

89. Some supplies of land must be zero-rated. Section 11(1)(mb) provides that a supply that wholly or partly consists of land must be zero-rated if at settlement date:
    - the supply is made by a registered person to a purchaser who is a registered person;
    - the purchaser acquires the goods (including land) with the intention of using them for making taxable supplies; and
    - the land included in the supply is not intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative.
90. If s 11(1)(mb) applies, the supply must be zero-rated, whether the land is the dominant element of the supply or not.
91. Example | Tauira 23 describes the GST treatment where members of a GST group sell their respective parts of a business to a single GST-registered purchaser, and one of those parts includes land. The Commissioner has been asked whether the GST grouping rules would operate to merge these single supplies into one composite, zero-rated supply.
92. The Commissioner considers that whether the supplies are a single, zero-rated composite supply or three separate supplies (of which only the supply of land is zero-rated) will depend on the terms of the contract and the true and substantial nature of what is being supplied. For a more detailed consideration of this issue, see **IS 18/04: Goods and Services Tax – single supply or multiple supply**.

Example | Tauira 23 – Sale of a business by a GST group

Three members of GST Group enter into three separate agreements to dispose of business assets to a GST-registered purchaser. Property Co is selling an interest in land, IP Co is selling intellectual property and Trading Co is selling stock and plant. Together, these assets are not sufficient to qualify as a zero-rated transfer of a going concern as there is not a supply of a taxable activity that is capable of separate operation (s 2).

Under the GST grouping rules, taxable supplies made by group members are treated as made by the representative member. GST Group wants to know whether this means there is a single supply by the representative member that includes land, so that the entire transaction must be zero-rated.

Trading Co, as the representative member, is treated as making all the separate supplies but they are not merged into a single, zero-rated, composite supply.

The GST treatment will depend on the terms of the contracts and the true and substantial nature of what is being supplied. In this example, it is likely that the three supplies would be seen as three separate supplies so the zero-rated sale of land by Property Co would not affect the GST treatment of the supply of the other assets. However, if more of the factors identified in IS 18/04 as supporting a single composite supply were present, then the supplies may be treated as a single, zero-rated, composite supply. Alternatively, the sale assets might be first transferred to one company in the group (and ignored as intra-group taxable supplies) before being sold outside the group as a single composite supply.

Part 5: Compliance and administration

93. This part discusses the compliance and administrative requirements for GST groups.
    - Applying to be a GST group (from [95]).
    - The role of the representative member (from [98]).
    - Accounting basis and taxable periods (from [104]).
    - Taxable supply information and supply correction information (from [113]).
    - Membership changes (from [119]).
    - Elections, notices and land statements (from [130]).
    - Joint and several liability (from [135]).
    - Cancelling a GST group (at [146]).

Applying to be a GST group

94. Two or more companies can apply to the Commissioner to register as a GST group if they meet the eligibility requirements discussed in Part 2.
95. Applications must be made by the company that has been nominated as the representative member of the intended GST group. The representative member can apply through myIR or by using the form *Goods and services tax application for group registration* (IR 374). Details on how to apply for GST group registration can be found on the Inland Revenue website: Register for GST as a group (ird.govt.nz).
96. If the Commissioner is satisfied the companies are eligible to be a GST group, the GST group will start from the beginning of a taxable period determined by the Commissioner (s 55(2)).

The role of the representative member

97. Where two or more companies apply to register as a GST group, they must nominate one of the companies as the representative member. This company must be GST-registered (s 55(3)).

98. The role of the representative member is central to the operation of a GST group. The representative member is treated as carrying on all activities that are carried on by group members. It is treated as making all supplies of goods or services made by members of the GST group to persons outside the group, and it is treated as receiving all supplies of goods or services made to members of the GST group from persons outside the GST group.

99. The representative member is treated as paying all tax that a member of the GST group pays (s 55(1AL)(b)). The representative member is also responsible for paying the tax payable by the members of the GST group to the Commissioner, subject to the joint and several liability obligations discussed from [135].

100. The representative member is responsible for filing GST returns for the GST group (s 55(1AL)(a)). It completes the group GST return using a standard GST return. The representative member files the return in its name, using its own registration number (no separate registration number is assigned to the GST group).

101. In addition, the representative member is responsible for keeping all records required by the GSTA (s 55(1AL)(a)). However, it shares this responsibility with the other group members (see from [137]).

102. The representative member is also responsible for:

- issuing taxable supply information and supply correction information for group members in some situations (see from [113]);
- applying to the Commissioner to alter the membership of a GST group (see from [119]); and
- making any elections on behalf of the GST group (see from [130]).

Accounting basis and taxable periods

103. When companies apply to be a GST group, they must choose a group accounting basis and a group taxable period. Once grouped, all members of the GST group use the chosen accounting basis and taxable period (s 55(1AK)).

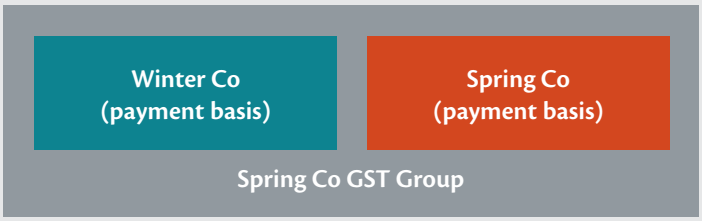
Accounting basis

104. Companies can account for GST using the invoice basis, the payments basis or the hybrid basis (s 19). In a grouping context, whether a group is eligible to use an accounting basis depends on the total value of all taxable supplies that the GST group is likely to make for the next 12 months, as if the group were a single company. This includes supplies unregistered members of the GST group are likely to make, if those supplies would be taxable if made by a registered person. This is because the representative member, as a registered person, is treated as making those supplies (discussed from [21]).

105. Once a GST group has chosen its group accounting basis, the representative member must record it in the GST group registration form (IR 374) or in the representative member's myIR account. If the chosen group accounting basis would require a change for a particular member, the Commissioner will contact that member and they may need to file a final wash-up return for the taxable period immediately before the members form the GST group. Example | Tauira 24 illustrates how a GST group chooses an accounting basis.

Example | Tauira 24 – Choosing an accounting basis

Before forming Spring Co GST Group, Winter Co and Spring Co each accounted for GST on a payments basis.



Winter Co estimates its total taxable supplies for the next 12 months are likely to be $1.5 million. Spring Co estimates that its total taxable supplies for the next 12 months are likely to be $1 million.

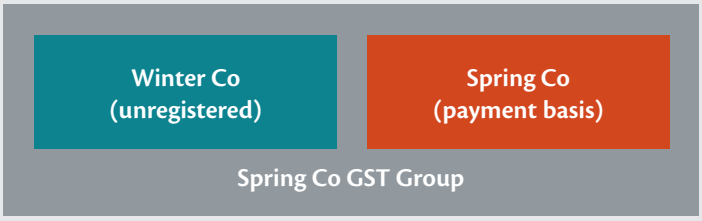
Combined, Winter Co and Spring Co's total taxable supplies for the next 12 months are likely to exceed $2 million. This means once they form Spring Co GST Group, the group would not be eligible to account for GST on a payments basis unless it successfully applies to the Commissioner for permission to do so.

For this reason, Spring Co and Winter Co decide that Spring Co GST Group should use the invoice basis.

106. Example | Tauira 25 illustrates how a GST group chooses an accounting basis when a group member is unregistered.

Example | Tauira 25 – Choosing an accounting basis where a company is not GSTregistered

Winter Co and Spring Co want to form a GST group. Spring Co is GST-registered and accounts for GST on a payments basis. Winter Co is not registered for GST because it does not meet the threshold for GST registration.



Winter Co estimates that, if it was GST-registered, its total taxable supplies for the next 12 months would likely be $50,000. Spring Co estimates that its total taxable supplies for the next 12 months are likely to be $1 million.

Combined, Winter Co and Spring Co's total taxable supplies for the next 12 months are not likely to exceed $2 million. This means Spring Co GST Group is eligible to account for GST on a payments basis.

Spring Co and Winter Co decide that Spring Co GST Group should use the payments basis when accounting for GST.

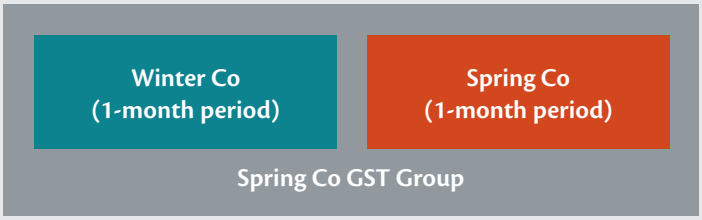
Taxable periods

107. In a grouping context, eligibility to use a particular taxable period is based on the total value of all taxable supplies likely to be made by the GST group for the next 12 months, as if the group were a single company. This includes supplies unregistered members of the GST group are likely to make, if those supplies would be taxable if made by a registered person. This is because the representative member, as a registered person, is treated as making those supplies (s 55(1AD) and discussed from [21]).

108. Once a GST group has chosen a taxable period, it needs to confirm this in the GST group registration form (IR 374) or in the representative member's myIR account. If the selected taxable period requires a change for a particular member, the Commissioner will contact that member and they may need to file a final return or part return for the taxable period immediately before the members form the GST group. Example | Tauira 26 illustrates how a GST group chooses a taxable period.

Example | Tauira 26 – Choosing a taxable period

Before forming Spring Co GST Group, Winter Co had a 1-month taxable period and Spring Co had a 2-month taxable period.



When the companies applied to the Commissioner to form Spring Co GST Group, they chose to file their GST returns on a 2-monthly basis. They could have chosen a 1month taxable period under s 15(3). The companies could not have chosen a 6month taxable period because collectively the GST group was expected to make taxable supplies of more than $500,000 in the next 12 months.

Distantly taxable goods or remote services

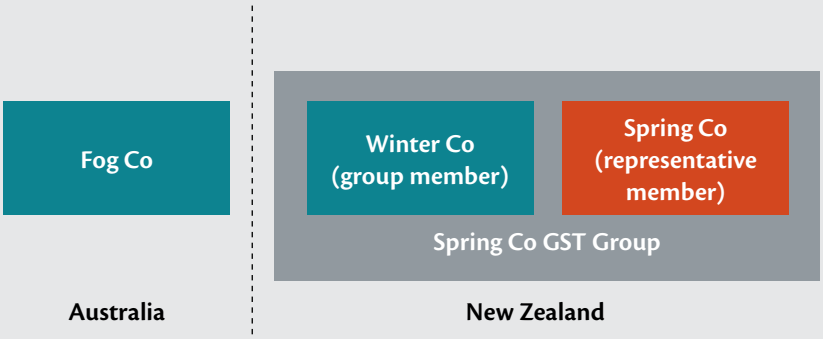
109. A non-resident supplier must use a 3-month taxable period if the only supplies they make are supplies of distantly taxable goods or remote services (ss 15(6) and 8(3)(c)). Therefore, if all members of a GST group are non-resident suppliers who only make supplies of distantly taxable goods or remote services, the GST group must use a 3-month taxable period.

110. However, a non-resident supplier who only makes supplies of distantly taxable goods or remote services may still form a GST group with a New Zealand–resident company or with other non-resident companies that do not only make supplies of distantly taxable goods or remote services. This is because s 15(6) applies to distantly taxable goods or remote services suppliers whose **only** supplies are supplies of distantly taxable goods or remote services. As the GST group collectively makes other supplies in addition to supplies of distantly taxable goods or remote services, it cannot use the 3-month taxable period. This approach is consistent with the GST group operating as a single company (s 55(1AB)).

111. Example | Tauira 27 illustrates how a GST group chooses a taxable period where a group member makes supplies of remote services.

Example | Tauira 27 – Taxable periods when a group member only makes supplies of remote services

Fog Co is an Australian-resident company, a subsidiary of Spring Co and a remote services supplier. It provides consultancy services to Spring Co GST Group. Spring Co GST Group has a 2-month taxable period. Fog Co (as a remote services supplier) has a 3-month taxable period. The group wants Fog Co to join Spring Co GST Group.



Section 55(1AK) requires all companies in Spring Co GST Group to have the same taxable period. As Fog Co will be part of Spring Co GST Group, and as the group collectively will make supplies in addition to Fog Co's supplies of remote services, s 15(6) does not apply. Therefore, Fog Co can join Spring Co GST group and must use a 2-month taxable period.

Taxable supply information and supply correction information

112. Section 55(1AM) permits a GST group to choose who issues and retains taxable supply information and supply correction information for a taxable supply. The GST group can choose to issue this information in the name of:
    - the representative member; or
    - the group member who actually makes the supply (known as the "active member"); or
    - another group member (known as the "issuing member").
113. If the GST group nominates an issuing member, the representative member must notify the Commissioner of the issuing member's identity and role (s 55(1AM)(b)(ii)).
114. The representative member, the issuing member or the active member must meet the requirements of ss 19J and 19L (s 55(1AN)). Under s 19L, taxable supply information must include the name and registration number of the supplier or the representative member and any other information that would be required if the supplier were not a member of a GST group. The taxable supply information is treated as provided by the issuing member or, if there is no issuing member, by the representative member.
115. Where a group member has issued taxable supply information or supply correction information, that group member must keep a record of the supply. That record must include the name, address and registration number (if registered) of the active member (s 19J).
116. Example | Tauira 28 illustrates how a GST group issues taxable supply information.

Example | Tauira 28 – Taxable supply information

Spring Co GST Group nominates Frost Co as the group's issuing member. Spring Co, as representative member, must notify the Commissioner of this decision (s 55(1AM)). Frost Co is then responsible for issuing and retaining all taxable supply information and supply correction information for the Spring Co GST Group's taxable supplies.

Frost Co ensures that all taxable supply information contains the name and registration number of Spring Co, as the representative member. Frost Co also keeps a record of each supply, including the name, address and registration number of the group member that makes the supply.

117. If taxable supply information or supply correction information is provided to a group member, that information is treated as provided to the representative member.

Membership changes

118. The representative member must apply to the Commissioner to make changes to the GST group's membership (s 55(4), (4AA), (4A) and (5)). It can make all applications through myIR. Unless otherwise specified, all eligible applications are granted from the beginning of the taxable period determined by the Commissioner.

Adding a member

119. The representative member must apply to the Commissioner to add a company to the GST group (s 55(4)(a)).
120. If the company is eligible to join the GST group, the application will be granted from the beginning of the taxable period determined by the Commissioner. However, if the company was incorporated less than 12 months before the date of application, and the company was eligible to be a member of the GST group when it was incorporated, the representative member may choose as the start date either the date of incorporation, or the start of the taxable period following the date of incorporation (s 55(4AA)).

Removing a member

121. The representative member must also apply to the Commissioner to remove a company from the GST group (s 55(4)(b)). If the removed company was GST-registered before joining the GST group, it will need to start filing its own GST returns and paying GST. The removed company may still be liable for any GST due while it was a member of the GST group (see [135]).

122. If the removed company is no longer eligible to use the GST group accounting basis and taxable period, it will need to choose a new accounting basis and taxable period.

Termination of membership because a company is no longer eligible

123. Where a company is no longer eligible to be a member of a GST group, that company or the representative member must notify the Commissioner of this status within 21 days (ss 53(1)(d) and 55(5)(a)).
124. The Commissioner may also terminate a company's GST group membership if the Commissioner is satisfied the company is no longer eligible to be part of the GST group (s 55(5)(b)).
125. In both situations, the company's GST group membership will be terminated from a date that the Commissioner specifies in a notice to the company or the representative member. This will usually be at the end of the taxable period in which the company ceased to be eligible. The terminated company may still be liable for any GST due while it was a member of the GST group (see [135]).
126. If the terminated company is no longer eligible to use the GST group accounting basis and taxable period, it will need to choose a new accounting basis and taxable period.

Appointing a new representative member

127. If a GST group wants to appoint a new representative member, the representative member must apply to the Commissioner to remove itself and to nominate another company as representative member (s 55(4)(c)).

Specified agents do not affect membership

128. The appointment of a specified agent does not affect the membership of a GST group (s 55(4A)). This means the incapacitated company continues to be a member of the GST group throughout the agency period.

Elections, notices and land statements

Elections

129. The representative member is responsible for making any elections required under the GSTA, on behalf of the GST group (s 55(1AL)(a) and (1AB)(a)(iii)). An election made on behalf of the GST group applies to all group members, while those members remain in the GST group. However, if a group member leaves a GST group, the election will no longer apply to the exiting member, unless the original election specified that is also applied to the member individually.

Notices

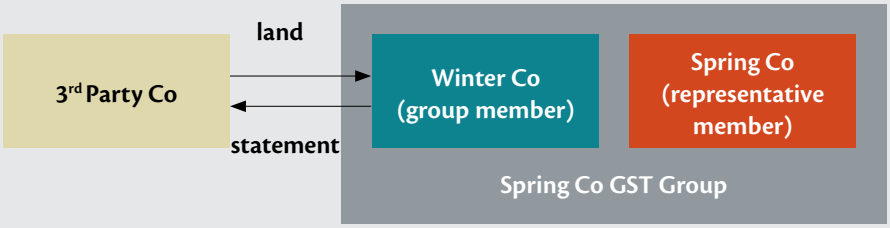
130. Any notices that are served under the GSTA and addressed to the representative member are treated as served on the representative member and on all members of the GST group (s 55(6)). The representative member is also responsible for serving any notices required under the GSTA on behalf of the GST group.

Land statements

131. The disclosure requirements for zero-rating land transactions are in s 78F. Section 78F requires a recipient of a supply of land to provide certain information to the supplier to enable the supplier to determine whether the supply should be zero-rated. The supplier may then rely on that information to determine the tax treatment of the supply. The recipient must provide the information in a written statement to the supplier. That statement must explain whether, at the date of settlement, the recipient:
    - is, or expects to be, a registered person;
    - is acquiring the goods with the intention of using them for making taxable supplies; and
    - does not intend to use the land as a principal place of residence (or an associated person does not intend to use the land in this way).
132. Section 55(1AI) states that information provided to or by a member of the GST group under s 78F is provided to or by the representative member.
133. The company buying or selling the land is obviously the entity that must provide or receive the s 78F statement. However, without s 55(1AI), the rules might have suggested that, because the representative member is treated as making or receiving the supply of land, the representative member must also provide or receive the s 78F statement. Section 55(1AI) clarifies that it is the company buying or selling the land that must provide or receive the s 78F statement. However, under the GST grouping rules, the representative member is treated as providing or receiving that statement. Example | Tauira 29 illustrates this situation.

Example | Tauira 29 – Land statements

Winter Co purchases land from 3rd Party Co, an unrelated company. Under s 78F, Winter Co must provide 3rd Party Co with a disclosure statement at the date of settlement (covering the factors set out in s 78F), so 3rd Party Co can determine the correct tax treatment of the supply of land.



Under s 78F, Winter Co must provide the disclosure statement to 3rd Party Co. However, under s 55(1AI), Spring Co, as the representative member, is treated as providing that statement.

Joint and several liability

134. A company that is, or has been, a member of the GST group is jointly and severally liable with the other members of the GST group for all tax payable and not paid by the representative member for each taxable period or part of a taxable period in which the company was part of the GST group (s 55(1AO)(a)).

135. Therefore, even though the representative member is considered to carry on the taxable activities of the group members, all group members share liability for any tax payable. In this way, s 55(1AO)(a) exposes a group member to liability beyond what they would otherwise be exposed to if they were not part of a GST group.

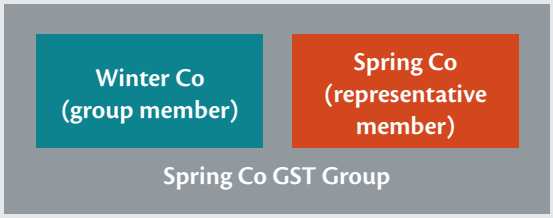
136. All group members remain responsible and liable for complying with:

- s 25 (adjustments for inaccuracies);
- s 75 (record-keeping) – for the activities of the member while part of the GST group; and
- Part 8 (registration) of the GSTA, if the company is a registered person when it was a member of the GST group (s 55(1AO)(b)).

137. These responsibilities are not affected by the company ceasing to be part of the GST group or by a representative member ceasing to exist (s 55(1AQ)). However, they may be relieved by the Commissioner (see from [143]).

138. Example | Tauira 30 illustrates how joint and several liability applies where a representative member is in liquidation.

Example | Tauira 30 – Joint and several liability where a representative member is in liquidation



Spring Co goes into liquidation without filing the latest group GST return for Spring Co GST Group. The GST group owes Inland Revenue $5,000. As Spring Co does not have enough funds to pay its share, Winter Co must pay the amount owing. This is because, under s 55(1AO)(a), Winter Co is jointly and severally liable for any tax payable and not paid by the representative member.

139. Example | Tauira 31 illustrates how joint and several liability applies where a company leaves the GST group.

Example | Tauira 31 – Joint and several liability where a company leaves the GST group

Frost Co leaves Spring Co GST Group at the end of March. In June, a calculation error is uncovered with the GST group's March GST return, with the result that an additional $5,000 of tax is payable. Spring Co contacts Frost Co and asks it to pay its share of the outstanding tax. Spring Co reminds Frost Co that it remains jointly and severally liable with Spring Co and Winter Co for all tax payable by the representative member for the taxable periods in which Frost Co was a member of Spring Co GST Group.

140. Example | Tauira 32 illustrates the responsibilities of group members when a group member decides to change its trading name.

Example | Tauira 32 – Responsibilities of group members when a member changes its trading name

Winter Co decides to change its trading name to Water Co. Winter Co asks Spring Co, as the representative member, to notify the Commissioner of this change.

Section 53(2) (in Part 8 of the GSTA) sets out the requirements for notifying the Commissioner of a trading name change. While Spring Co, as representative member, is treated as carrying on Winter Co's taxable activity, s 55(1AO)(b)(iii) means s 53(2) still applies to Winter Co as if it were not part of a GST group. Therefore, Winter Co must apply to the Commissioner to change its trading name.

141. Example | Tauira 33 illustrates the responsibilities of group members where a group member decides to cease trading.

Example | Tauira 33 – Responsibilities of group members where a member ceases trading

Winter Co decides to cease trading. Therefore, it will be leaving Spring Co GST Group and will need to cancel its GST registration. Winter Co asks Spring Co, as representative member, to notify the Commissioner of this decision.

Spring Co, as representative member, is responsible for notifying the Commissioner that Winter Co has left Spring Co GST Group (s 55(4)). However, Winter Co also has notification responsibilities. Under s 53(1)(d), Winter Co has 21 days to notify the Commissioner that it is no longer eligible to be a member of a group. Section 53(1)(d) (which is in Part 8 of the GSTA) applies to Winter Co as if it were not part of a GST group.

Relief from joint and several liability – exiting companies

142. Where a company leaves a GST group, the Commissioner may relieve that exiting company from joint and several liability for tax payable by the GST group if:
    - The Commissioner makes an assessment for a taxable period while the company was still a member of the GST group.
    - That assessment is made after the later of:
        - the date the company leaves the GST group, or
        - the date of the event that results in the company being treated as having left the group.
    - The amount assessed is more than an earlier assessment of the GST group for that taxable period or part of the taxable period.
    - The Commissioner considers the removal of joint and several liability will not significantly prejudice the recovery, or likely recovery, of the amount assessed and has notified the company and the representative member of this conclusion (s 55(1AP) and (1AQ)).
143. If the Commissioner relieves an exiting company from joint and several liability, that company is relieved from all reassessments of GST for all taxable periods when the company was part of the GST group. However, an exiting company will remain liable for any GST assessment or reassessment made before it exits the GST group.
144. Example | Tauira 34 illustrates how the Commissioner may relieve an exiting company from joint and several liability.

Example | Tauira 34 – Relief from joint and several liability for an exiting company

Spring Co GST Group was formed in 2020 with Frost Co, Winter Co, and Spring Co. On 31 May 2023, Frost Co is sold and Spring Co GST Group gets approval from the Commissioner under s 55(1AP) to remove Frost Co's joint and several liability.

Frost Co's GST joint and several liability is removed for any assessment of the Spring Co GST Group made after Frost Co exits the group, where that assessment increases the GST liability of the group for any taxable period from 2020 (when the GST group was formed) until Frost Co is sold out of the group.

However, Frost Co's joint and several liability remains for GST assessments made before Frost Co left the Spring Co GST Group.

This example is based on Example 131 in *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3.

Cancelling a GST group

145. The representative member must apply to the Commissioner to cancel a GST group (s 55(4)(d)). This application will be granted from the beginning of the taxable period determined by the Commissioner.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Customs and Excise Act 2018

Goods and Services Tax Act 1985 – ss 2 (definitions of "company", "going concern" and "remote services"), 5B, 8, 11, 11A, 12, 15, 19, 19J, 19L, 20, 20C, 20F, 20H, 21, 21A, 21D, 21FB, 21G, 51, 53, 54B, 55, 78F

Income Tax Act 2007 – ss IA 6, IC 3

Limited Partnerships Act 2008

Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022

Case references | Tohutoro kēhi

Case P4 (1994) 14 NZTC 4,024 (TRA)

Case R38 (1994) 16 NZTC 6,212 (TRA)

Other references | Tohutoro anō

GST Policy Issues (officials' issues paper, Policy and Strategy, February 2020).
taxpolicy.ird.govt.nz/publications/2020/2020-ip-gst-issues

IRRUIP 13: Consequences of GST Group Registration (April 2019).
taxtechnical.ird.govt.nz/issues-papers/2019/irruip13

IS 18/04: Goods and Services Tax – single supply or multiple supply, *Tax Information Bulletin* Vol 30, No 10 (November 2018): 5.
taxtechnical.ird.govt.nz/tib/volume-30---2018/tib-vol30-no10

IS 21/03: GST – Registration of non-residents under section 54B, *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3
taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no5

IS 22/07: Company losses – ownership continuity, sharing and measurement, *Tax Information Bulletin* Vol 34, No 11 (December 2022): 23.
taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no11

IS 24/03: GST – Who can group register?

IS 24/03: GST – Who can group register?

Issued | Tukuna: 22 March 2024

This interpretation statement considers who can group register under s 55 of the Goods and Services Tax Act 1985. All legislative references are to the Goods and Services Tax Act 1985 (GSTA) unless otherwise stated.

Summary | Whakarāpopoto

1. This interpretation statement provides guidance on who can form a GST group. It makes the following key points.

Groups of companies – s 55(1)

2. Under s 55(1), two or more companies can group register if they are a "group of companies" or part of a "group of companies" under s IC 3 of the Income Tax Act 2007. This requires that a "group of persons" holds 66% common ownership interests in the companies.
3. The GSTA specifies that look-through companies, multi-rate portfolio investment entities (PIEs) and listed PIEs can be members of a group of companies under s 55(1) if they meet the 66% common ownership interests test (despite not qualifying for inclusion in a "group of companies" under s IC 3 of the Income Tax Act 2007).
4. Limited partnerships registered under the Limited Partnerships Act 2008 (LPA 2008) similarly cannot be members of a group of companies under s IC 3 of the Income Tax Act 2007. This is because the tests used to determine common ownership interests in s IC 3 cannot be applied to limited partnerships. However, the GSTA specifies that limited partnerships can be members of mixed groups under s 55(8) (see from [8]).
5. Companies that are not GST-registered persons (**unregistered companies**) can be members of GST groups of companies under s 55(1), provided the group meets a "75% taxable supplies" requirement (see from [28]) (and provided the proposed group members meet the other requirements for GST grouping).
6. Non-resident companies can be members of GST groups of companies under s 55(1) (provided the proposed group members meet the requirements for GST grouping in that section). Non-resident companies (whether registered under s 51 or unregistered) may be members of GST groups that have New Zealand resident members, provided, if they are unregistered, they meet the requirements set out at [5].
7. Non-resident companies that do not make taxable supplies in New Zealand (and meet the other relevant requirements) may register under s 54B. A non-resident cannot become a member of a GST group with New Zealand resident members while it is registered under s 54B (even if it would otherwise qualify to do so), as discussed from [154].

Mixed groups – s 55(8)

8. Under s 55(8), registered persons that are under common control can be members of a GST group. A group formed under s 55(8) (a **mixed group**) must contain at least one non-company or at least one limited partnership. All members must be registered persons. There is no requirement for a mixed group to contain a company.
9. Under s IC 3 of the Income Tax Act 2007, a "group of persons" must hold 66% common ownership interests. In contrast, under s 55(8):
   - **one person** in the GST group must control each of the others; or
   - **one person** outside the GST group must control all the GST group members; or
   - **two or more persons carrying on a taxable activity in partnership** must control all the GST group members.
10. "Control" in s 55(8) means legal control: *Case K54* (1988) 10 NZTC 444. Legal control means control through an identifiable legal power vested in a particular person or persons outside the entity. For example, they may have the power to vote in respect of company shares.
11. The meaning of legal control under s 55(8) for each of these types of GST registered persons is:
    - For **individuals** (eg sole traders) – an individual acting in their individual capacity (eg as a sole trader) is registered for GST in this capacity. The question of control does not arise for an individual who is registered for GST in their individual capacity.
    - For a **company** – legal control is in the hands of the shareholder holding a majority (ie greater than 50%) ownership interest (discussed further at [24], [26] and [66]). That interest is calculated under s IC 3 of the Income Tax Act 2007, with some modifications.

- For a **trust** – generally, the trustee or trustees of a trust have control, acting in their capacity as trustee(s) of that trust. Because of the different capacity, trusts with the same trustee(s) cannot usually group with each other; that is, the trustee of one trust is treated as a different "person" from the same trustee acting in their capacity as trustee of another trust. However, if under the trust deed another person has the power to appoint and remove the trustees of a trust, the Commissioner considers that the person holding the power to appoint and remove trustees controls the trust.
- For a **partnership** – as a starting point, a majority of partners acting together exercise legal control, unless the partnership agreement makes a lawful modification to this. Partnership agreements will frequently modify the presumption in the legislation that partners have equal voting power and share profits equally.
- For a **limited partnership** – a partner who can make "resolutions of the limited partnership" has legal control. This is usually a limited partner who has contributed at least 75% of the total partnership capital (although the written partnership agreement may modify this). Where capital contributions are split across several limited partners, however, this approach may establish that no "one person" controls the limited partnership. In some cases, it may be possible to identify who controls a limited partnership by referring to the respective partnership interests of the partners.
- For a **joint venture** – the respective interests of the joint venturers determine legal control. In most cases the voting powers of the joint venturers as set out in the joint venture agreement will show who has legal control. However in some cases there may be legal arrangements in place which mean the ordinary voting powers of the joint venturers under the joint venture agreement will not show who has legal control. An alternative approach may be required, eg to refer to the joint venturers' respective capital contributions and income entitlements as set out in the joint venture agreement or elsewhere. If the joint venture agreement requires all decisions to be made unanimously, it may be that no "one person" controls the joint venture.

12. A non-resident (company or non-company) may join a mixed group if it is a registered person and meets the control test described at [9].

Introduction | Whakataki

13. We have been asked to clarify the Commissioner's position on who can group register for GST under s 55. This interpretation statement updates and replaces "QB (July 2004): GST Group Registration of Trusts".[1]
14. There are two tests for group registration. First, under s 55(1), companies that qualify as a "group of companies" under s IC 3 of the Income Tax Act 2007 (companies with at least 66% common ownership interests) can group register. Second, under s 55(8), non-companies and limited partnerships may group register (with or without companies) as a mixed group if they are under common control.
15. This interpretation statement covers:
    - which entities can register as a GST group of companies under s 55(1);
    - which registered persons can register as a mixed group under s 55(8); and
    - various practical matters including how to register a GST group, and when to register a group consisting only of non-residents (eg, persons registered under s 54B).
16. For summary tables by entity, see from [163].

[1] *Tax Information Bulletin* Vol 16, No 6 (July 2004): 32.

Groups of companies

17. Section 55(1) sets out when two or more "companies" are eligible to be a GST group. The following are the requirements for grouping under s 55(1):
    - There must be two or more "companies".
    - Under s IC 3 of the Income Tax Act 2007, the "companies" are a group of persons (the **eligibility group**) that:
        - is a group of companies; or
        - is part of a group of companies; or
        - would be a group of companies but is not, only because one or more members are a multi-rate PIE or a look-through company; or
        - would be a group of companies but is not, only because one or more members are a listed PIE.
    - The companies meet **either** or **both** of the following requirements:
        - The companies are each a registered person.
        - The companies, as the eligibility group (in a 12-month period that includes the current time) make at least 75% taxable supplies (as a percentage by value of their taxable and other supplies) to persons outside the eligibility group. For this purpose, "taxable supplies" include supplies that would be "taxable supplies" if a registered person made them.

The definition of "company"

18. Section 2 sets out the definition of "company". A "company" as defined means any body corporate whether incorporated in New Zealand or elsewhere; but does not include a local or public authority.
19. Section 2 confirms that a limited partnership registered under the LPA 2008 is a "company" under the GSTA.[2] However, limited partnerships cannot be members of "groups of companies" under s IC 3 of the Income Tax Act 2007. Limited partnerships are therefore grouped under s 55(8) (see from [37]).
20. A look-through company is a body corporate and may group under s 55(1).
21. Multi-rate PIEs and listed PIEs are treated as companies for GST grouping purposes and may group under s 55(1).

The "group of companies" rules in s IC 3, Income Tax Act 2007

22. Under s 55(1), two or more companies are eligible to be a GST group if they are a "group of companies" or part of a "group of companies" under s IC 3 of the Income Tax Act 2007. Two or more companies are also eligible to be a GST group if they would be a "group of companies" but are not, only because one or more members are a multi-rate PIE, a look-through company or a listed PIE.
23. The "group of companies" test in s IC 3 of the Income Tax Act 2007 requires 66% common ownership between the companies that are members of the group.
24. Specifically, a "group of companies" means two or more companies, in relation to which a group of persons holds:
    - common voting interests that add up to at least 66%; and
    - if a market value circumstance exists for a company that is part of a group of companies, common market value interests that add up to at least 66%.
25. For **income tax** purposes, a look-through company cannot be a member of a "group of companies", and multi-rate PIEs and listed PIEs require 100% common ownership to be members of a "group of companies". However, for **GST grouping** purposes, these restrictions are ignored. Look-through companies, multi-rate PIEs and listed PIEs are eligible to be members of GST groups under s 55(1) if they meet the 66% common voting interests test and, if applicable, the 66% common market value interests test.

[2] A limited partnership registered under the LPA 2008 is a "body corporate". See "QB 14/03: Goods and Services Tax – Transfer of interest in a partnership", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 57. (See references section for link.)

26. For information on how to calculate common voting interests and common market value interests, see "IS 22/07: Company losses – ownership continuity, sharing and measurement".[3]

Company shares held on bare trust

27. Where a company's shares are held on bare trust for a beneficiary, for the purposes of deciding whether the company is a member of a "group of companies" under s IC 3 of the Income Tax Act 2007, its shares will be treated as held by the beneficiary of the bare trust (s YB 21, Income Tax Act 2007).[4]

Unregistered companies

28. Under s 55(1)(b), two or more companies are eligible to be a GST group if they meet **either** or **both** of the following requirements:
    - At the time, they are each a registered person.
    - The companies, as the eligibility group (in a 12-month period that includes the current time) make at least 75% taxable supplies (as a percentage by value of their taxable and other supplies) to persons outside the eligibility group. For this purpose, "taxable supplies" include supplies that would be "taxable supplies" if a registered person made them.
29. Section 55(1)(b) allows for unregistered companies to be members of GST groups, provided the group meets the 75% taxable supplies requirement (see Example | Tauira 1).
30. In contrast, under s 55(8), the GST group must consist of "registered persons".

An unregistered company cannot be the representative member of a GST group

31. An unregistered company cannot be the representative member of a GST group (s 55(3)(b)).[5] An application for registration as a group of companies should name a GST registered company as the proposed representative member of the group.

[3] *Tax Information Bulletin* Vol 34, No 11 (December 2022): 53. Some provisions discussed in IS 22/07 are only relevant to the loss continuity rules. The provisions relevant to s IC 3 "groups of companies" are ss YC 2 – YC 6, s YA 5, s YB 21, and the related definitions in s YA 1 of the Income Tax Act 2007.

[4] See also "QB 16/03: Goods and Services Tax – GST treatment of bare trusts", *Tax Information Bulletin*, Vol 28, No 5 (June 2016): 16. (See references section for link.)

[5] Every GST group must have a representative member. The representative member is the person generally responsible for carrying out tasks such as making returns, keeping records and paying tax for the group. This role is central to the operation of a GST group.

Example | Tauira 1 – A group of companies with an unregistered holding company charging management fees

Companies A, B and C are members of a group of companies under s IC 3 of the Income Tax Act 2007 (A owns 100% of the shares of both B and C). Companies A, B and C are all New Zealand residents for GST purposes.

A does not make taxable supplies, other than supplies of management services to B and C. To date, A's supplies to B and C have not exceeded the $60,000 registration threshold in a 12-month period and are not expected to do so in the next 12 months. In addition, A has not voluntarily registered for GST. A is therefore an unregistered company.

B and C are trading companies. They are each registered for GST. B makes a mix of taxable and exempt supplies to third parties. C makes only taxable supplies to third parties. B and C do not make supplies to each other or to A.

The GST exclusive value of B's supplies to persons outside the group in the 12-month period that includes the time is:

Taxable supplies	$100,000
Other supplies	$ 50,000

The GST exclusive value of C's supplies to persons outside the group in the 12-month period that includes the time is:

Taxable supplies	$100,000
Other supplies	$0

This means the supplies of the eligibility group are:

Taxable supplies	$200,000
Taxable and other supplies	$250,000

The "taxable supplies percentage" is:

taxable supplies/taxable and other supplies x 100/1

$200,000/$250,000 = 0.8 x 100/1 = 80%

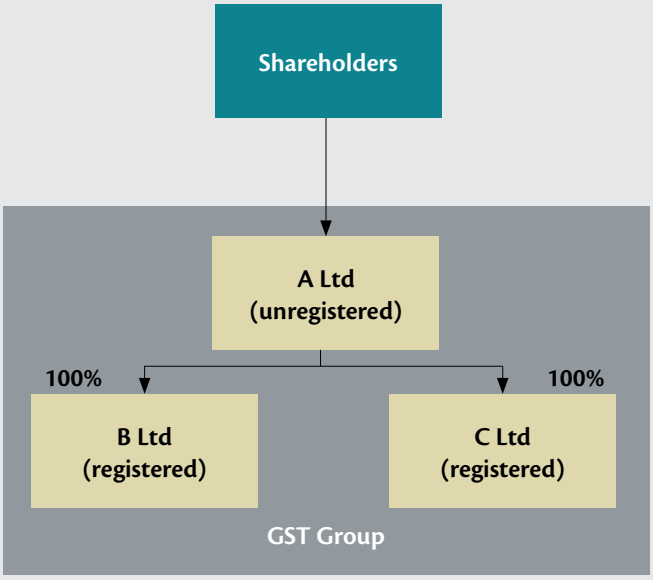
This is more than 75%, so meets the (at least) 75% taxable supplies requirement.

B and C can be members of GST group on the basis that they:

- are part of a group of companies; and
- are each a registered person.

Alternatively, A, B and C can be members of a GST group on the basis that:

- they are a group of companies; and
- the total value of their taxable supplies made to persons outside the group is at least 75% of the total value of all their supplies made to persons outside the group in the 12-month period that includes the time of testing their eligibility for grouping.



A, B and C opt to group all three companies. This means that A does not have to charge GST on the supplies of management services it makes to B and C as they are ignored under the GST grouping rules. Note that A cannot be the representative member of the GST group because A is not registered. Any input tax A incurs that relates to the group's taxable supplies can be recovered by the representative member.

Non-resident companies

32. Non-residents may be required to register for GST under the general registration provision (s 51). This may be because they carry on a taxable activity and have made taxable supplies in New Zealand over the GST registration threshold of $60,000 in the previous 12-month period, or because they intend to do so in the next 12-month period. Non-residents may also be entitled to register voluntarily under s 51 because they carry on a taxable activity somewhere in the world (the term "taxable activity" is not limited to an activity carried on in New Zealand) and do not make taxable supplies in New Zealand that exceed the $60,000 threshold: see Registering for GST (ird.govt.nz) and GST for overseas businesses (ird.govt.nz).
33. However, the Commissioner is entitled to deregister a non-resident that does not make taxable supplies in New Zealand (s 52(7)). Such persons may be entitled to register under s 54B (if they meet the relevant criteria): see from [155].
34. A non-resident company can be a member of a "group of companies" under s IC 3 of the Income Tax Act 2007: *CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175 (CA).
35. There is nothing that specifically prevents a non-resident company from being a member of a GST group. Therefore, if a non-resident is a member of a s IC 3 group of companies, it can be a member of a GST group made up of all or part of the s IC 3 group of companies if **either** or **both** of the following apply:
    - the companies are registered for GST in New Zealand.
    - the companies, as an eligibility group, meet the 75% taxable supplies requirement.
36. Example | Tauira 1 illustrates the 75% taxable supplies requirement. Example | Tauira 2 shows how a non-resident company may be part of a GST group.

Example | Tauira 2 – A group of companies with an unregistered holding company includes a non-resident company

Companies A, B and C are members of a group of companies under s IC 3 of the Income Tax Act 2007 (A owns 100% of the shares of both B and C).

A is a New Zealand resident for GST purposes. A does not make taxable supplies, other than supplies of management services to B and C. To date, A's supplies to B and C have not exceeded the $60,000 registration threshold in a 12-month period and are not expected to do so in the next 12 months. In addition, A has not voluntarily registered for GST. A is therefore an unregistered company.

B is a New Zealand resident for GST purposes. B is a trading company and is registered for GST.

C is Australian resident for GST purposes. However, C makes taxable supplies in New Zealand over the registration threshold so is registered for GST in New Zealand.

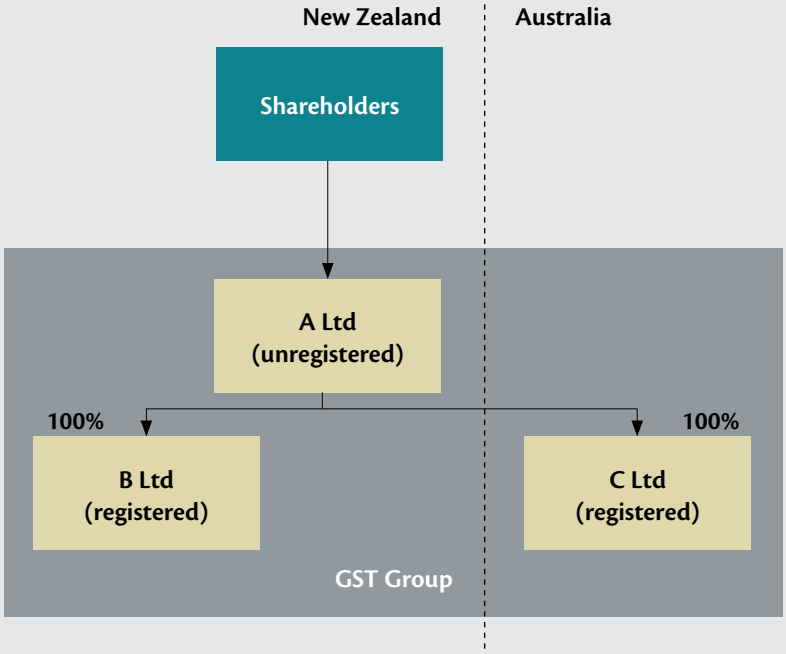
The taxable supplies percentage for the eligibility group consisting of A, B and C is 80%. (For the calculation method, see Example | Tauira 1.)

B and C can be members of a GST group on the basis that:

- they are part of a group of companies; and
- they are each registered for GST.

Alternatively, A, B and C can be members of a GST group on the basis that:

- they are a group of companies; and
- the total value of their taxable supplies made to persons outside the group is at least 75% of the total value of all their supplies made to persons outside the group in the 12-month period that includes the time of testing their eligibility for grouping.



A, B and C opt to group all three companies, with B as the representative member. This means that A does not have to charge GST on the supplies of management services it makes to B and C as they are ignored under the GST grouping rules. The supplies that C makes in New Zealand will continue to be taxable (or exempt) as they were prior to grouping taking effect. Supplies that C makes outside New Zealand will be brought within the scope of NZ GST. However, such supplies will generally be zero-rated supplies.

Mixed groups

37. Section 55(8) sets out when two or more "registered persons" that include a non-company or a limited partnership are eligible to be members of a GST group (a **mixed group**).

38. The requirements for grouping under s 55(8) are as follows:

- There is a group of two or more "registered persons".
- At least one of the persons is not a "company", or is a "company" but is a limited partnership.
- The Commissioner is satisfied in relation to the members of the group that:
  - one of them controls each of the others (s 55(8)(a)); or
  - one person controls all of them (s 55(8)(b)); or
  - two or more persons carrying on a taxable activity in partnership control all of them (s 55(8)(c)).

39. The first bullet at [38] requires that the persons are "registered persons". A "registered person" is a person who is registered or who is liable to be registered under the GSTA. A person is liable to be registered if they carry on a taxable activity and have made taxable supplies in New Zealand over the GST registration threshold of $60,000 in the previous 12-month period or there are reasonable grounds for believing they will do so in the next 12-month period. A person may register voluntarily if they carry on a taxable activity and their taxable supplies in New Zealand are below the registration threshold (see Registering for GST (ird.govt.nz)). A non-resident can be a member of a mixed group if it is a registered person and meets the "control" requirements discussed from [42].

40. The second bullet at [38] requires that at least one of the persons is not a "company", or is a company but is a limited partnership. We discussed the meaning of "company" from [18]. There is no requirement for a mixed group to contain a company.

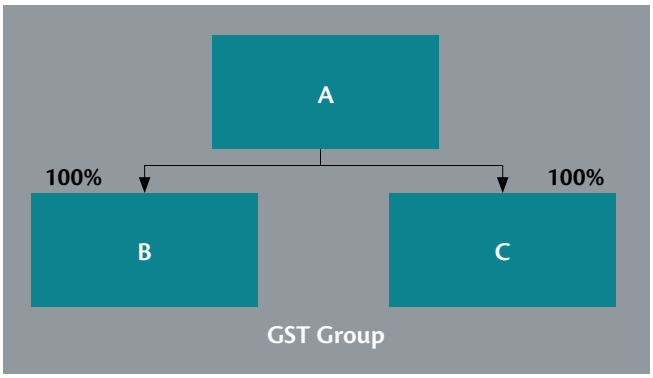
41. The description "mixed" is used because such groups are likely to consist of a mix of persons, such as sole traders, partnerships, trusts, and companies. However, there is no requirement for there to be more than one type of person in a mixed group (as long as at least one of the group members is a non-company or is a limited partnership). For example, two trusts may form a mixed group, or two partnerships may form a mixed group, if they are both registered persons and the control requirements (discussed from [42]) are met.

42. The third bullet at [38] explains how to determine common control for s 55(8) purposes. Unlike under s 55(1), where a group of companies may be under 66% common control of a "group of persons", common control under s 55(8) requires that **one person**, or **two or more persons carrying on a taxable activity in partnership**, exercise common control of the registered persons seeking to group register.

43. The following figures illustrate the common control requirements in s 55(8).

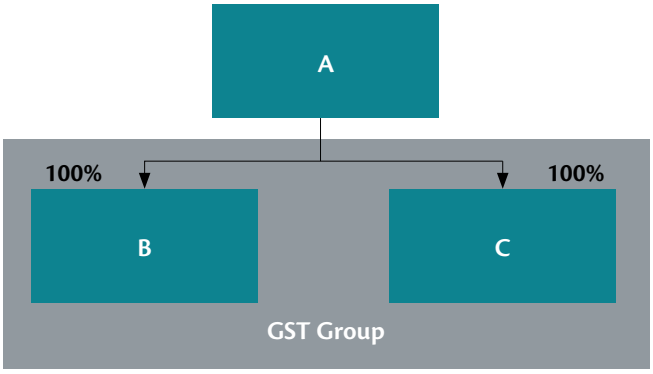
44. Figure | Hoahoa 1 illustrates the first of the three possible ways registered persons may group under s 55(8) (one member of the group controls each of the others). In this scenario, A, B and C can be members of a mixed group. This is because A (a member of the group) controls B and C.

Figure | Hoahoa 1 – Common control: one group member controls each of the others



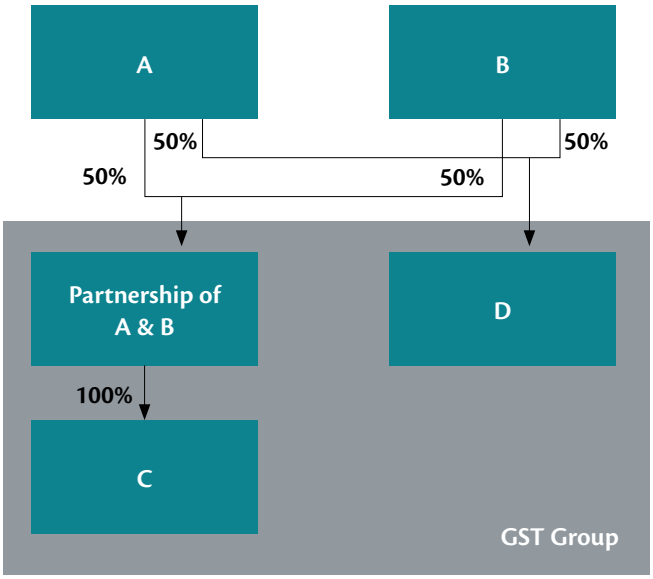
45. Figure | Hoahoa 2 illustrates the second way registered persons may group under s 55(8) (one person controls all of the group members). In this scenario, B and C can be members of a mixed group. This is because A controls B, and A also controls C.

Figure | Hoahoa 2 – Common control: one person controls all of the group members



46. Figure | Hoahoa 3 illustrates the third way registered persons may group under s 55(8) (two or more persons carrying on a taxable activity in partnership control all of the group members). In this scenario, a partnership of A and B, and persons C and D can be members of a GST group. This is because two persons carrying on a taxable activity in partnership (A and B) control all of them.

Figure | Hoahoa 3 – Common control: two or more persons carrying on a taxable activity in partnership control all of the group members



47. For information on how to apply for group registration, see from [150]. For information on the consequences of GST grouping, refer to IS 24/02: GST – Grouping for companies. While IS 24/02 focuses on the GST grouping rules as they apply to companies, the same principles may apply to persons that are eligible to form a mixed group.

48. For the rest of this section, we discuss the meaning of "control" in s 55(8) and comment on matters relevant to the control of the following types of persons:

- individuals;
- companies;
- trusts;
- general partnerships;
- limited partnerships; and
- joint ventures.

Meaning of "control" in s 55(8)

49. The term "control" is not defined in the GSTA (or in the Income Tax Act 2007).

50. The *Oxford English Dictionary* defines "control" as follows:[6]

> **control, *v***, 3. a. *transitive*. To exercise power or authority over; to determine the behaviour or action of, to direct or command; to regulate or govern.

Case K54

51. The Taxation Review Authority (TRA) considered the meaning of "control" in s 55(8) in *Case K54* (1988) 10 NZTC 444. Three cases were considered together.

52. Judge Bathgate held that the test for GST groups of companies in s 55(1) (which was based on s 191 of the Income Tax Act 1976 – now s IC 3 of the Income Tax Act 2007) should be used as a guide. This was on the basis that the test relied on for GST groups of companies (two-thirds or 66% common ownership interests) gives the persons holding the rights (typically shareholders) a discernible and usually effective source of control of all the companies in the group. The rights give the shareholders legal control of the group. The rights may not always give the shareholders "de facto" (ie factual) control, but no provision in s 191 (now s IC 3), or in s 55 of the GSTA, specified a factual control test:

> The common question in issue in each of the cases is what is meant by "control" or "controls" in the sec 55(8) of the Goods and Services Tax Act. **I think that question is to be answered by looking at the situation where all members of a group are companies, because there seems no good reason to differentiate between a situation for grouping when all members are companies to that when only some members are companies, or where there are no members who are a company.** Because companies depend on formal statutory or discernible written powers and liabilities it is possible to specify in detail what requirements must be met by all of the companies to be contained in a group. However when individuals and unincorporated entities come into the equation for grouping, with or without companies, and they do not always all have formal written documentation defining their powers and liabilities amongst themselves, more general and unspecified tests are to be applied for grouping purposes.
>
> **Before 2 or more companies are eligible to be members of the group there must be a group of companies pursuant to sec 191 of the Income Tax Act. … The significant factor is that the two-thirds entitlement specified in sec 191(3) is a discernible and usually effective source of control of the companies for the person or persons holding that entitlement. That gives them legal control of all the companies in the group. Whether or not it is always actual effective control may be debatable. It is however a statement of a variety of situations by which legal control rather than actual, factual control is specified.** …Under sec 7(2) of the Income Tax Act companies are deemed to be under the control of the persons holding the two-thirds of the rights or powers mentioned in sec 191(3). **Legal control may also be de facto control. However there is no provision in sec 191 or for the registration of the grouping of companies where one or more persons may have only de facto control of the companies rather than legal control.** [Emphasis added]

53. In terms of legislative purpose, Judge Bathgate considered it would be inconsistent with the objects of the GSTA if "control" meant anything other than legal control. He also considered it would be inconsistent with the objects and intent of the GSTA if "control" between persons who were not companies was of a different nature to the control that exists between companies as a group. He considered that a factual control test would make it almost impossible to determine who was in control:

> In the context of the Goods and Services Tax Act, and in particular sec 55 of the Act and having regard to the largely self-controlling nature of goods and services tax and compliance with the provisions of the Act, **it would not be in accordance with the objects of the legislation for control in sec 55(8) to mean anything other than legal control. Nor would it be in accord with the objects and intent of the Act for control between persons when all of them are not companies to be of a different nature and character of the control that exists between companies as a group; that is legal control. I think it would be well nigh impossible on occasions to discern whether or not there was de facto control, in the sense of one person acting for another …** There would be difficulties in ascertaining when that control starts and finishes, whether it is effective, who has control, what matters are relevant to that question, who decides whether or not there is control is it on a day-to-day basis or on a long term basis, is it to be effective only at the end of each month, two months or whatever the accounting period may be for goods and services

[6] *Oxford English Dictionary*, OED Online Version (December 2022).

> purposes? It may well be that in fact in the cases mentioned A controls the partnership of A and B, not by reason of the partnership documents but by reason of the fact that A has actual control by physically undertaking all of the activities of A and B. However that may not be a discernible control, or a controllable control, because the situation could easily change from time to time. A could hand over physical control to B if, as in one case, A and B were two brothers. **The bewildering variety of facts that may have to be considered to determine whether or not there was de facto control by one or more persons of a group of persons, whether by reason of age, family ties, family seniority, business acumen, or whatever, and the lack of any yardstick to gauge what is or is not control, when it stops and starts, are all very good reasons why it could not have been the intent of parliament for sec 55(8) control to be other than discernible and effective legal control.** That is it is the same sort of control that applies in a group of companies before they obtain group registration. [Emphasis added]

54. Judge Bathgate concluded in *Case K54* that "control" in s 55(8) means legal control rather than factual control:

> I conclude that "control" or "controls" in the context of sec 55(8) means discernible, **legal control.** Anything less would be unlikely to have been intended having regard to the objects of the Act, the method of implementation of the Goods and Services Tax Act and in particular the method provided for the registration of companies as a group. [Emphasis added]

Case L42

55. In *Case L42* (1989) 11 NZTC 1,261, a partnership applied for group registration with an individual under s 55(8). The individual was a 50% partner in the partnership. The Commissioner declined the application. Judge Bathgate affirmed *Case K54* at 1,262, namely that there must be legal control. With only a 50% legal interest in the partnership, the individual did not have legal control of the partnership. Whether the individual had factual control of the partnership was irrelevant. The TRA held for the Commissioner.

Summary: legal control test

56. For mixed GST groups under s 55(8), a registered person is "controlled" by one person, or by two or more persons carrying on a taxable activity in partnership, if that person has, or the partners of the partnership have, legal control of the registered person. The reasons for this are as follows:
    - The test that applies to groups of companies in s 55(1) is a legal control test and it would be inconsistent to determine "control" under s 55(8) on a different basis.
    - It would be extremely difficult to work out who had factual control of a group of entities. It would require considering a wide range of factors such as age, family ties, family seniority and business acumen.
    - Even if it was possible to identify factual control of a group of entities at a given time, it might be very difficult to establish when that factual control started and stopped.

57. Legal control is usually exercised by one or more persons external to the registered person. For example, in the context of companies, the company's shareholders (not its directors) exercise legal control.

Applying the legal control test

58. This part of the item considers how the legal control test applies to different types of persons.[7]

Individuals

59. An individual acting in their individual capacity (eg as a sole trader) is registered for GST in this capacity. The question of control does not arise for an individual who is registered for GST in their individual capacity.

60. If the individual becomes incapacitated (eg due to death or bankruptcy), a specified agent may be appointed: see "IS 23/03: GST – Section 58: Specified agents of incapacitated persons, and mortgagees in possession".[8] The appointment of a specified agent does not affect GST grouping (s 55(4A)).

Companies

61. Legal control of a company usually rests with a majority shareholder (ie a greater than 50% shareholder). In most cases where a company has no majority shareholder, no "one person" will have legal control of it for GST grouping purposes.

62. As noted at [53], in *Case K54*, Judge Bathgate considered that it would be inconsistent for the control of registered persons in mixed groups to differ from the control of groups of companies under s 55(1). Therefore, in most respects determining who the shareholder or shareholders are will involve applying the "group of companies" test in s IC 3 of the Income Tax Act 2007.

[7] This list is not exhaustive. Other types of person may qualify for GST grouping as a member of a mixed group under s 55(8).

[8] *Tax Information Bulletin* Vol 35, No 5 (June 2023): 43.

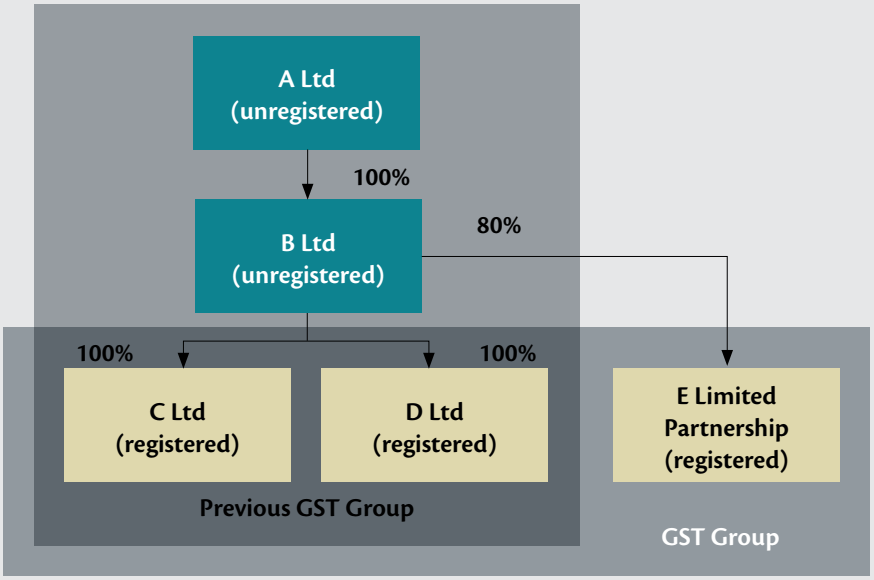
63. However, the legislative provision for mixed groups under s 55(8) differs from the legislative provision for groups of companies under s 55(1) in two ways:
    - The test is one of "control" in s 55(8), rather than a 66% common voting or market value interests test.
    - "One person" or "two or more persons carrying on a taxable activity in partnership" must exercise control under s 55(8), rather than a "group of persons".
64. In *British American Tobacco Company Ltd v IRC* [1943] AC 335, the appellant company British American Tobacco Company Ltd (BATCL) argued that to have a "controlling interest" in another company, the controlling shareholder must have a holding that is sufficient to pass special resolutions or other resolutions that need more than a bare majority of votes to pass. BATCL also argued that an indirect interest in a company was not a controlling interest, because "interest" meant "an interest of a proprietary nature". Therefore, a shareholder company must hold the relevant interest itself (directly) to hold a "controlling interest".
65. The House of Lords held that a bare majority (ie greater than 50% holding) was sufficient to give rise to a "controlling interest". This was on the basis that the owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes. It was true that for some purposes a 75% majority vote may be required – for instance (under some company regulations), to remove directors who oppose the wishes of the majority. However, the bare majority can always refuse to re-elect those directors and so in the long run can remove them. Further, the articles of association of the company cannot be altered to defeat the wishes of the bare majority, because the bare majority can always prevent the passing of the necessary resolution. The House of Lords also held that the word "interest" had a wide meaning and could apply where a company held an indirect interest in another company. The indirect interest test is part of the common law when it comes to determining "control" of a company.
66. The Commissioner therefore considers that legal control of a company under s 55(8) is determined by applying the same tests that are applied for determining whether there is a group of companies under s 55(1) (ie the tests in s IC 3 of the Income Tax Act 2007 as to common voting interests and common market value interests). However, it is necessary to make the following modifications:
    - The relevant percentage shareholding for control of a company under s 55(8) is "greater than 50%", instead of 66% as is required for groups of companies under s 55(1).
    - The requirement to "look through" intermediate and ultimate holding companies in s YC 4(2) is "turned off" for ultimate holding company shareholders.
67. The Commissioner also notes these specific points:
    - Many of the rules in subpart YC of the Income Tax Act 2007 only apply for the purposes of the continuity of ownership provisions (which determine whether tax losses and imputation credits may be carried forward). A common example is the "notional single shareholder" rule for direct interests of less than 10% (s YC 10). These rules do not apply for the purposes of determining whether there is a "group of companies" under s IC 3. The Commissioner considers they similarly do not apply for the purposes of determining whether there is legal control under s 55(8).
    - The aggregation rules for associated persons contained in subpart YB of the Income Tax Act 2007 do not apply for the purposes of determining whether there is a "group of companies" under s IC 3. Again, the Commissioner considers they do not apply for the purposes of determining whether there is legal control under s 55(8).
68. The second modification at [66] recognises that the objectives of the GST grouping rules are to treat GST groups as if they were a single entity and to simplify GST administration. It applies where a mixed group of registered persons that would be a group of companies under s IC 3 of the Income Tax Act 2007 if all the registered persons in the mixed group were companies has an ultimate holding company. In this case, that ultimate holding company may be treated as "one person" that controls each of the others (see Example | Tauira 3).
69. However, the specific legislative requirements of s 55(8) mean that if a group that would be a group of companies under s IC 3 of the Income Tax Act 2007 if all the registered persons in the mixed group were companies does not have an ultimate holding company, but instead each registered person is controlled independently by the same "group of persons", that group of registered persons cannot group under s 55(8). Example | Tauira 4 illustrates this situation. The exception would be where the "group of persons" consists of one person, which is possible under s IC 3, or are partners in a partnership that carries on a taxable activity.

Example | Tauira 3 – Mixed group of companies and a limited partnership with a holding company controlling all the members of the GST group

A Ltd is the ultimate holding company of a 100% owned group, comprising A Ltd, B Ltd, C Ltd and D Ltd. A Ltd owns 100% of B Ltd, and B Ltd owns 100% of both C Ltd and D Ltd.

A Ltd does not carry on a taxable activity and is not registered for GST. B Ltd similarly does not carry on a taxable activity and is not registered for GST. C Ltd and D Ltd each carry on a taxable activity and are each registered for GST. All four companies are members of a GST group of companies under s 55(1).

B Ltd acquires an 80% partnership interest in E Limited Partnership, that carries on a taxable activity and is registered for GST. B Ltd is a limited partner and does not participate in the management of E Limited Partnership. However, under the E Limited Partnership Agreement, B Ltd, because it contributed at least 75% of the total partnership capital, can make decisions on matters listed in sch 1 of the Limited Partnerships Act 2008 (including a decision to remove the general partner, approve a replacement general partner and transfer the general partner's partnership interest (if any)). Each partner's entitlement to distributions under the E Limited Partnership Agreement, including on winding up, is proportional to the partnership capital it has contributed.



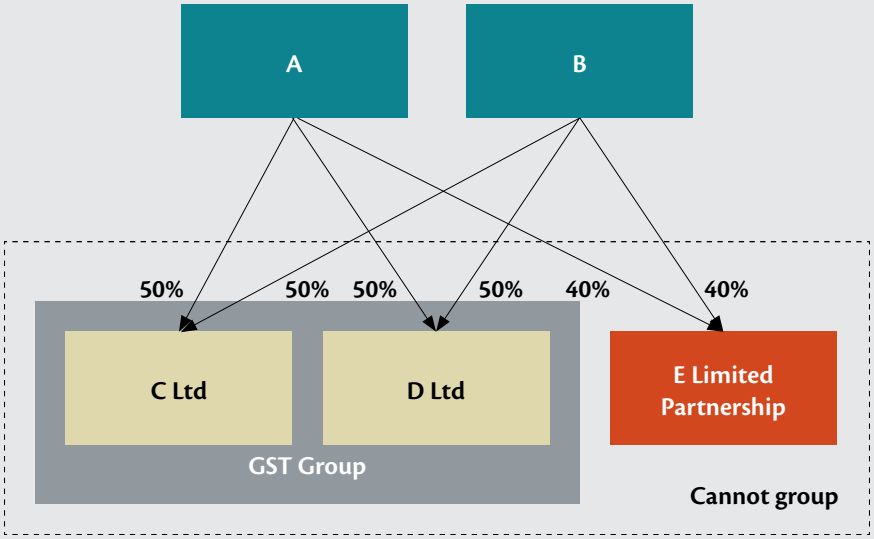
Going forward, C Ltd, D Ltd and E Limited Partnership can be members of a mixed group of registered persons under s 55(8). This is because "one person" (A Ltd or B Ltd) controls all the members of the GST group (C Ltd, D Ltd and E Limited Partnership). However, A Ltd and B Ltd cannot be members of the mixed group of registered persons under s 55(8), because they are not individually registered for GST.

Example | Tauira 4 – Mixed group of companies and a limited partnership with no holding company

Individuals A and B each hold 50% of C Ltd and 50% of D Ltd. A and B are not carrying on a taxable activity in partnership.

C Ltd and D Ltd each carry on a taxable activity and are each registered for GST. C Ltd and D Ltd are members of a GST group of companies under s 55(1).

A and B each acquire a 40% interest in E Limited Partnership. A and B are limited partners and do not participate in the management of E Limited Partnership. However, under the E Limited Partnership Agreement, A and B together, because they are treated as having contributed 80% of the total partnership capital, can make decisions on matters listed in sch 1 of the Limited Partnerships Act 2008 (including a decision to remove the general partner, approve a replacement general partner and transfer the general partner's partnership interest (if any)). Each partner's entitlement to distributions under the E Limited Partnership Agreement, including on winding up, is proportional to the partnership capital it is treated as having contributed.



However, C Ltd, D Ltd and E Limited Partnership cannot be members of a mixed group of registered persons under s 55(8). This is because in this case, no "one person" controls all of C Ltd, D Ltd and E Limited Partnership (and A and B are not carrying on a taxable activity in partnership). The existing GST group under s 55(1) can continue.

Trusts

70. Generally, the trustee or trustees of a trust exercise legal control of it, acting in their capacity as trustee(s) of that trust. An exception exists where a person holds the power to appoint and remove the trustee(s) of the trust.

Standard position

71. A trust is an equitable obligation, which has four elements: a trustee, trust property, a beneficiary, and an obligation to deal with the trust property. The beneficiaries of a trust, subject to the terms of any deed constituting the trust, do not have the power to direct the trustee(s). Therefore, the beneficiaries of a trust are not the equivalent of the shareholders of a company. Instead, the deed permits the trustees to exercise control of the trust assets through unanimous or majority voting.

72. The common law recognises that trustees act under certain fiduciary obligations on behalf of the beneficiaries, and not in their own personal capacity: *Case K68* (1988) 10 NZTC 544; *Case L72* (1989) 11 NZTC 1,419; *Gasparini v Gasparini* (1978) 87 DLR (3d) 282; 20 OR (2d) 113. A person who is a trustee of more than one trust has a separate trustee capacity for each trust: *Fraser v Murdoch* (1880–81) LR 6 App Cas 855; *Commissioner of Taxes v Trustees of Joseph (deceased)* (1908) 2 NZLR 1085; 10 GLR 556; *Case 98* (1951) 1 CTBR (NS) 423.

73. The Commissioner considers that these common law principles apply under the GSTA. This is because the definition of "trustee" in the GSTA is inclusive. By using an inclusive definition, Parliament must have intended to rely partly on the common law meaning of "trustee".[9]

[9] The GSTA definition differs from the definition of "trustee" in the Income Tax Act 2007. The Income Tax Act 2007 (s YA 1) specifically states that a reference to a "trustee", for a trust, "means the trustee only in the capacity of trustee of the trust". The GSTA is silent on this point. Until 1988 both Acts had the same definition of "trustee" (the definition that the GSTA still uses). However, the Commissioner considers the amendment to the Income Tax Act 2007 was only for the purpose of clarifying the definition and did not change the meaning of "trustee" for income tax purposes.

74. While each trust is different, the standard position is that:
    - the trustee or trustees of a trust have legal control of a trust and no person has legal control of the trustee(s);
    - because a trustee or trustees possess a separate trustee capacity for each trust of which they are a trustee, a trust cannot group with another registered person simply because it has the same trustee(s) as that other person; and
    - because a trustee's personal or corporate capacity differs from their trustee capacity, a trustee of a trust cannot group the trust with a person they control in their personal capacity (if they are an individual trustee) or their corporate capacity (if they are a corporate trustee). For example, an individual trustee cannot group a trust of which they are a trustee with a GST registered business they run as a sole trader in their personal capacity.

Exception to standard position: Power to appoint and remove trustees

75. Many modern trust deeds include a clause granting a person (eg, the trust settlor) the power to appoint and remove the trustee(s) of the trust.
76. In *Concepts 124 Limited v CIR* (2014) 26 NZTC 21,100, the High Court held that an individual who held the power to appoint and remove the trustee(s) of a trust "controlled" the trust.
77. The trust in question had a corporate trustee. On the facts, the individual at [76] also held all the shares in the corporate trustee. Clifford J referred to this fact when stating the reasons for concluding that the individual controlled the trust.
78. However, the Commissioner considers that the key factor causing the individual to control the trust was that the individual held the power to appoint and remove the corporate trustee. If the shareholder of a corporate trustee causes the corporate trustee to act in a way that is not in accordance with the wishes of a person who holds the power to appoint and remove the corporate trustee, the person holding the power to appoint and remove the trustee(s) could exercise it to remove the corporate trustee.
79. The Commissioner therefore accepts that a person with the power to appoint and remove the trustee(s) of a trust will usually, subject to the terms of the trust, have legal control of the trust.
80. Such control is analogous to the control the shareholders of a company exercise over the company. (That is, both the shareholders and the person holding the power to appoint and remove the trustee(s) are persons outside the person in question.)

Corporate trustees

81. The definition of "company" in s YA 1 of the Income Tax Act 2007 expressly excludes "a company that is acting in the capacity of trustee". Therefore, a corporate trustee acting in its **trustee capacity** is not capable of being a member of a "group of companies" under s IC 3 of the Income Tax Act 2007. It follows that a corporate trustee acting in its trustee capacity cannot be a member of a s 55(1) group of companies.
82. For GST purposes, a trustee, including a corporate trustee, is treated as an unincorporated body of persons (s 57). Therefore, a corporate trustee acting in its trustee capacity can be a member of a mixed group of registered persons under s 55(8). To join a GST group under s 55(8) in its trustee capacity, the corporate trustee must be registered for GST in its capacity as trustee of that trust.
83. On the other hand, a corporate trustee acting in its **corporate capacity** is a "company", under the definition of "company" in both s 2 of the GSTA and s YA 1 of the Income Tax Act 2007. Therefore, a corporate trustee acting in its corporate capacity can be a member of a s 55(1) group or a member of a s 55(8) group. If a corporate trustee acting in its corporate capacity wishes to join a s 55(1) group, it may do so even if it is unregistered, as s 55(1) groups may contain unregistered companies.
84. The discussion in this section demonstrates that a corporate trustee may be registered as two separate registered persons: one in its trustee capacity, and the other in its corporate capacity. Further, a trustee acts in a different capacity in respect of each trust of which it is a trustee. Therefore, if a corporate trustee acts as trustee of two or more trusts, it may be registered as three or more registered persons.
85. However, a person cannot be a member of more than one GST group at one time in respect of a particular capacity in which they act. Therefore, a person may be a member of two GST groups if they act in two legal capacities, or three GST groups if they act in three legal capacities, and so on. However, for each legal capacity in which they act, they may only be a member of one GST group at any one time.

Special purpose corporate trustees of post-settlement governance entities

86. Sometimes the constitution of a corporate trustee will provide that it can only act as trustee of one trust. This is typically the case in the context of a corporate trustee of a post-settlement governance entity (PSGE).

87. Under a typical PSGE structure, the shareholders (and the directors) of the corporate trustee will be elected representatives of the hapū members. The hapū members will also have the power to appoint and remove the trustee of the settlement trust.

88. If a corporate trustee can group with the settlement trust of which it is trustee, this will remove the requirement for the corporate trustee to charge GST on its trustee fees. The question is whether the corporate trustee and settlement trust are entitled to group (and, if so, on what basis).

89. As discussed at [38], for mixed GST groups there must be "one person" who controls each of the other members of the group (s 55(8)(a)) or "one person" who controls all members of the group (s 55(8)(b)).

90. Although the corporate trustee in its **trustee capacity** controls a settlement trust, the corporate trustee in its **corporate capacity** does not. Section 55(8)(a) is not satisfied.

91. However, if "one person" outside the proposed GST group controls both the corporate trustee in its trustee capacity and the corporate trustee in its corporate capacity, there will be "one person" who controls all members of the group for the purposes of s 55(8)(b).

92. In the case of a PSGE, the people with the potential to control both the corporate trustee and the settlement trust are the hapū. The hapū is a group of individuals, not one individual or one entity. However, a group of individuals may, in certain circumstances, be treated as an "unincorporated body of persons" for the purposes of the GSTA. An "unincorporated body of persons" is a "person" as defined in s 2.

Unincorporated body

93. A group of individuals may be treated as an unincorporated body if it has the following kinds of characteristics:
    - It is formed by its members for one or more common purposes;
    - There is some regulation of the relationship between its members;
    - It has agreed rules (not necessarily written) that govern for example, how decisions are made, how its funds may be used, and what happens when members join and leave the group; and
    - It is a structure recognised as a collective entity of its members.[10]

94. The Commissioner considers that the members of a hapū will usually have a sufficient degree of common purpose, regulation of relationships, agreed rules, and recognition of the hapū's collective entity status to be treated as an "unincorporated body of persons".[11] The hapū will therefore usually be treated as "one person" who controls:
    - the corporate trustee in its corporate capacity, because its shareholders act as elected representatives of the hapū, and
    - the corporate trustee acting in its trustee capacity (ie the trust) because the hapū members hold the power to appoint and remove the trustee of the trust.

95. Therefore, a corporate trustee acting in its corporate capacity may be a member of mixed group of registered persons with a settlement trust in a PSGE structure under s 55(8)(b) (assuming both are registered persons).

Examples

96. Examples 5 to 8 illustrate the standard position for trusts. Examples 9 to 10 demonstrate the exception for trusts where the deed includes a power to appoint and remove the trustee(s) (including an example relating to a typical PSGE structure: see Example | Tauira 10).

Company

97. The trustee or trustees of a trust have legal control of a company when the trust holds more than 50% of the voting interests or, if a market value circumstance exists, more than 50% of the market value interests, in the company (see from [61]). This assumes that the trustees have the power to hold shares and vote at company meetings, in terms of the relevant trust deed (see Example | Tauira 5).

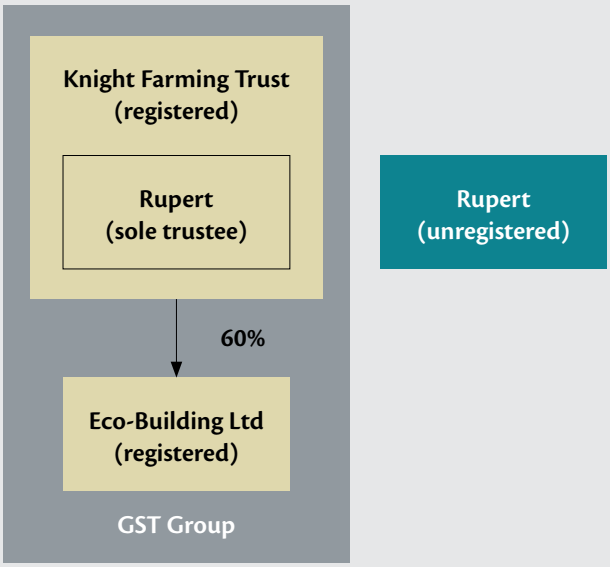
[10] *Taunton Syndicate v C of IR* (1982) 5 NZTC 61,106; (1982) 5 TRNZ 259; *Anglesea Builders Partnership v CIR* (1987) 9 NZTC 6,181; *McElwee v CIR* (1988) 10 NZTC 5,181; *Case P70* (1992) 14 NZTC 4,469; *Case U19* (1999) 19 NZTC 9,186.

[11] See also *Edwards v Legal Services Agency* [2003] 1 NZLR 145, in which the Court of Appeal treated an iwi as an unincorporated body.

Example | Tauira 5 – The trustee of a trust holds shares in a company on trust for the beneficiaries

Rupert is the sole trustee of the Knight Farming Trust. The trust deed for the Knight Farming Trust contains no power to appoint and remove the trustee.

The Knight Farming Trust owns 60% of the shares in Eco-Building Limited. Both the trust and the company carry on taxable activities (of farming and building respectively) and are registered for GST. The trust instrument states that Rupert, as trustee, has the legal authority to deal with the trust property for the financial benefit of the beneficiaries.



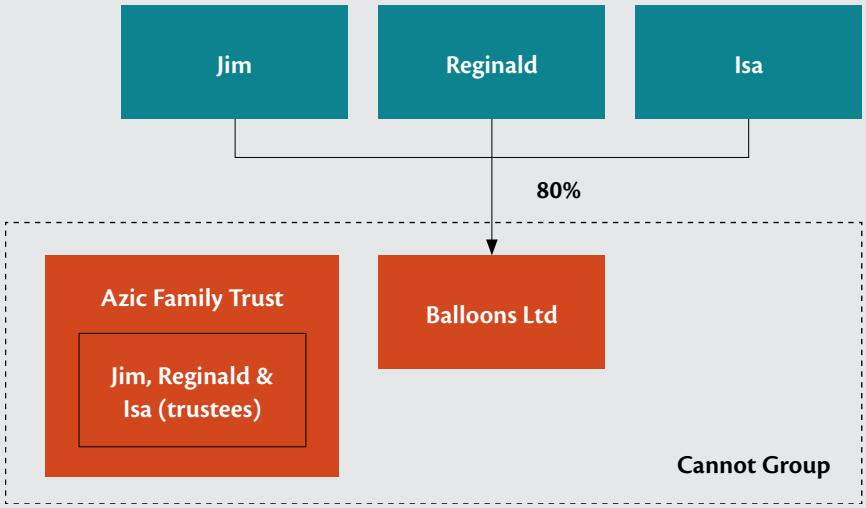
As the sole trustee of the Knight Farming Trust, Rupert has legal control of Eco-Building Limited because of the trust's 60% shareholding in the company. The Knight Farming Trust and Eco-Building Limited can be members of a mixed group of registered persons for GST purposes.

98. The trustee or trustees of a trust cannot group with a company simply because they are the same persons as the company's shareholder or shareholders. This is because the person(s) act in a separate capacity from their individual or corporate capacities when they are acting as trustee(s) (see Example | Tauira 6).

Example | Tauira 6 – The trustees of a trust are the same individuals as the shareholders of a company

In the deed forming the Azic Family Trust, Jim, Reginald and Isa have been appointed as trustees. The trust deed for the Azic Family Trust contains no power to appoint and remove the trustees. Jim, Reginald and Isa also own 80% of the shares in Balloons Limited. Both the Azic Family Trust and Balloons Limited carry on taxable activities.

The trust deed gives the trustees a wide discretion to exercise their powers. Jim, Reginald and Isa have met in their capacity as trustees to discuss the possibility of grouping with Balloons Limited and have unanimously agreed that it is in the interests of the trust to group.



The trust deed provides the trustees with legal control of the trust, and the same individuals control Balloons Limited. Despite this, the three individuals act in a trustee capacity as the trustees of the Azic Family Trust, while they act in their own personal capacities as shareholders of Balloons Limited. The trustees may not group the Azic Family Trust with Balloons Limited for GST purposes.

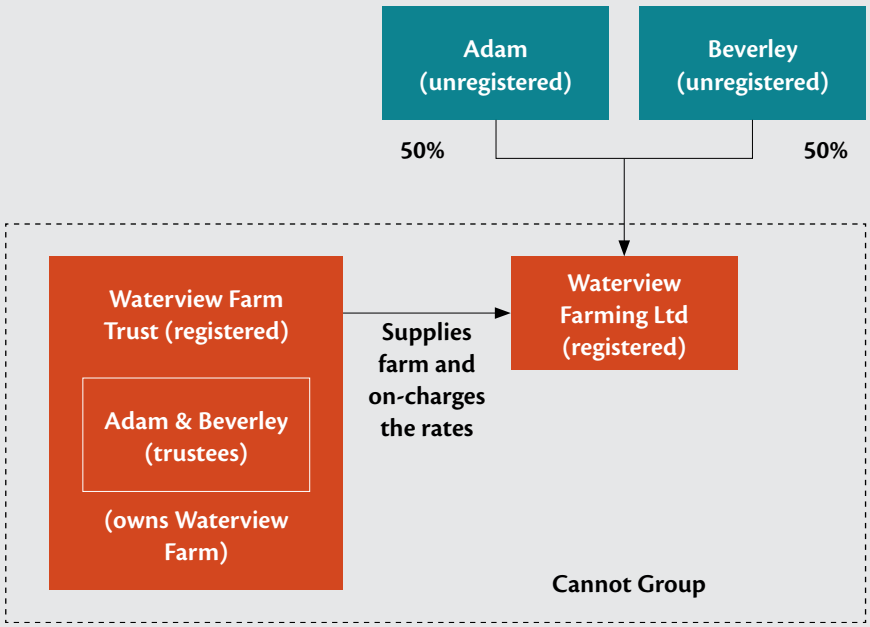
99. Although a land-owning trust and company operating a business that uses the land cannot group simply because the trustees of the trust are the same individuals as the shareholders of the company, where land holding costs must be charged to a trust as landowner (eg rates charged by a local authority), the trust may recover those costs from the related company in the form of lease rentals. Section 10(3) usually requires a supply that an associated person makes to be treated as a supply that they have made at open market value. However, no open market value requirement applies if the recipient of the supply is entitled to deduct input tax on the supply (see Example | Tauira 7).

Example | Tauira 7 – A trust that recovers rates from a company

Adam and Beverley are the settlors and trustees of the Waterview Farm Trust. There is no power to appoint and remove trustees under the trust deed.

The trust leases the Waterview Farm to a company, Waterview Farming Ltd. Adam owns 50% of the shares in Waterview Farming Ltd and Beverley owns the other 50%.

The Waterview Farm Trust has a taxable activity of leasing the farm, and charges Waterview Farm Ltd the GST-exclusive amount of the rates that the local authority charges to the trust. The trust is registered for GST. Waterview Farming Ltd carries on a taxable activity of farming and is registered for GST.



Although Adam and Beverley are both the trustees of the trust and the shareholders of the company, they cannot register the trust and company as members of a mixed group for GST purposes. This is because Adam and Beverley act in a trustee capacity as trustees of the Waterview Farm Trust, and in their individual capacities as shareholders of Waterview Farming Ltd. As a result, there is no one person who controls, or two or more persons carrying on a taxable activity in partnership who control, both the trust and the company. However, as Waterview Farming Limited carries on a taxable activity and is registered for GST, it may recover the GST input tax on the lease rentals that the Waterview Farm Trust charges to it.

Partnership

100. The terms of the partnership agreement will determine the degree of legal control a trustee has in a partnership. This is usually dictated by the level of voting power – see from [109].

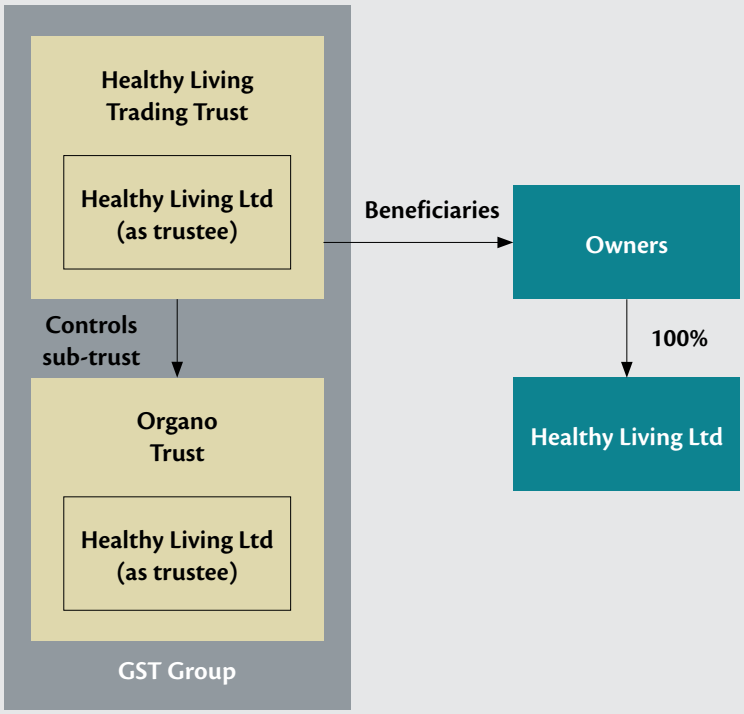
Trust

101. In certain circumstances, a trustee can group with another trust under s 55(8). This includes situations involving trustees of sub-trusts. The trustee of the principal trust will have control of the principal trust because of the terms of the trust deed. Where the trust deed vests in the trustees of the principal trust the same power for the sub-trust, the trustees of the principal trust may be considered to control the trustees of the sub-trust (see Example | Tauira 8). However, careful analysis of the terms of the relevant trust deed by the Commissioner will normally be required before the Commissioner will accept this.

Example | Tauira 8 – Trustees of principal trust control sub-trust

Healthy Living Limited manufactures organic products. The company decides to create a trading trust called Healthy Living Trading Trust. Healthy Living Limited is appointed as the trustee. The beneficiaries are the owners of the company. Healthy Living Limited, acting as trustee, decides to create a sub-trust called Organo Trust under a power contained in the deed. The instrument settling the Healthy Living Trading Trust provides the trustee with the power to deal with Organo Trust for the financial betterment of the beneficiaries within the general purposes of the Healthy Living Trading Trust, including the power to appoint and remove trustees of the Organo Trust.

As the trustee of Healthy Living Trading Trust, Healthy Living Limited has legal control of both Healthy Living Trading Trust and Organo Trust. It is the trustee of both trusts, which are linked together beneficially in the principal deed. Healthy Living Limited can control the sub-trust (Organo Trust) for the benefit of the principal trust (Healthy Living Trading Trust). Therefore, the trusts may be members of a mixed group for GST purposes.



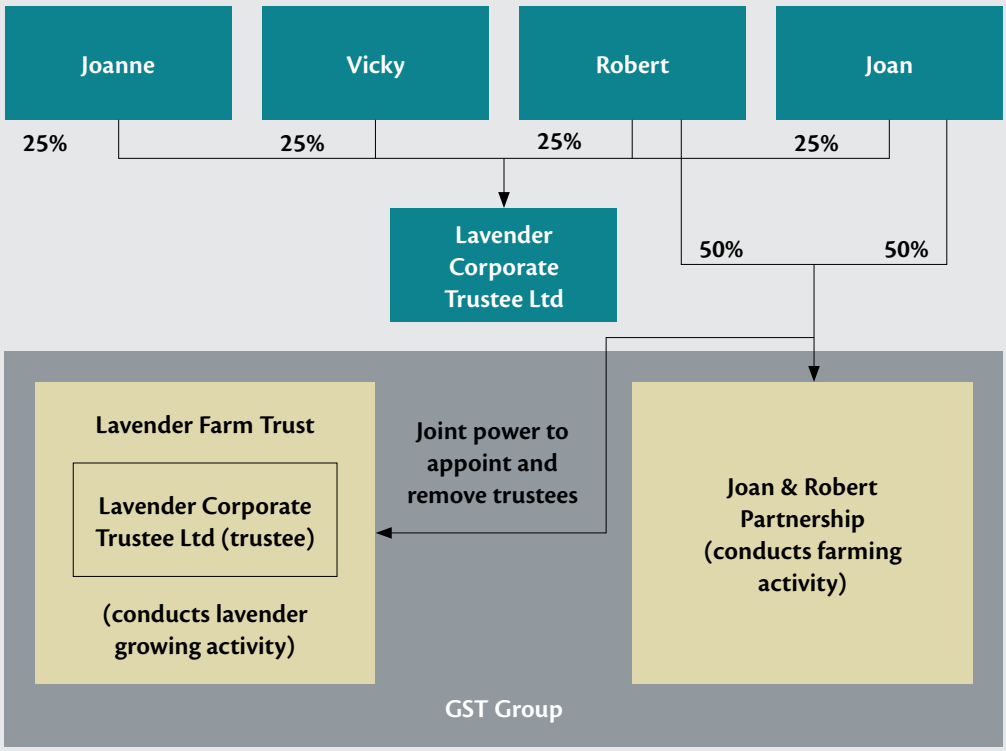
This reasoning will also apply where two or more trusts are not linked together by a principal deed, but the trustees of the first trust have the power to appoint and remove the trustees of the second trust, for the benefit of the first trust – see from [102].

102. A trust may be a member of a mixed group under s 55(8) if a person with the power to appoint and remove the trustee(s) of the trust also controls the other member(s) of the mixed group.

103. A trust may also be a member of a mixed group for GST purposes if two or more persons carrying on a taxable activity in partnership hold a power to appoint and remove the trustee(s) of the trust, and the two or more persons also control the other member(s) of the mixed group (see Example | Tauira 9).

Example | Tauira 9 – Two or more persons carrying on a taxable activity in partnership have the power to appoint and remove the trustee(s) of a trust

Robert and Joan are married and carry on a taxable activity of sheep and cattle farming in partnership. Robert and Joan are also the settlors of a trust, the Lavender Farm Trust. The trust carries on a taxable activity of growing lavender and manufacturing and selling lavender-scented soaps and hand creams. The beneficiaries of the trust are Robert, Joan and their two adult daughters, Joanne and Vicky. The trustee of the trust is Lavender Corporate Trustee Limited, and Robert, Joan, Joanne and Vicky each own 25% of the shares in it. Under the deed of trust, Robert and Joan together have the power to appoint and remove the trustee(s) of the Lavender Farm Trust. The partnership and the trust are each registered for GST.



Robert and Joan together control the sheep and cattle farming partnership. Robert and Joan together also control the Lavender Farm Trust, through holding the power to appoint and remove the trustee of the trust (Lavender Corporate Trustee Limited). Therefore, the partnership and trust may be members of a mixed group of registered persons for GST purposes.

104. A corporate trustee may be registered in more than one capacity. It may be registered in its corporate capacity (ie the capacity in which it charges trustee fees) and it may be registered in its capacity (or capacities) as a trustee. Further, an unincorporated body of persons is treated as a "person" for the purposes of the GSTA. Therefore an unincorporated body of persons may be "one person" who controls all the members of a GST group under s 55(8)(b). If the same unincorporated body of persons controls a corporate trustee in both its corporate capacity and its trustee capacity, the two registered persons may be members of a GST group (see Example | Tauira 10).

Example | Tauira 10 – Grouping the corporate trustee and trust for a post-settlement governance entity

A hapū has received a settlement under The Treaty of Waitangi | Te Tiriti o Waitangi. The settlement is held on trust (the Settlement Trust) for the hapū members as beneficiaries.

A company has been incorporated and appointed to act as trustee of the Settlement Trust (the Corporate Trustee).

The trust deed of the Settlement Trust includes the following provisions:

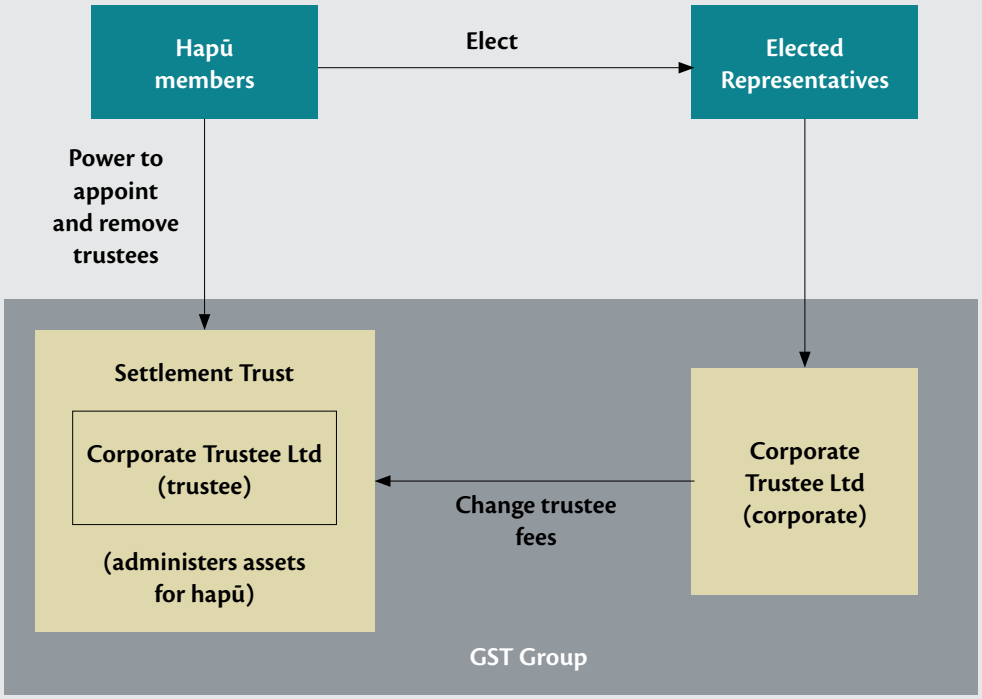
- A special resolution of the hapū members can remove the Corporate Trustee by appointing one or more substitute trustees.
- Representatives are elected from time to time to represent the hapū members as directors and shareholders of the Corporate Trustee (Elected Representatives).

The Corporate Trustee's constitution includes the following provisions:

- The sole purpose of the Corporate Trustee is to act as corporate trustee for the Settlement Trust.
- The Corporate Trustee's shareholders are the Elected Representatives, and they are the only persons eligible to hold shares. The Elected Representatives cannot transfer their shares except in the way the constitution sets out.
- If a person ceases to be an Elected Representative, they must transfer the shares they hold to one of three persons: to their replacement; to the chairperson of the board to hold on trust until they have a replacement; or back to the Corporate Trustee if the number of elected representative positions has been reduced. No consideration is provided for this transfer.
- The Elected Representatives cannot receive any dividends.
- If the Corporate Trustee is liquidated, all its assets are distributed to and vested in the successor trustee of the Settlement Trust.

The Corporate Trustee, acting in its corporate capacity, provides trustee services and charges trustee fees to the Corporate Trustee acting in its capacity as trustee (ie to the Settlement Trust). The Corporate Trustee, acting in its corporate capacity, is carrying on a taxable activity (providing trustee services) and is registered for GST.

The Corporate Trustee, acting in its capacity as trustee of the Settlement Trust, receives, administers, manages, protects and governs the settlement assets on trust for the cultural, commercial and social development of the hapū. The Corporate Trustee, acting in its trustee capacity, is carrying on a taxable activity and is registered for GST.



The Corporate Trustee acting in its corporate capacity and the Corporate Trustee acting in its capacity as trustee of the Settlement Trust may be members of a mixed group of registered persons.

This is because the hapū members, as an "unincorporated body of persons" (which is a "person" for the purposes of the GSTA), are treated as "one person" who controls:

- the Corporate Trustee acting in its corporate capacity, because the Elected Representatives hold the shares of the Corporate Trustee only while they act as such, and are appointed by and act for the hapū members, and
- the Corporate Trustee acting in its capacity as trustee of the Settlement Trust, because the hapū members have the power to appoint and remove, by special resolution, the trustee of the trust.

Bare trusts

105. Control of a bare trust rests with the beneficiary or beneficiaries of the trust. It is generally the beneficiary or beneficiaries who carry on the taxable activity and are registered for GST. Therefore GST grouping is not usually relevant to bare trusts, because if multiple bare trusts exist for the same beneficiary or beneficiaries, there will usually only be one GST registered person (ie the beneficiary or, where there are multiple beneficiaries, there may be a partnership or unincorporated body of which the beneficiaries are the partners or members).

Nature of a bare trust under common law

106. A bare trust is a type of trust under which the trustee holds property on trust without any duties to perform other than to convey the trust property to the beneficiary or as the beneficiary directs. The reference to "duties" in this definition is to duties that the settlor has specified. For example, the trustee may have been appointed to hold the property as nominee, or the settlor may have required that the beneficiary be maintained until becoming entitled to call for capital and income on reaching the age of majority. Once the beneficiary reaches the age of majority, the trustee no longer has a duty to maintain the beneficiary. In both situations, the trustee is "bare" of any duties specified by the settlor. However, so long as a trustee holds property on trust, they always retain their legal duty to take reasonable care of the trust property. The trustee cannot escape this duty: *Herdegen v FCT* 88 ATC 4995 (FCA).

Bare trusts under the GSTA

107. Where there is a bare trust, the beneficiary rather than the bare trustee is the party that makes and receives taxable supplies of the trust property, unless the trustee and the beneficiary agree otherwise under s 60(1B). This is because it is the beneficiary who carries on the taxable activity and may be registered or liable to be registered under s 51. This is discussed in detail in "QB 16/03: Goods and Services Tax – GST treatment of bare trusts".[12]

108. Therefore where assets are held by the same bare trustee (or by different bare trustees) on two bare trusts for the same beneficiary and are used by the beneficiary for making taxable supplies in the same taxable activity, there will only be one GST registered person (the beneficiary of the two bare trusts). The question of group registration does not arise.

General partnerships

109. The default position under partnership law is that each partner has equal voting power and the partnership profits are shared equally between the partners. Therefore, if there are four partners, three (a majority) must vote in favour to pass a resolution and each partner will be entitled to receive one quarter of the partnership profits. It follows that under the default position a majority of partners (ie more than 50% of the partners) exercise legal control of a partnership. This will not place legal control of the partnership in the hands of "one person", because no one partner will hold more than 50% of the voting power where it is deemed equally shared. However, the partnership agreement may modify the default position. Partnership agreements do frequently modify this presumption of equal voting power and equal profit-sharing between the partners, so that one partner's vote carries greater weight than another's, and one partner is entitled to receive a greater share of partnership profits than another. If so, a majority partner (ie any partner who holds more than 50% of the voting rights and profit-sharing entitlements) will exercise legal control.

Nature of a general partnership under partnership law

110. The law relating to general partnerships is set out in the Partnership Law Act 2019 (PLA 2019).[13]

111. A partnership is the relationship that exists between persons carrying on a business in common with a view to profit (s 8, PLA 2019). The term "person" includes a natural person. In legislation, the term "person" also includes a corporation sole, a body corporate and an unincorporated body (s 13, Legislation Act 2019). However, certain Acts restrict who may be a partner in a professional partnership to natural persons holding specific qualifications.

112. Co-ownership of property does not by itself create a partnership in relation to the property, even if the owners share profits made from use of the property (s 12, PLA 2019). Similarly, sharing the gross returns of a venture does not by itself create a partnership (s 13, PLA 2019). However, if a person receives a share of the profits of a business, it is presumed, unless there is evidence to the contrary, that the person is a partner in the business (s 14, PLA 2019).[14]

Control of a general partnership under partnership law

113. Under partnership law, all partners are entitled to share equally in the capital and profits of the partnership business, and all the partners must contribute equally towards the losses (s 45, PLA 2019). Every partner may take part in the management of the partnership business (s 48, PLA 2019).

114. Any difference about ordinary matters connected with the partnership business may be decided by a majority of the partners. However, no change may be made to the nature of the partnership business without the consent of all existing partners (s 51, PLA 2019).

115. The rules at [113] to [114] are subject to any agreement (express or implied) between the partners (s 44, PLA 2019).

Legal control of a general partnership

116. A partner with a majority (greater than 50%) partnership interest exercises legal control of a general partnership. The majority partner may be (with some restrictions for professional partnerships) a natural person, a body corporate (eg a company), a corporation sole or an unincorporated body (eg the trustees of a trust – see Example | Tauira 11). It may be that no one partner controls the partnership.

[12] *Tax Information Bulletin*, Vol 28, No 5 (June 2016): 16.

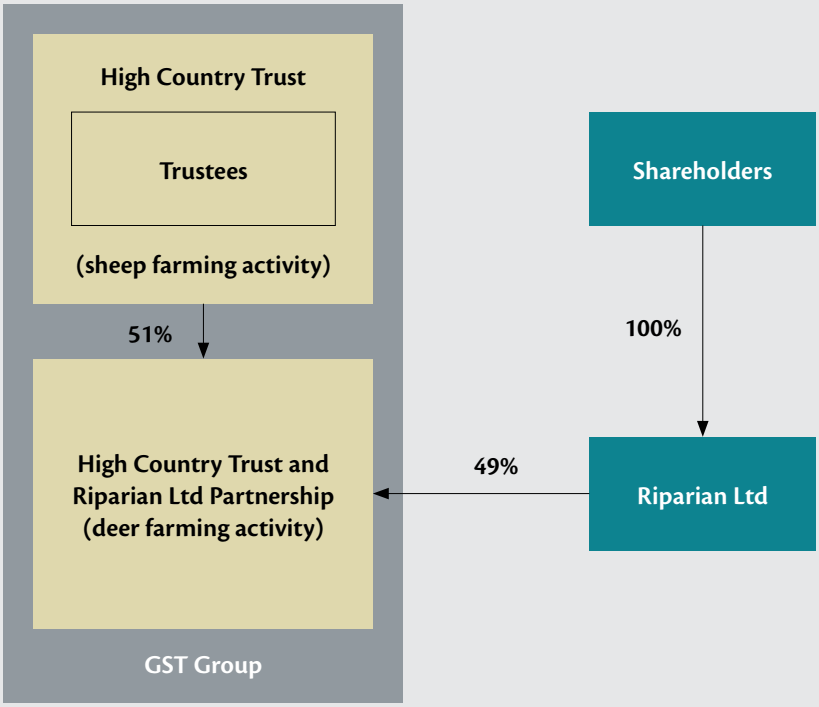
[13] The rules of equity and common law that apply to partnerships also apply, except if they are inconsistent with express provisions of the PLA 2019 (sch 1, part 1).

[14] Despite s 14, there is no presumption of partnership if a person: (1) is an employee or agent of a person engaged in the business and receives a share of the business profits under a contract as remuneration, (2) in specified circumstances, receives the amount in payment of a debt or repayment of a loan, (3) receives the amount as an annuity when they were the spouse or child of a deceased partner of the business, or (4) receives the amount as consideration for the sale of the goodwill of the business (s 15, PLA 2019).

Example | Tauira 11 – A trust controls a partnership

The High Country Trust carries on a taxable activity of sheep farming. The trustees of the High Country Trust are registered for GST for the sheep farming activity. There is no power to appoint and remove trustees in the trust deed of the High Country Trust.

The High Country Trust holds 51% of the voting power and is entitled to 51% of the profits of the High Country Trust & Riparian Ltd Partnership. The High Country Trust & Riparian Ltd Partnership carries on a taxable activity of deer farming and is also registered for GST.



The High Country Trust and the High Country Trust & Riparian Ltd Partnership can be members of a mixed group of registered persons for GST purposes.

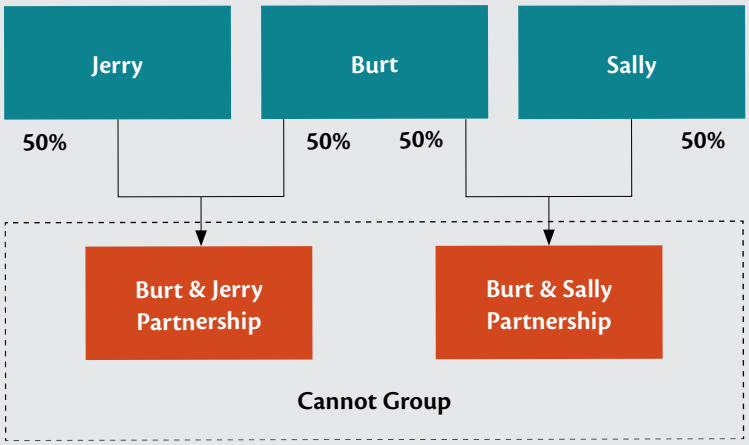
117. If there is no majority partner, no "one person" controls the partnership in terms of s 55(8). This is the case, for example, in a 50:50 partnership of two persons (see Example | Tauira 12 and Example | Tauira 13).

Example | Tauira 12 – Two partnerships, same individual is 50% partner in each

Burt carries on a taxable activity in partnership with Jerry (the Burt & Jerry Partnership). Burt and Jerry are each entitled to 50% of the partnership profits.

Burt also carries on a (separate) taxable activity in partnership with Sally (the Burt & Sally Partnership). Burt and Sally are each entitled to 50% of the partnership profits.

Both partnerships are registered for GST. Burt applies to form a GST group consisting of the two partnerships as members.

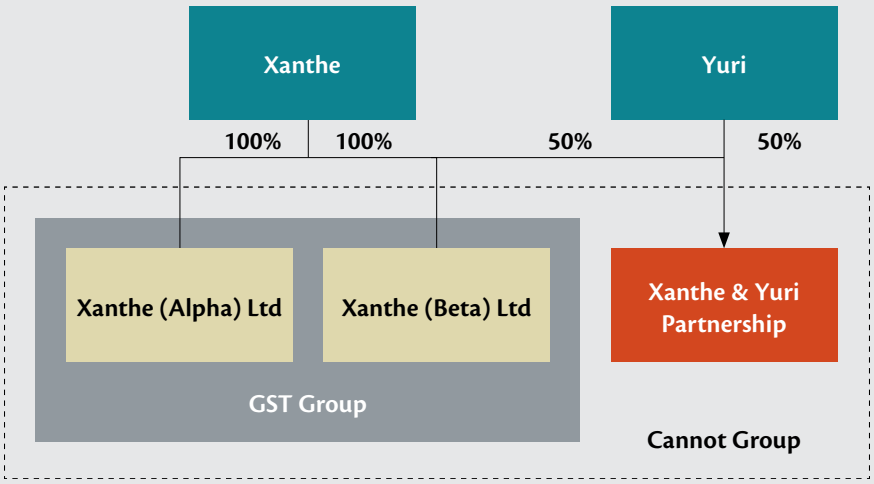


The two partnerships are unable to be members of a GST group. Burt, as a 50% partner in each partnership, does not have legal control of either partnership.

Example | Tauira 13 – Two companies 100% owned by one of the partners in a 50:50 partnership

Xanthe owns 100% of the shares in Xanthe (Alpha) Ltd and 100% of the shares in Xanthe (Beta) Ltd. Xanthe is also a 50% partner in a business with her colleague Yuri.

Xanthe (Alpha) Ltd, Xanthe (Beta) Ltd and the Xanthe & Yuri Partnership are each carrying on a taxable activity and are each registered for GST. Xanthe has grouped Xanthe (Alpha) Ltd and Xanthe (Beta) Ltd. She wants to know if, for ease of administration, she can add the Xanthe & Yuri Partnership to the group to form a mixed group of registered persons for GST purposes.



Xanthe (Alpha) Ltd, Xanthe (Beta) Ltd and the Xanthe & Yuri Partnership cannot be members of a mixed group for GST purposes. Xanthe controls both Xanthe (Alpha) Ltd and Xanthe (Beta) Ltd. However, Xanthe's 50% share in the Xanthe & Yuri Partnership does not give her legal control of the partnership.

Yuri has no ownership interest in Xanthe (Alpha) Ltd or Xanthe (Beta) Ltd. Therefore, the three entities cannot group on the basis that two or more persons carrying on business in partnership control all three entities.

118. However, s 55(8) allows a partnership to be a member of a mixed group of registered persons "... if the Commissioner is satisfied in relation to the members of the group that 2 or more persons carrying on a taxable activity in partnership control all of them".

119. Partnerships may therefore be members of mixed groups with entities that they control (ie where more than 50% of the other entity's ownership interests are partnership property). Example | Tauira 14 illustrates this situation.

Example | Tauira 14 – Partnership owns 51% of the shares in a company

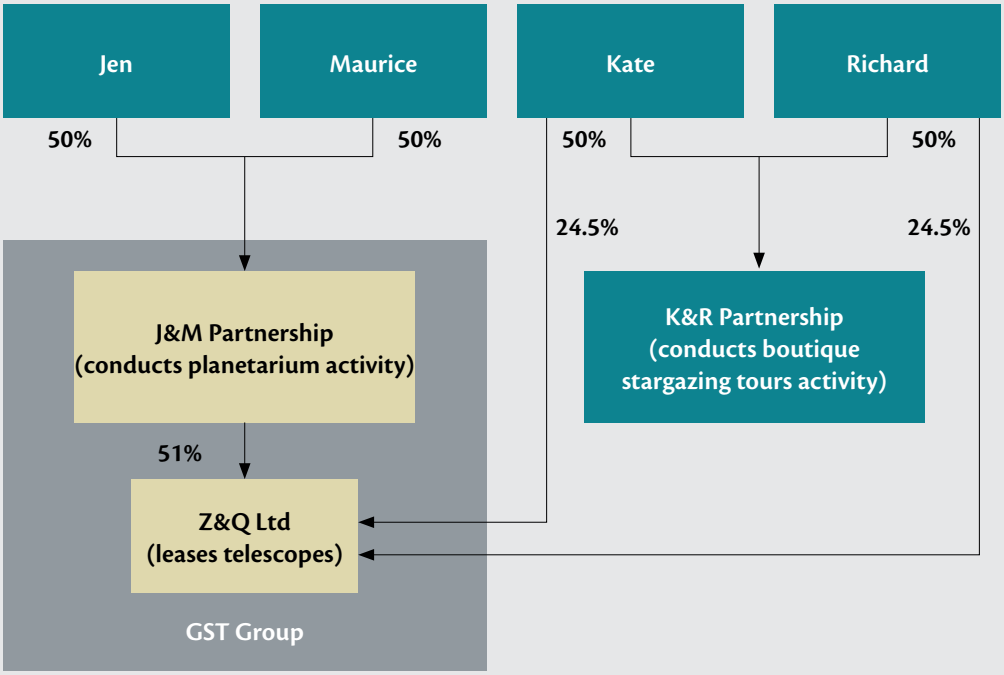
Jen and Maurice are 50:50 partners in a partnership, the J&M Partnership. The J&M Partnership carries on the taxable activity of running a planetarium and is registered for GST.

Kate and Richard are also 50:50 partners in a partnership, the K&R Partnership. The K&R Partnership carries on a taxable activity of running boutique star-gazing tours and is registered for GST.

Initially, Kate and Richard each own 50% of the shares in Z&Q Ltd. Z&Q Ltd owns a powerful telescope, which it leases to the K&R Partnership. However, as tourist numbers are down, Kate and Richard decide to sell some of their shares in Z&Q Ltd. The J&M Partnership agrees to acquire a 51% share in Z&Q Ltd from Kate and Richard, who collectively retain 49% (24.5% each).

Following the acquisition of shares, Jen and Maurice relocate the telescope to the planetarium's premises. Z&Q Ltd lets the telescope to both partnerships on a time-shared basis. Z&Q Ltd is registered for GST.

The J&M Partnership and Z&Q Ltd can be members of a mixed group of registered persons for GST purposes. This is because the J&M Partnership holds 51% of the ownership interests in Z&Q Ltd.



120. The Commissioner considers that partnerships may also be members of mixed groups with entities that are controlled by some (ie two or more) or all of the partners of a partnership. Example | Tauira 15 illustrates this situation.

Example | Tauira 15 – Two or more persons carrying on a taxable activity in partnership own shares in a company

John, Paul and George carry on business together in partnership (the JPG Partnership). The partnership agreement provides the partnership interests are as follows:

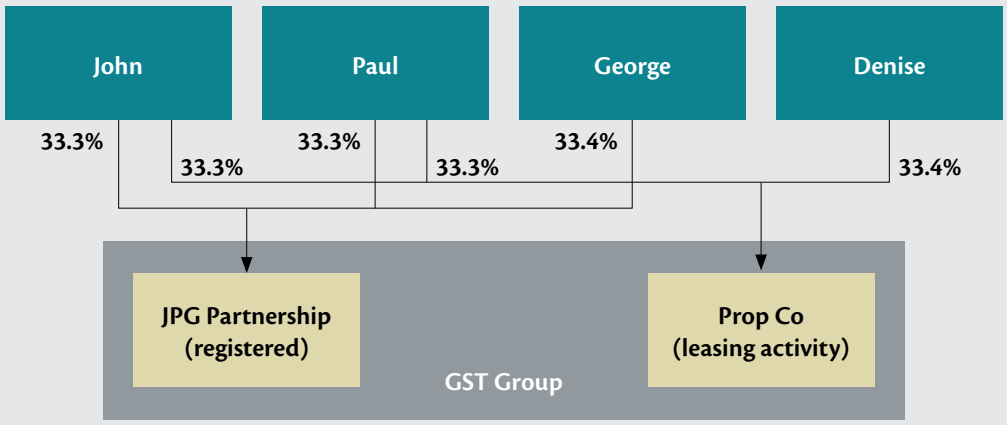
	John	Paul	George
Partnership interest	33.3%	33.3%	33.4%

The partnership carries on a taxable activity and is registered for GST.

The partnership's landlord decides to sell the commercial building, part of which the partnership rents as its business premises. John, Paul and their business associate Denise decide to acquire the building in a company incorporated for this purpose (Prop Co). Prop Co carries on a taxable activity of letting commercial property to the partnership and to other commercial tenants. It is registered for GST.

The shareholdings in Prop Co are as follows:

	John	Paul	Denise
Shareholdings	33.3%	33.3%	33.4%



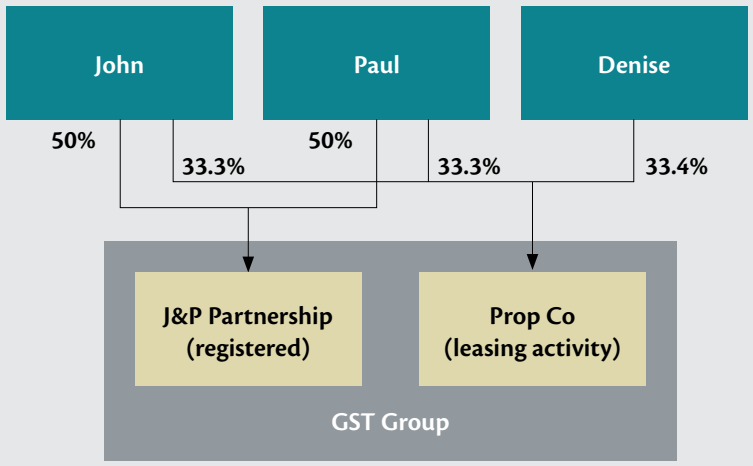
The JPG Partnership and Prop Co can be members of a mixed group of registered persons for GST purposes. This is because two persons who carry on a taxable activity in partnership (John and Paul) together hold more than 50% of the shares in Prop Co (66.6%) and so "control" Prop Co and they also together control the JPG partnership.

Variation 1

George decides to retire from the partnership. The JPG partnership ends and a new partnership between John and Paul (J&P Partnership) begins. The J&P Partnership agreement provides the partnership interests are held 50:50. The shareholdings in Prop Co remain the same.

The partnership interests and shareholdings are therefore as follows:

	John	Paul	Denise
Partnership interest	50%	50%	0%
Shareholdings	33.3%	33.3%	33.4%



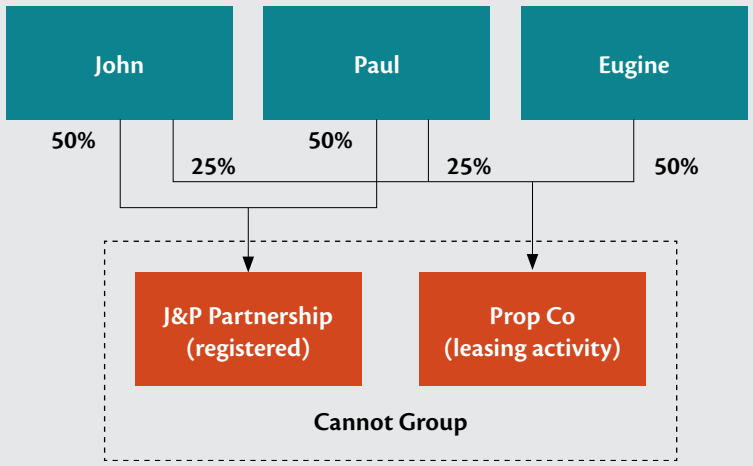
The J&P Partnership and Prop Co can be members of a mixed group of registered persons for GST purposes. John and Paul are two persons who carry on a taxable activity in partnership and control the partnership. Together, their voting interests in Prop Co are greater than 50% (ie 66.6%). Therefore, together, John and Paul control both the J&P Partnership and Prop Co.

Variation 2

A year later, Denise decides to exit Prop Co. She finds a buyer for her shares in Prop Co (Eugenie). Eugenie indicates to John and Paul that she is interested in acquiring some or all their shares in Prop Co if they wish to sell. John and Paul each decide to sell an 8.3% shareholding in Prop Co to Eugenie.

After the sale, the partnership interests and shareholdings in Prop Co are as follows:

	John	Paul	Eugenie
Partnership interest	50%	50%	0%
Shareholdings	25%	25%	50%



After the sale, the J&P Partnership and Prop Co cannot be members of a mixed group of registered persons for GST purposes. This is because the two persons carrying on a taxable activity in partnership (John and Paul) together hold only 50% of the shares in Prop Co, and so do not "control" Prop Co.

121. Co-owners of property who are not carrying on a taxable activity in partnership cannot use the method of grouping in s 55(8)(c). Example | Tauira 16 illustrates this situation.

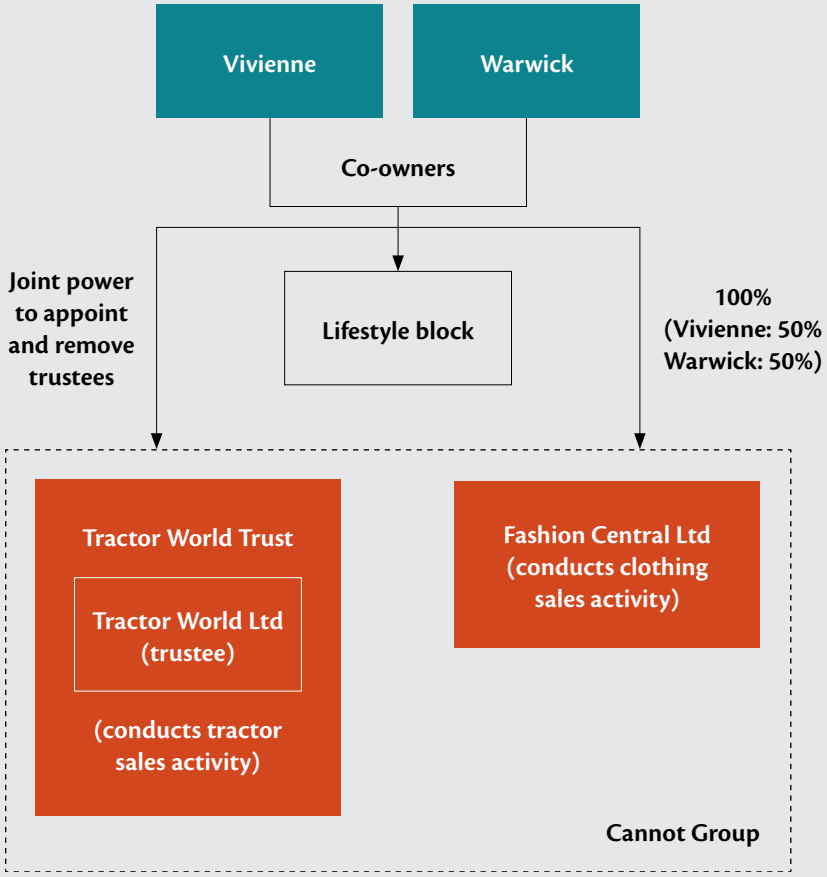
Example | Tauira 16 – Co-owners of property own 50% each of a company, and hold the power to appoint and remove the trustees of a trust

Vivienne and Warwick own and occupy a lifestyle block as tenants in common. Their 18-year-old twins, Tony and Ursula, live with them.

Vivienne and Warwick each own 50% of the shares in Fashion Central Ltd (FCL). FCL imports and sells clothing items from France and Italy. It rents business premises in the local town. The premises include both a shop and sufficient storage for excess merchandise. Vivienne manages the business. FCL is registered for GST.

Vivienne and Warwick are also settlors of the Tractor World Trust (TWT), and jointly hold the power to appoint and remove the trust's corporate trustee, Tractor World Ltd. TWT imports and sells tractors. It operates from business premises on the outskirts of the local town. Warwick manages the business. TWT is registered for GST.

Vivienne and Warwick want to reduce their GST compliance costs so apply to form a mixed group of registered persons consisting of FCL and TWT.

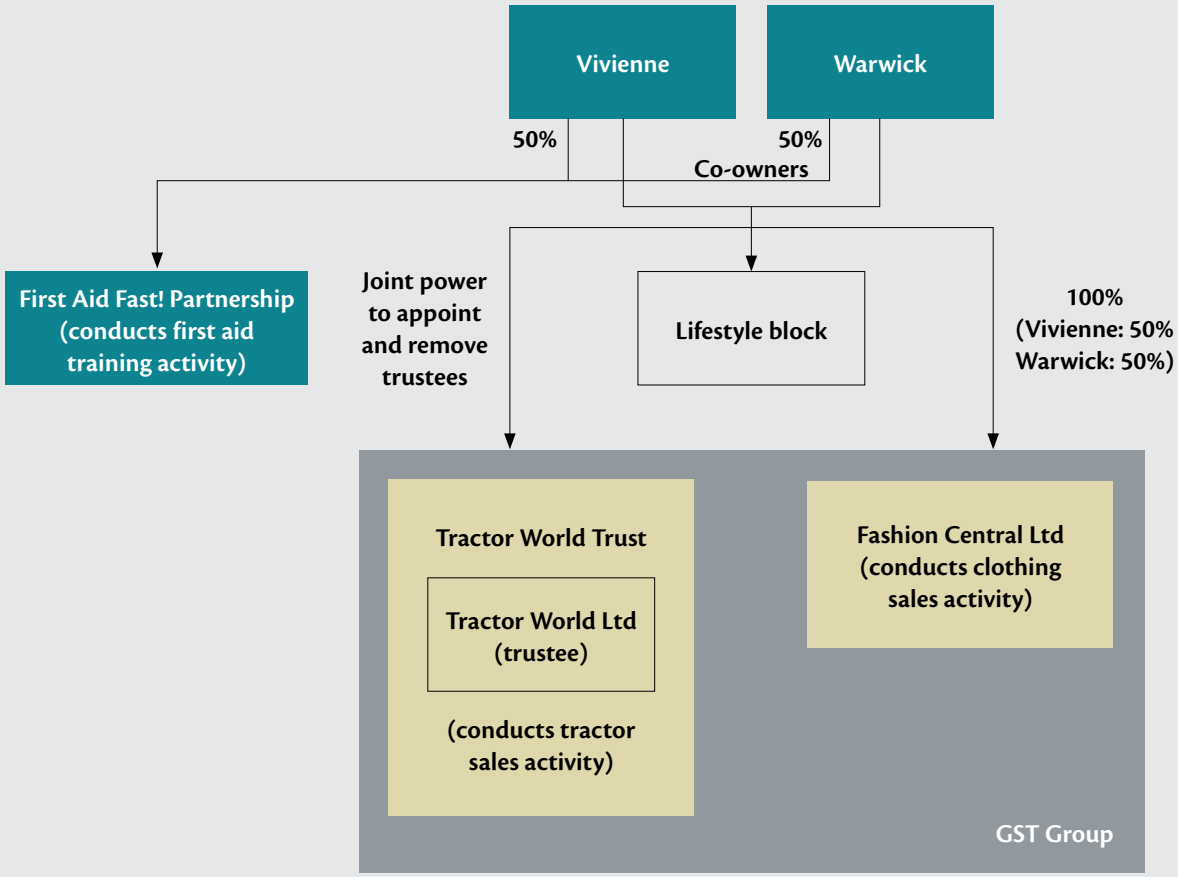


FCL and TWT cannot be members of a mixed group of registered persons for GST purposes. Vivienne and Warwick each hold 50% of the shares in FCL, so neither of them, as "one person", controls FCL. Similarly, Vivienne and Warwick jointly hold the power to appoint and remove the trustees of TWT. Although they jointly control TWT, neither Vivienne nor Warwick controls TWT on their own. Vivienne and Warwick do not carry on a taxable activity together in partnership.

Variation

Five years later, Vivienne and Warwick decide to employ their son Tony to manage Tractor World (with oversight from Warwick) and their daughter Ursula to manage Fashion Central (with oversight from Vivienne).

Vivienne and Warwick decide to establish a partnership providing first-aid training to local schools, businesses and government agencies, the First Aid Fast! Partnership (FAF Partnership). They expect the taxable supplies that the FAF Partnership will make in the first 12-month period will be about $50,000 (ie under the registration threshold of $60,000). Vivienne and Warwick decide they will not voluntarily register the partnership for GST; however, on the advice of their accountant, they apply again to group register FCL and TWT.



Following the establishment of the FAF Partnership, FCL and TWT can be members of a mixed group of registered persons. This is because two or more persons carrying on a taxable activity in partnership (Vivienne and Warwick) control both FCL (through their 100% combined shareholding) and TWT (through their joint power to appoint and remove trustees).

Limited partnerships

122. As noted at [19], a limited partnership registered under the LPA 2008 is a "company" under the GSTA.[15] However, limited partnerships cannot be members of "groups of companies" under s IC 3 of the Income Tax Act 2007. Limited partnerships are therefore grouped under s 55(8).

[15] A limited partnership registered under the LPA 2008 is a "body corporate". See "QB 14/03: Goods and Services Tax – Transfer of interest in a partnership", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 57. (See references section for link.)

123. Legal control of a limited partnership registered under the LPA 2008 will usually be exercised by a partner that can make "resolutions of the limited partnership" without requiring the support of other partners. Under the LPA 2008, the default percentage of capital contribution required to make a resolution is at least 75% of all the capital contributions to the limited partnership. However, the actual level of capital contribution required to pass a resolution will depend on the terms of the partnership agreement for the limited partnership in question.

Nature of a limited partnership

124. In New Zealand, the law governing limited partnerships is not grounded in general partnership law. Although the LPA 2008 includes some provisions from the Partnership Act 1908 (now the PLA 2019) and from the Companies Act 1993, the LPA 2008 is intended to be a "code" (ie a self-contained set of rules governing limited partnerships). This recognises that a limited partnership is a hybrid of a company and a general partnership.[16]

125. A limited partnership is a partnership that is registered under the LPA 2008 (s 6, LPA 2008). A limited partnership only exists when it is registered (s 7, LPA 2008). A limited partnership must have at least one limited partner and one general partner, but a person cannot be both a limited partner and a general partner of the same limited partnership at the same time (s 8, LPA 2008). Once registered, a limited partnership is a separate legal person (s 11, LPA 2008).

126. Any person (including a general partnership or an overseas limited partnership) may be a limited partner in a limited partnership (s 18, LPA 2008). The general partner must be a natural person, a limited partnership, a general partnership, a company or an overseas company, and must have a connection with New Zealand (as described in s 8(4), LPA 2008).

Control of a limited partnership

127. A limited partnership must have a written agreement (s 9, LPA 2008). The partnership agreement must deal with certain issues, including (among other things):
    - meetings and procedure; and
    - entry and exit from the limited partnership (including whether a partner may be expelled from the limited partnership) (s 10, LPA 2008).

128. Decisions are made by a "resolution of the limited partnership". The default position under the LPA 2008 is that a resolution must be passed or signed by partners that have contributed at least 75% of the capital contributions of all the partners. So under this position, for example, a partner who has contributed 51% of total partnership capital does not "control" the limited partnership. However, the partnership agreement may modify this requirement (s 4, LPA 2008).

Role of safe harbours

129. The general partner is responsible for managing the limited partnership (s 19, LPA 2008). Limited partners cannot usually participate in managing the limited partnership (s 20, LPA 2008). If they do so, these partners may lose (or partially lose) their limited liability status (s 30, LPA 2008). At first glance, it may appear that the combined effect of ss 19, 20 and 30 would be to reduce limited partner resolutions to a few or perhaps none, meaning that the LPA 2008, in most cases, would confer legal control of a limited partnership on the general partner.

130. However, a limited partner can participate in decision-making on a list of matters that, under the LPA 2008, do not constitute taking part in the management of a limited partnership. These matters are known as "safe harbours" (s 31 and sch 1, LPA 2008).

131. One of the "safe harbours" is to take part in a decision to replace the general partner. Therefore, if the partnership agreement grants a limited partner a right to participate in a decision to replace the general partner, the limited partner may participate in the decision without losing (or partially losing) their limited liability status.

132. Depending on the specific clauses of the partnership agreement, the safe harbours therefore ensure that the limited partners can exercise control over the general partner's management of the limited partnership (and therefore over the limited partnership).

[16] N Wells and P Wilkie, *Wells' Limited Partnership Handbook* (Wellington, LexisNexis NZ Limited, 2008), [1.1.2].

Partnership interest includes rights to receive distributions, other benefits, and liabilities and burdens

133. In a limited partnership, a partner's "partnership interest" is:
    - the partner's share of the assets of the limited partnership;
    - the partner's right to receive distributions from the limited partnership;
    - the partner's right to any other benefit that the partnership agreement confers; and
    - any liability or other burden of the partner in relation to the limited partnership (s 38, LPA 2008).
134. Unlike general partnership law, the LPA 2008 does not contain a presumption that the partners in a limited partnership will share the profits equally between them. Instead, it requires that the partnership agreement specifically deals with the partners' entitlement to distributions (s 10(c), LPA 2008).
135. There may be circumstances in which the amount of the partner's capital contribution (which usually determines their voting rights) does not accurately reflect who has legal control of the limited partnership. Other relevant factors in assessing control include the right to receive distributions, the right to receive other benefits that the partnership agreement confers, and the liabilities and other burdens of a partner in relation to the limited partnership.
136. The Commissioner considers that where either or both of the following apply, the relevant partner may be seen as having legal control of the limited partnership:
    - The partner has the right, under the partnership agreement or otherwise, to receive distributions from the limited partnership (including on winding up) that are not proportional to the partner's capital contribution and are not proportional to its voting rights. For example, assume there are two limited partners in a limited partnership. Under the partnership agreement, each limited partner's capital contribution is 49.5% of the total partnership capital and each has 49.5% of the voting rights. (The general partner is required to contribute 1% of the total partnership capital and has 1% of the voting rights. Each limited partner holds 50% of the shares in the general partner.) However, the partnership agreement does not entitle each limited partner to receive 49.5% of the total amount distributed by the limited partnership. Instead, it entitles Limited Partner A to receive 59.5% and Limited Partner B 39.5% of the total amount distributed. (The general partner is entitled to receive 1% of the amount distributed.) In this case, Limited Partner A may be considered to have legal control of the limited partnership.
    - The partner has the right, under the partnership agreement or otherwise, to receive any other benefit that is not conferred on all the other partners (after taking into account any liability or burden that the partnership agreement confers on that partner). For this reason, its economic entitlements are not proportional to its voting rights. For example, assume the partner contributions, voting rights and shareholdings in the general partner are the same as in the bullet point above. However, Limited Partner A is entitled to receive from the limited partnership, each year for the first 5 years, an amount equal to 8% of the limited partnership's net profit for that year. Limited Partner B is not entitled to receive any amount from the limited partnership for the first 5 years. From year 6, each limited partner is entitled to receive a distribution equal to 4% of the limited partnership's net profit for the year. In this case, Limited Partner A may be considered to have legal control of the limited partnership during the first 5 years.
137. However, in this type of situation, it would be necessary to carefully assess all clauses of the partnership agreement and other relevant documents to confirm whether Limited Partner A has legal control.
138. Therefore, who has legal control of a limited partnership will depend on the provisions of the partnership agreement governing the limited partnership. The default position under s 4, LPA 2008 is that one or more partners who have contributed at least 75% of the partnership capital can make resolutions of the limited partnership. The default position under s 31 and sch 1 is that limited partners can participate in decision-making on all safe harbour matters, which include replacing the general partner, without compromising their limited liability status.
139. The Commissioner considers that the following positions apply under a "standard" limited partnership agreement (ie one that adopts the default positions covered in this section and provides that distributions (including on winding up) are made proportionally to the partners' capital contributions):
    - A limited partner who has contributed at least 75% of the total partnership capital would, usually, have legal control of the limited partnership.
    - If no one person has contributed at least 75% of the partnership capital, then no one person would control the limited partnership for GST grouping purposes.

140. However, if the partnership agreement allows a partner who has contributed more than 50% of total partnership capital (a majority partner) to make resolutions without the support of any of the other partners, the majority partner would, usually, have legal control of the limited partnership (see Example | Tauira 17).

141. In some limited partnerships, no "one partner" is able to make resolutions of the limited partnership. Instead, the limited partnership will be under the joint control of some or all of the limited partners, and no "one person" will control the limited partnership for GST grouping purposes (see the variation in Example | Tauira 17).

Example | Tauira 17 – 51% controlled partnership; 50:50 jointly controlled partnership

The NZ ESL Limited Partnership is a limited partnership registered under the LPA 2008. It carries on a taxable activity of teaching English as a second language (ESL) to secondary school students in New Zealand and is registered for GST.

The NZ ESL Limited Partnership has two limited partners: the Flora Family Trust (which has contributed 50.5% of partnership capital) and the NZ ESL Charitable Trust (which has contributed 48.5%). The general partner, NZ ESL GP Ltd, has contributed 1%. The Flora Family Trust holds 51% of NZ ESL GP Ltd's shares and the NZ ESL Charitable Trust holds the other 49%.

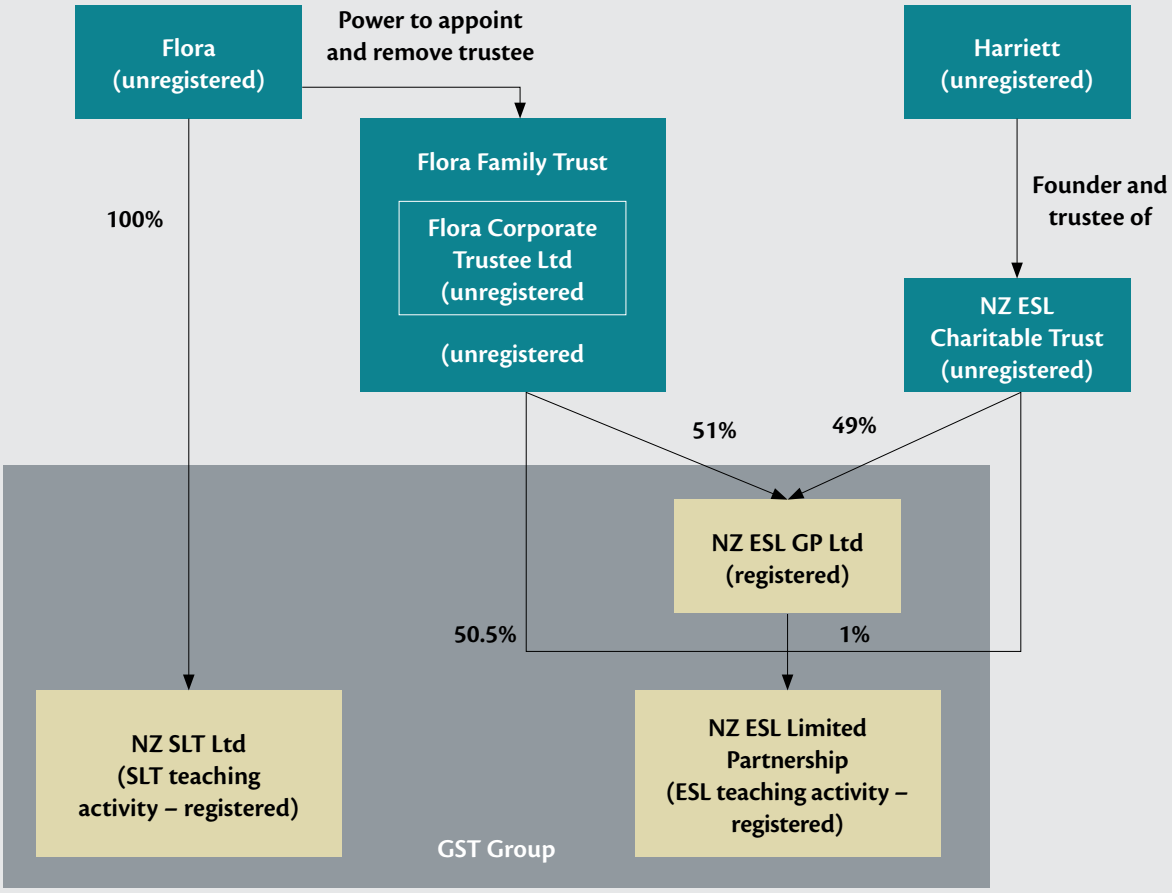
Flora is a settlor of the Flora Family Trust. The trust has a corporate trustee, Flora Corporate Trustee Ltd, of which Flora is the sole shareholder. Under the trust deed, Flora holds the power to appoint and remove the trustee of the trust. Before the NZ ESL Limited Partnership was registered, Flora was an ESL teacher. She developed many of the materials the NZ ESL Limited Partnership now uses and trained many of the ESL teachers it now employs. She also trained the business manager, Iris.

Flora has since retrained and NZ SLT Ltd now employs her as a private speech language therapist. NZ SLT Ltd is a look-through company and is registered for GST. Flora owns 100% of NZ SLT Ltd's shares.

Harriett is the founder and trustee of the NZ ESL Charitable Trust. Before the NZ ESL Limited Partnership's registration, Harriet was also heavily involved in developing the educational materials the NZ ESL Limited Partnership now uses and in training the teachers it now employs.

The partnership agreement for the NZ ESL Limited Partnership states that a partner or partners that have contributed more than 50% of the capital contributions of all the partners must pass or sign any resolution of the limited partnership. The partnership agreement also allows limited partners to participate in decisions on all safe harbour matters listed in sch 1, LPA 2008. The partnership agreement states that distributions (including on termination) are to be made proportionately to the partners' capital contributions.

Flora wishes to simplify the GST filing for the NZ ESL Limited Partnership and NZ SLT Ltd and applies for them to be treated as members of a mixed group of registered persons for GST purposes.



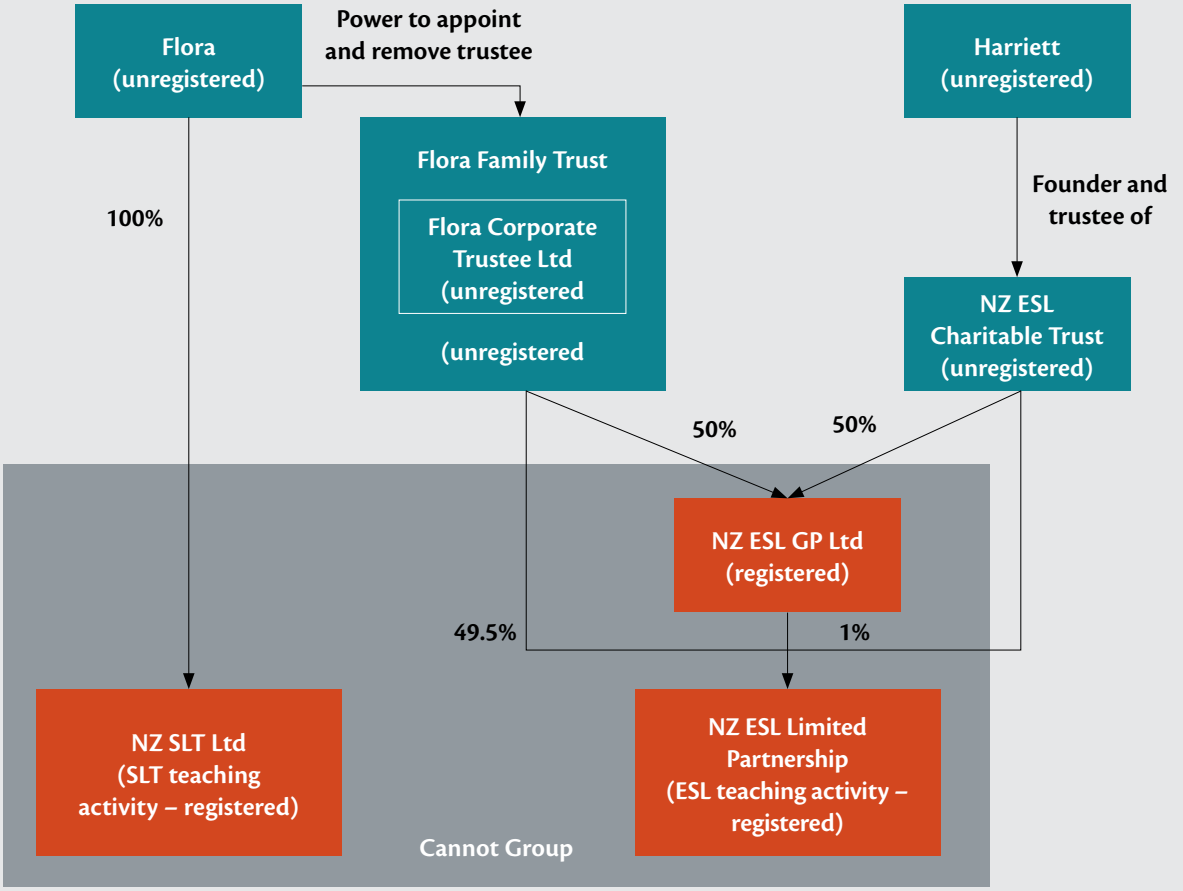
The NZ ESL Limited Partnership and NZ SLT Ltd can be members of a mixed group of registered persons for GST purposes. Flora controls the NZ ESL Limited Partnership because:

- the Flora Family Trust (as limited partner) has contributed more than 50% of the partnership capital and holds more than 50% of the voting rights in the NZ ESL Limited Partnership (and is entitled to more than 50% of the distributions, including on winding up). The Flora Family Trust therefore controls the NZ ESL Limited Partnership; and
- Flora controls the Flora Family Trust, through holding the power to appoint and remove the trust's corporate trustee.

Flora also controls NZ SLT Ltd because she holds 100% of the ownership interests in NZ SLT Ltd. The NZ ESL Limited Partnership and NZ SLT Ltd are each registered for GST.

Variation

The facts are as above, but the contributions to the NZ ESL Limited Partnership are: Flora Family Trust 49.5%, NZ ESL Charitable Trust 49.5%, NZ ESL GP Ltd 1%. The Flora Family Trust holds 50% of the shares in NZ ESL GP Ltd and the NZ ESL Charitable Trust holds the other 50%.



The NZ ESL Limited Partnership and NZ SLT Ltd cannot be members of a mixed group of registered persons for GST purposes. Although both entities are registered persons and Flora controls NZ SLT Ltd, Flora does not control the NZ ESL Limited Partnership. This is because the Flora Family Trust (which Flora still controls) can no longer pass resolutions of the limited partnership without the support of other partners.

Joint ventures

142. In most cases, the way to determine legal control of a joint venture is to refer to the voting powers contained in the contracts establishing the joint venture (joint venture agreement). However, if the joint venture agreement requires all decisions to be made unanimously, this approach will establish that the joint venture has no "one person" that controls it. In some cases there may be legal arrangements outside the joint venture agreement which mean the ordinary voting powers of the joint venturers under the joint venture agreement will not show who has legal control of the joint venture. An alternative approach will be required, eg to refer to the joint venturers' respective capital contributions and income entitlements set out in the joint venture agreement, or in other legally enforceable agreements or arrangements. Such entitlements (potentially combined with other legally enforceable agreements or arrangements as to voting or refraining from voting) may determine who has control of the joint venture.

The nature of a joint venture

143. There is no particular legal definition of a joint venture (*United Dominions Corp Ltd v Brian Pty Ltd* (1985) 157 CLR 1 and *Commercial Factors Ltd v Scenic Hotel Group Ltd* [2019] NZHC 2370). However, case law indicates that a joint venture will have the following features.

144. The term usually refers to a situation where parties come together for a particular common commercial goal (*Commercial Factors*). There must be a joint undertaking where plans are worked through for the benefit of, and with input from each party (*Commerce Commission v Fletcher Challenge Ltd* [1989] 2 NZLR 554 (HC)).

145. Joint ventures are fundamentally formal contractual associations (although the contract does not need to be in writing). Joint ventures are usually distinguishable from partnerships because they are not formed to conduct a general and ongoing business but tend to have a finite and confined purpose (*Commercial Factors*).

146. To have a joint venture, something more is needed than mere fortuitous co-ownership as would have occurred if somehow each side independently purchased 50% of an asset without reference to the other (*Fletcher Challenge*). There must also be something more than mere passive co-ownership, where each party advances money and is interested merely in a return without any participation in decision-making (*Fletcher Challenge*).

Control of a joint venture

147. The general approach to determining legal control of a joint venture is to refer to the respective interests of the joint venturers in the joint venture, as outlined in the joint venture agreement.

148. In most cases, to determine who has legal control of the joint venture it will be sufficient to refer to the voting powers of the joint venturers as outlined in the joint venture agreement. An alternative approach, where the voting powers in the joint venture agreement do not accurately reflect the joint venturers' legal interests in the joint venture, is to refer to the joint venturers' respective capital contributions and the profit-sharing arrangements contained in the joint venture agreement (or in other legally enforceable agreements or arrangements, if relevant).

149. If the joint venture agreement requires all decisions to be made jointly, it may be that no "one person" controls the joint venture (see Example | Tauira 18).

Example | Tauira 18 – A 50:50 or 60:40 joint venture; unanimous agreement required

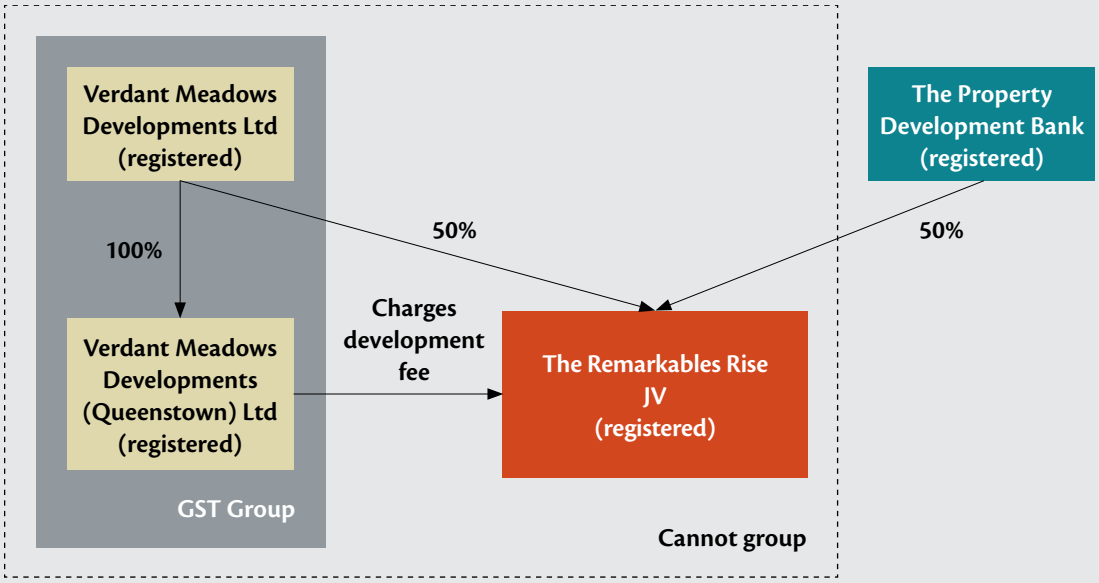
Verdant Meadows Developments Ltd (VMDL), a property development company, has identified a potential site for a residential development near Queenstown. The site has commanding views of the Remarkables. VMDL starts negotiations with the landowner but cannot agree on a price it can afford without bringing a funder on board.

VMDL approaches the Property Development Bank (PDB) with a development proposal for the site, which will be marketed as "Remarkables Rise". PDB agrees to contribute 50% of the total amount required to purchase, develop and subdivide the land into lots ready for sale, on the basis it will be entitled to 50% of the net sales proceeds. Verdant Meadows Developments (Queenstown) Ltd (VMDQL), a VMDL group company, will provide the expertise and equipment necessary to carry out the development work and charge a development fee. VMDL and PDB will each be responsible for their own administrative costs relating to the joint venture.

The parties record their agreement in a written contract, the Remarkables Rise Joint Venture Agreement (JVA). The JVA also:

- provides that in making any decisions about the joint venture, both VMDL and PDB must pass or sign a resolution; and
- confirms that the parties do not intend to create a partnership.

The development begins and the Remarkables Rise JV is registered for GST on the basis that it carries on a taxable activity of property development. VMDL applies to the Commissioner to include the Remarkables Rise JV in the VMDL GST group.

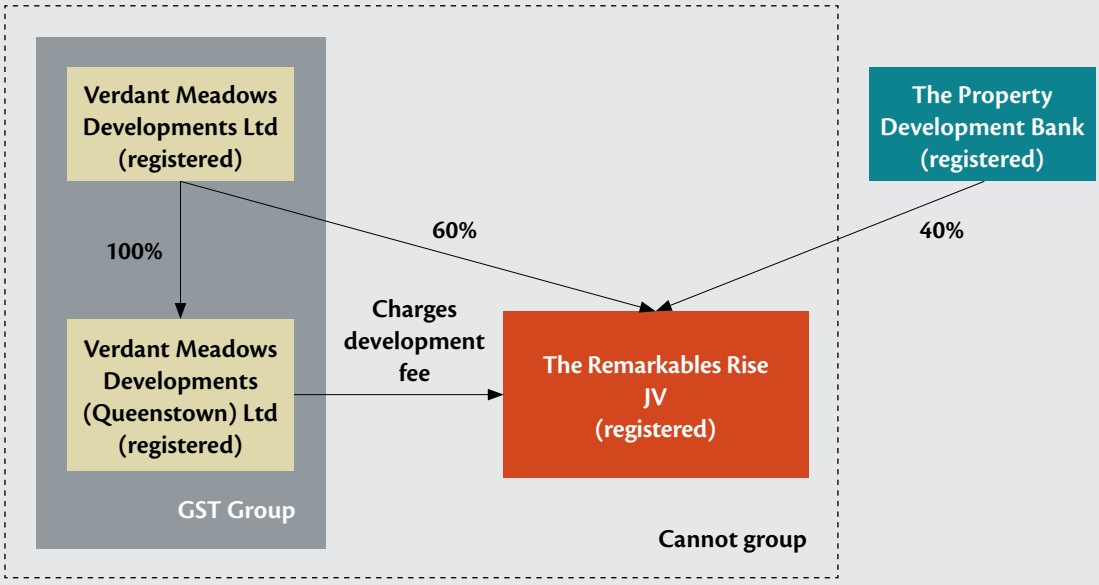


The Remarkables Rise JV cannot be a member of a mixed group with companies in VMDL's group that are registered persons. (Similarly, the Remarkables Rise JV cannot be a member of a mixed group with companies in PDB's group that are registered persons.) This is because no "one person" controls the Remarkables Rise JV. VMDL and VMDQL can continue to be members of a GST group of companies under s 55(1).

Variation

The facts are as above, except that under the JVA:

- VMDL will contribute 60% of the costs and will be entitled to receive 60% of the net sales proceeds; and
- PDB will contribute 40% of the costs and will be entitled to receive 40% of the net sales proceeds.



The requirement for unanimous decision-making remains unchanged.

The Remarkables Rise JV still cannot be a member of a mixed group with companies in VMDL's group that are registered persons. (Similarly, the Remarkables Rise JV cannot be a member of a mixed group with companies in PDB's group that are registered persons.) This is because, due to the requirement for unanimous decision-making, no "one person" controls the Remarkables Rise JV. VMDL and VMDQL can continue to be members of a GST group of companies under s 55(1).

How to register a GST group

150. A GST group of companies under s 55(1) or a mixed group of registered persons under s 55(8) must be registered with Inland Revenue.

151. Persons seeking to register a GST group of companies or a mixed group should either apply to Inland Revenue through myIR or complete form IR 374 and submit it through IR's secure online service. Include the following information:

- the name and IRD number of the proposed representative member;
- the IRD number for each proposed member of the GST group. If one or more of the proposed members has no IRD number, then they need to apply for one. They can do so online – see IRD numbers for businesses and organisations (ird.govt.nz). Each proposed member of a mixed group under s 55(8) will also need to be registered for GST. For instructions on registering for GST, see Register for GST (ird.govt.nz);
- the name and IRD number (if applicable) of each person who controls the proposed GST group;
- if a trust will be a member of the GST group, a copy of the trust deed, showing the name of each trustee of the trust and, if relevant, the clause granting a person the power to appoint and remove trustees; and
- if a limited partnership will be a member of the GST group, a copy of the partnership agreement for the limited partnership, or relevant clauses showing who may make resolutions of the limited partnership, and the rules governing contribution of partnership capital, distributions, and any other benefits or burdens making up a partner's partnership interest.

152. An unregistered company cannot be the representative member of a GST group. Therefore, the application should name a GST registered person as the proposed representative member.

153. For further information, see Register for GST as a group (ird.govt.nz). For a discussion of the consequences of GST grouping, see "IS 24/02: GST – Grouping for companies".

Grouping non-residents registered under s 54B

154. Non-residents may be required to register for GST under the general registration provision (s 51) because they carry on a taxable activity and have made taxable supplies in New Zealand over the GST registration threshold of $60,000 in the previous 12-month period, or they intend to do so in the next 12-month period. Non-residents may also be entitled to register voluntarily under s 51 because they carry on a taxable activity and do not make taxable supplies in New Zealand that exceed the $60,000 threshold: see Registering for GST (ird.govt.nz) and GST for overseas businesses (ird.govt.nz). The special rules discussed in this section do not apply to non-residents registered under the general registration provision (s 51).

155. Non-residents that do not make taxable supplies in New Zealand (and that meet certain other requirements) are entitled to register for GST under s 54B to recover New Zealand GST they have incurred (see "IS 21/03: GST – Registration of non-residents under section 54B"[17]).

156. Non-residents who are registered under s 51 may have a branch or division that does not make taxable supplies in New Zealand. The non-resident may register that branch or division under s 54B, if it meets the requirements for registration in s 54B(1). The branch or division will be treated as a separate person (s 54B(4)-(5)).

157. Section 55(1B) sets out special rules for persons registered under s 54B who are members of GST groups. Section 55(1B) provides that non-residents registered under s 54B cannot group register with persons who are New Zealand residents. However, s 55(1B) does not prevent non-residents who are registered under s 54B from group registering with other non-residents.

158. One of the consequences of GST group registration is that supplies members of the group make are usually treated as made by the representative member (s 55(1AE)).

159. If all the proposed members of a GST group are registered under s 54B, then none of the proposed group members will make taxable supplies in New Zealand.

160. However, if some of the proposed members of the group are s 51 registered persons who make taxable supplies in New Zealand, and their supplies are treated as made by the representative member who is a s 54B registered person, this will disqualify the person from being registered under s 54B.

[17] *Tax Information Bulletin* Vol 33, No 6 (July 2021): 140.

161. Therefore, in practice, the Commissioner will only allow a s 54B registered person to be the representative member of a GST group if all members of the group are s 54B registered persons. An application for group registration containing non-residents registered under both s 51 and s 54B should name a person registered under s 51 as the proposed representative member.

162. The comments at [161] apply to a non-resident's branch or division registered under s 54B as if it were a separate person (s 54B(5)). Therefore, the Commissioner will not process an application that names a branch or division registered under s 54B as the representative member of a GST group that contains persons registered under s 51. For this purpose, persons registered under s 51 include the non-resident of which the s 54B registered person is a branch or division, assuming the non-resident is registered under s 51 when the application for group registration is made. A non-resident registered under s 51 that has a branch or division registered under s 54B may be the representative member of a GST group.

Summary tables

Groups of companies

163. Figure | Hoahoa 4 summarises, for various types of "company" that may group register under s 55(1), considerations that can help you determine whether group registration is available. This list is not exhaustive. It is relevant only to the requirements of s 55(1)(a). The companies must also meet the requirements of s 55(1)(b).

Figure | Hoahoa 4 – Entities that may be members of GST groups of companies

Entity	Comments
Companies Act 1993 company	A company can group if there is 66% common ownership between it and the other companies.
Look-through company	A look-through company can group if there is 66% common ownership between it and the other companies.
Multi-rate PIE	A multi-rate PIE can group if there is 66% common ownership between it and the other companies.
Listed PIE	A listed PIE can group if there is 66% common ownership between it and the other companies.
A body corporate that is none of the above, whether incorporated in New Zealand or elsewhere, but excluding a local authority or a public authority (eg a foreign company)	Is capable of being a member of a "group of companies" under s IC 3, ITA 2007 if 66% commonly owned. Also satisfies the s 2 definition of "company". Can group if there is 66% common ownership between it and the other companies. **Note**: If the body corporate is a non-resident registered under s 54B, it can only group with other non-residents. A s 54B registered person cannot be the representative member of a GST group, unless all group members are s 54B registered persons.

The control test for mixed groups

164. Figure | Hoahoa 5 summarises, for various types of registered person, considerations that can help you determine who has legal control of the registered person, and therefore when it may group register for GST under s 55(8). This list is not exhaustive.

Figure | Hoahoa 5 – Legal control for members of mixed groups

Person	Comments
An individual (eg a sole trader)	An individual acting in their individual capacity (eg as a sole trader) is registered for GST in this capacity. The question of control does not arise for an individual who is registered for GST in their individual capacity. If an individual becomes incapacitated (including on death or bankruptcy), a specified agent may be appointed under s 58. The appointment of a specified agent does not affect GST grouping (s 55(4A)).
A "company" as defined in s 2, excluding a limited partnership. For example, it may be: • a company incorporated under the Companies Act 1993, • a look-through company, • a multi-rate PIE or listed PIE that is established as a body corporate, or • a foreign company. A multi-rate PIE or a listed PIE that is not established as a body corporate, but is a "company" as defined in s YA 1 of the Income Tax Act 2007.	A person has legal control of a company (or multi-rate PIE or listed PIE) if they hold more than 50% of the ownership interests. At least one member of the group must be a non-company or a limited partnership.
A trust	The general rule is that the trustee or trustees have legal control of a trust and so "control" the trust in their capacity as trustee(s) of that trust. Despite the above, the Commissioner considers that the following person(s) have legal control of the trust (where they exist): • a person with the power under the trust deed to appoint and remove trustees, or • two or more persons carrying on a taxable activity in partnership who jointly hold the power under the trust deed to appoint and remove trustees.
A partnership	Under s 51 of the Partnership Law Act 2019, a majority of the partners generally exercise legal control of a partnership. Where a majority of the partners exercise legal control, there will be no "one person" that controls the partnership. However, where all partners have consented to one partner making decisions about ordinary matters connected with the partnership business, that partner will have legal control of the partnership.
A limited partnership	The general rule is that a partner "controls" the limited partnership if they can make resolutions of the limited partnership without the support of the other partners. Under a standard limited partnership agreement, a partner will be able to do so if they have contributed at least 75% of the partnership capital. If there are multiple limited partners (or two 50% limited partners), there may be no "one person" that controls the limited partnership. In a limited number of cases, legal control may be determined by referring to the partners' respective partnership interests.
A joint venture	The general approach to determining legal control of a joint venture is by referring to the respective interests of the joint venture partners in the joint venture. In most cases it will be sufficient to refer to the voting powers of the joint venturers contained in the joint venture agreement. If the joint venture agreement requires decisions to be made unanimously, this approach will establish that no "one person" controls the joint venture. In some cases, where voting powers do not accurately reflect legal control of the joint venture, it may be necessary to adopt an alternative approach of referring to the profit-sharing arrangements and the joint venturers' respective capital contributions.

Legislation

165. Sections 55(1), (1B) and (8) provide:

> **55 GST groups**
>
> (1) For the purposes of this Act, 2 or more companies (the companies) are eligible to be a GST group at a time if,—
>
> (a) at a time and under section IC 3 of the Income Tax Act 2007, the companies are a group of persons (the eligibility group) that—
>
> (i) is a group of companies; or
>
> (ii) is part of a group of companies; or
>
> (iii) would be a group of companies but for 1 or more members being a multi-rate PIE or a look-through company; or
>
> (iv) would be a group of companies but for 1 or more members being a listed PIE; and
>
> (b) the companies meet either or both of the following requirements:
>
> (i) at the time, are each a registered person:
>
> (ii) as the eligibility group and in a 12-month period that includes the time, make supplies to persons outside the eligibility group that are taxable supplies, or would be taxable supplies if made by a registered person, and that have a total value of at least 75% of the total value of the taxable supplies and other supplies made in that period by persons in the eligibility group to persons outside the eligibility group.
>
> …
>
> (1B) Despite subsections (1) and (4)(a), a person registered under section 54B may not apply to be a member of a GST group or for a further company to be a member of a GST group, if the resulting GST group would have both resident and non-resident persons as members.
>
> …
>
> (8) If the members of a group of 2 or more registered persons include a person that is not a company or is a limited partnership and the Commissioner is satisfied in relation to the members of the group that—
>
> (a) one of them controls each of the others; or
>
> (b) one person controls all of them; or
>
> (c) 2 or more persons carrying on a taxable activity in partnership control all of them,—
>
> the Commissioner may accept that the registered persons are a GST group, and subsections (2) to (6) apply to the group of registered persons as a GST group and to each of the registered persons as a member of the GST group.

166. Section 2 provides:

> **2 Interpretation**
>
> (1) In this Act, other than in section 12, unless the context otherwise requires,—
>
> …
>
> **company** means any body corporate, whether incorporated in New Zealand or elsewhere, and any limited partnership registered under the Limited Partnerships Act 2008; but does not include a local authority or a public authority
>
> **…**
>
> **trustee** includes an executor and administrator; and also includes Public Trust and the Māori Trustee

References | Tohutoro

Legislative references | Tohutoro whakatureture

Goods and Services Tax Act 1985 – ss 2 (definitions of "company", "person", "trustee" and "unincorporated body"), 54B, 55, 57 and 58

Income Tax Act 2007 – ss IC 3, YA 1 (definitions of "company", "market value interest" and "trustee"), YA 5, YB 21 and YC 2 – YC 6

Legislation Act 2019 – s 13 (definition of "person")

Limited Partnerships Act 2008 – ss 4, 6–11, 18–20, 30–31, 38 and sch 1

Partnership Law Act 2019 – ss 8, 12–15, 44–45, 48, 51 and sch 1, part 1

Case references | Tohutoro kēhi

Anglesea Builders Partnership v CIR (1987) 9 NZTC 6,181

British American Tobacco Company Ltd v IRC [1943] AC 335

Case 98 (1951) 1 CTBR (NS) 423

Case K54 (1988) 10 NZTC 444

Case K68 (1988) 10 NZTC 544

Case L42 (1989) 11 NZTC 1,261

Case L72 (1989) 11 NZTC 1,419

Case P70 (1992) 14 NZTC 4,469

Case U19 (1999) 19 NZTC 9,186

Commerce Commission v Fletcher Challenge Ltd [1989] 2 NZLR 554 (HC)

Commercial Factors Ltd v Scenic Hotel Group Ltd [2019] NZHC 2370

Commissioner of Taxes v Trustees of Joseph (deceased) (1908) 2 NZLR 1085; 10 GLR 556

Concepts 124 Limited v CIR (2014) 26 NZTC 21,100

Edwards v Legal Services Agency [2003] 1 NZLR 145

Fraser v Murdoch (1880-81) LR 6 App Cas 855

Gasparini v Gasparini (1978) 87 DLR (3d) 282; 20 OR (2d) 113

McElwee v CIR (1988) 10 NZTC 5,181

Taunton Syndicate v C of IR (1982) 5 NZTC 61,106; (1982) 5 TRNZ 259

United Dominions Corp Ltd v Brian Pty Ltd (1985) 157 CLR 1

Other references | Tohutoro anō

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QB 14/03: Goods and Services Tax – Transfer of interest in a partnership, *Tax Information Bulletin* Vol 26, No 5 (June 2014): 57. www.taxtechnical.ird.govt.nz/tib/volume-26---2014/tib-vol26-no5

QB 16/03: Goods and Services Tax – GST treatment of bare trusts, *Tax Information Bulletin*, Vol 28, No 5 (June 2016): 16. www.taxtechnical.ird.govt.nz/tib/volume-28---2016/tib-vol28-no5

N Wells and P Wilkie, *Wells' Limited Partnership Handbook* (Wellington, LexisNexis NZ Limited, 2008).

LEGAL DECISIONS – CASE SUMMARIES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

CSUM 24/02: Taxpayer challenge to timeliness of Commissioner's Statement of Position (CSOP) dismissed by TRA

Decision date: 08 March 2024

Case

[2024] NZTRA 002

Legislative References

Tax Administration Act 1994

Contracts and Commercial Law Act 2017

Legal terms

Issue

Information System

Summary

This was a taxpayer initiated dispute. The Commissioner's Statement of Position (CSOP) was issued within the relevant response period even if it was not seen by the Disputant within that response period.

In regard to email, these are received when the email leaves the information system of the sender and enters the information system of the recipient.

"Information system" is not confined to a specific part of an information system (such as an email address) but extends to the architecture needed to produce, send, receive, store, display, or otherwise process electronic communications.

Impact

For this challenge the decision means this challenge has not been resolved by the preliminary issue and the challenge to the CIR's assessments remains to be determined by the TRA.

Facts

The CIR assessed the Disputant for income tax on omitted income. The Disputant commenced a dispute to those assessments. On 21 October 2022 the Disputant issued a timely TSOP in response to the CIR's disclosure notice. This meant the Commissioner's Statement of Position (CSOP) had to be issued by 20 December 2022.

On 16 December 2022 the CIR's investigator issued an email with the Commissioner's Statement of Position (CSOP) attached. This was sent to the disputant's tax agent at his email address. This was the address for service provided by the Disputant. The CIR's email was issued at 2.56pm. After this the CIR's investigator left work ill with COVID 19. At 2.59pm a "bounce back" message was received from the tax agent's email server advising the CIR's email had not been delivered to the tax agents email address for an unspecified reason.

The "bounce back" email was not seen until the investigator returned to work on 21 December 2022. On that date the investigator re-issued the Commissioner's Statement of Position (CSOP) and this was received by the tax agent.

The Disputant argued the re-issued Commissioner's Statement of Position (CSOP) was issued outside the response period. He argued that the CIR was deemed to accept his TSOP and the dispute was concluded in his favour.

The CIR argued that the Commissioner's Statement of Position (CSOP) had been issued on 16 December 2022 and did not need to be received by the Disputant within the response period (as set out at s 89AB(5) of the TAA).

Issues

1. Did the CIR's email on 16 December amount to the "issue" of the Commissioner's Statement of Position (CSOP) for the purpose of s 89M(6BA) of the TAA?
2. Was the email on 16 December 2022 deemed to have been received by the Disputant?
3. What are the consequences if the 16 December 2022 email did not amount to the "issue" of the Commissioner's Statement of Position (CSOP) within the response period?

Decision

1. *Did the CIR's email on 16 December amount to the "issue" of the Commissioner's Statement of Position (CSOP) for the purpose of s 89M(6BA) of the TAA?*

The Authority found the CIR's email and attached Commissioner's Statement of Position (CSOP) were issued on 16 December 2022. The TRA accepted the CIR's submission that issue under s 89AB(5) did not require receipt by the Disputant (at [11] to [12]). The Authority particularly relied upon the decision in *CIR v Abattis* (2001) 20 NZTC 17,013 (CA) [see at [15]).

The Authority expressly declined to adopt the test found at s 213 of the Contracts and Commercial Law Act 2017 [CCLA] of when an electronic communication is dispatched. The Authority found this provision was not incorporated into tax law by s 14F(7) of the TAA (at [14]).

The Authority concluded the "bounce back" message received by the Commissioner was irrelevant in the absence of actual knowledge by someone in the Inland Revenue of that bounce back message (at [16]).

2. *Was the email on 16 December 2022 deemed to have been received by the Disputant?*

The Authority briefly summarised technical aspects of the relevant email systems (at [18] to [19]). Having done this the Authority concluded the reason the 16 December 2022 email was rejected was probably the default settings on the tax agent's email mailbox (that these were too low to accept the attached Commissioner's Statement of Position (CSOP): at [20].

The Authority rejected evidence by the Disputant's expert witness that the designated information system (for the purposes of s 214 CCLA; incorporated into the TAA by s 145F(7) was confined to the tax agent's nominated email address's mailbox. The Authority considered this was a legal issue for the Authority to determine (at [21] to [22]).

The Authority considered the definition of an information system (found at s 213(2) for the purposes of s 214 of the CCLA):

> **information system** means a system for producing, sending, receiving, storing, displaying, or otherwise processing electronic communications.

The authority stated at [24]:

> The evidence established that the designation was an email address. It included a domain name that belonged to the Disputant's agent. Accordingly, any email addressed to that email address could only be delivered if the domain name service provider to which the disputant's agent subscribed provided DNS [Domain Name System] information for the specific email. I am satisfied that was the first part of the designated information system the first email [the CIR's email dated 16 December 2022] encountered. Without doing so, no email could be delivered to that email address.

> ...
>
> [25] ... [T]he first email entered the "virtual server", which comprised the hardware and software services allowing the Disputant's agent to produce, send, receive, store, display and otherwise process electronic communications. That was, for the first email, the Microsoft Exchange system, and the Disputant's agent could direct and manage the email flow using that software. ... I could not conclude that any part of the Disputant's agent exchange system as it related to emails was outside of the "information system" defined in s 213 for the purposes of the CCLA.

As such the Authority could not accept the Disputant's expert's opinion the information system was confined to the email address for the purposes of the CCLA (at [28]). The Authority continued at [30]:

> ... the [CCLA] legislation is highly consistent with the despatch of a correctly addressed email. Which reaches any part of the architecture a user has for receiving email is deemed delivered when it enters the recipient's system. I cannot conclude it must reach a specific part of that system, that is not how the CCLA is expressed.

3. *What are the consequences if the 16 December 2022 email did not amount to the "issue" of the Commissioner's Statement of Position (CSOP) within the response period?*

Having concluded the Commissioner's Statement of Position (CSOP) was both issued and received within the response period, it was unnecessary for the TRA to consider what the consequences would be if the CSOP had not been issued in a timely manner.

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation Review Authority, the District Court, the High Court, the Court of Appeal, or the Supreme Court in matters involving the Revenue Acts. For Taxation Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.

TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

TDS 24/04: Receipt of a one-off payment

Decision date | Rā o te Whakatau: 15 December 2023

Issue date | Rā Tuku: 25 March 2024

Subjects | Kaupapa

Income tax: derivation, financial arrangement, loan, money lent, one-off payment.

Taxation laws | Ture tāke

All legislative references are to the Income Tax Act 2007 (ITA 2007), unless otherwise stated.

Facts | Meka

1. The Taxpayer is an experienced real estate agent. They had entered into a contract (Contract) with an agency (Agency) as an individual contractor.
2. The Contract included a one-off payment (Payment) that was payable by the Agency upon the signing of the Contract. This was required to be repaid by the Taxpayer if the Agency or the Taxpayer terminated the Contract within two years.
3. The Agency deducted withholding tax from the Payment, which was passed to Inland Revenue.
4. The Taxpayer filed their return showing the withholding deduction but did not include the Payment as income.
5. Customer and Compliance Services, Inland Revenue (CCS) issued a notice of proposed adjustment to include the omitted income.
6. The Taxpayer argued that the Payment was a loan and that the Payment was only taxable after the expiry of the potential termination event.

Issues | Take

7. The main issues considered in this dispute were:
   - whether the Payment was a loan; and
   - when the Payment was derived.

Decisions | Whakatau

8. TCO concluded that:
   - the Payment received by the Taxpayer was not a loan; and
   - the Payment was derived on receipt and should have been included in the relevant return.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Whether the payment was a loan

9. The Taxpayer argued that the Payment was a loan of capital at nil interest over a 2-year period.
10. CCS disagreed and considered that the Payment did not meet the statutory definition of a loan and the contractual terms did not describe the Payment as a loan.
11. If the Payment was a loan from the Agency, the amount of principal is not treated as income under the ITA 2007.

Onus of proof

12. Section 149A of the Tax Administration Act 1994 places the onus of proof on the taxpayer and not the Commissioner.[1] The onus is on the taxpayer to show that an assessment is wrong, why it is wrong, and by how much it is wrong.
13. The courts have also held that the standard of proof required is the balance of probabilities.[2]

What is a loan?

14. To understand whether the Payment is a loan it is necessary to consider the legal arrangements entered into by the parties:
    - It is necessary to consider, objectively, the true nature of the legal arrangements that were entered into and carried out and not the overall economic consequences. This is determined by the contract that embodies the transaction.[3]
    - The aim is to ascertain the meaning the document would convey to a reasonable person having the background knowledge which would have been available to the parties at the time. Context provided by the contract as a whole and relevant background inform meaning.[4]
    - While context is important the text of the document remains centrally important, rather than particular words. When looking at the surrounding circumstances it is necessary to determine the agreement entered into as reflected in the documents. These circumstances cannot be used to alter the agreement.[5]
    - This interpretive approach to contracts is no different for tax cases.[6]
15. Loans are typically taxed under the financial arrangement rules in the ITA 2007. Included under the financial arrangement rules is a "debt" (s EW 3).
16. "Debt" is not defined in the ITA 2007, so it takes on its ordinary meaning. A debt can be summarised as an amount of money payable or due and that is recoverable by action.[7]
17. TCO also considered the definitions of "loan" and "money lent" in s YA 1. "Loan" has the same meaning as "money lent". The definition of "money lent" specifically includes an amount that a person lends, including by depositing it in an account, whether or not secured or evidenced in writing. It also includes an amount of credit a person gives, including by not enforcing a debt, whether or not the giving of credit is secured or evidenced in writing.
18. Further, the Concise Oxford English Dictionary defines an advance and loan as follows:

    advance … 4. hand over (payment) to (someone) as a loan or before it is due.

    loan n. a thing that is borrowed, especially a sum of money that is expected to be paid back with interest.

[1] *Case V17* (2002) 20 NZTC 10,192; *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC); *Vinelight Nominees Ltd v CIR* (No 2) (2005) 22 NZTC 19,519 (HC)

[2] *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Case Y3* (2007) 23 NZTC 13,028; *Case X16* (2005) 22 NZTC 12,216.

[3] *Buckley and Young Ltd v CIR* (1975) 2 NZTC 61,036; *CIR v Molloy* (1990) 12 NZTC 7,146.

[4] *Firm PI 1 Ltd v Zurich Australian Insurance and Body Corporate 398983* [2014] NZSC 147, (2014) 10 NZBLC 99–716 and see also Firm PI 1 Ltd v Zurich Australian Insurance and Body Corporate 398983 [2014] NZSC 147, (2014) 10 NZBLC 99–716; Pendarves Packaging Ltd v Baitworx Ltd [2014] NZHC 3,327, (2015) 1 NZBLC 99–718. [2014] NZHC 3,327, (2015) 1 NZBLC 99–718; Vector Gas Ltd v Bay of Plenty Energy Ltd [2010] NZSC 5, (2010) 9 NZBLC 102,874; *Buckley and Young Ltd v CIR* (1975) 2 NZTC 61,036; *CIR v Molloy* (1990) 12 NZTC 7,146.

[5] *Firm PI 1 Ltd v Zurich Australian Insurance and Body Corporate 398983* [2014] NZSC 147, (2014) 10 NZBLC 99–716

[6] *CIR v John Curtis Developments Ltd* [2014] NZHC 3,034, 26 NZTC 21-113 and see also *Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd* [1964] AC 948 (PC).

[7] The Concise Oxford Dictionary (12ed, 2011); *Case Q2* (1993) NZTC 5,005; *Colonial Mutual Life Assurance Society Limited v CIR* (1999) NZTC 1,573.

19. Similarly, the Black's Law Dictionary defines the terms as follows:

    advance, n (17c) 1. The furnishing of money or goods before any consideration is received in return. 2. The money or goods furnished,..

    loan 1. An act of lending; a grant of something for temporary use … 2. A thing lent for the borrower's temporary us; esp., a sum of money lent at interest …

20. In *CIR v Molloy*[8] it was found that the advance paid to the life insurance agent was not derived under the principles in *Arthur Murray*[9] (discussed further in Issue 2) due to the inherent risk of repayment that he held. This was based, at least in part, on the contract recording the advance as a debt.

21. Similarly, in *Case U4*[10] the contractual arrangements provided evidence that the advances the agent received were a loan from the outset and would only convert to revenue over time as it was progressively forgiven.

Application

22. TCO concluded that the Payment is not a loan because:

    - The substance of the Payment is determined by the terms of the Contract between the Taxpayer and the Agency, which describes the Payment as remuneration.
    - To receive the Payment, the Taxpayer was only obliged to sign the Contract and then the Agency was obliged to make the Payment. The Taxpayer's obligation to refund the Payment only arises if the Contract is terminated by the Taxpayer or the Agency within 2 years, not on signing the Contract. The potential repayment at a future time does not make the Payment a loan.
    - The Payment does not meet the definitions under the ITA 2007 for a financial arrangement, loan or money lent and does not meet the ordinary definitions of advance or loan. The terms of the Contract do not show the Payment was given to the Taxpayer temporarily with an expectation of repayment.
    - The case *Molloy* is not analogous to the current dispute. The risk of repayment in *Molloy* was significant as it was based on commissions yet to be earned and was secured by a mortgage over Molloy's assets. Additionally, the risk in *Molloy* was entirely out of the taxpayer's control as it could be triggered by unrelated third parties. However, the Taxpayer in this dispute did not provide evidence that the risk of termination was significant at the time the Contract was entered into.
    - *Case U4* is distinguished on the facts because in that case the amount advanced was progressively forgiven over time which was consistent with the advance being a loan. In contrast, the Contract does not provide for any forgiveness of the Payment, which suggests it was not considered a loan by the Agency.

Issue 2 | Take tuarua: When was the payment derived

23. The Taxpayer argued that the Payment is derived after the expiry of the potential termination event, while CCS argued that it was derived on receipt.

24. Section BD 3 allocates income to income years. Income is allocated to the income year in which it is derived (s BD 3(2)). To gain an understanding of when income might be derived and whether it is returned on a cash or accruals basis, case law must be considered (s BD 3(3)).

25. TCO identified the following principles from case law:[11]

    - Income is derived when it flows, springs, emanates, arises, or accrues from a particular source. (*Philips case*, *Hawke's Bay Power*)
    - When income is derived depends on the facts of the particular case. (*Carden's case*, *Arthur Murray*)
    - The two methods of recognising when income is derived are the cash or accruals methods. The choice of method should show the correct reflex of the taxpayer's true income. (*Carden's case*)

[8] *CIR v Molloy* (1990) 12 NZTC 7,146.

[9] *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 14 CLR 314.

[10] *TRA No 98/010* (1999) 19 NZTC 9,021 (*Case U4*).

[11] *CIR v NV Philips' Gloeilampenfabrieken* [1955] NZLR 868 (CA) (*Philips case*); *Hawke's Bay Power Distribution Limited v CIR* (1999) 19 NZTC 15,226 (CA) (*Hawkes Bay Power*); *C of T (SA) v Executor Trustee and Agency Company of South Australia Ltd* (1938) 63 CLR 108 (HCA) (*Carden's case*); *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 14 CLR 314 (*Arthur Murray*); *CIR v Molloy* (1990) 12 NZTC 7,146 (HC) (*Molloy*); *Bowcock v CIR* (1981) 5 NZTC 61,062 (HC) (*Bowcock*).

- The gains must "come home" to the taxpayer in a realised or immediately realisable form to be assessed as income. (*Carden's case, Arthur Murray*)
- "Income" is defined by the of use of the term in the practical affairs of business life. (*Carden's case; Arthur Murray*)
- The income must be unaffected by any legal restrictions or qualifications. (*Arthur Murray*)
- The relevance of accounting practice depends on whether it gives a true reflex of income as understood in business affairs (*Arthur Murray*) and is the main consideration in determining assessable income for tax purposes. (*Carden's case*)
- A taxpayer will not derive an advance payment received until they have rendered the contractual quid pro quo associated with the payment. This applies whether the advance payment is a true deposit or a prepayment. (*Arthur Murray*)
- Where a receipt has significant risk of repayment that is an integral part of the receipt and even in circumstances where there is no legal requirement for repayment the amount will not have "come home". (*Arthur Murray; Molloy*)
- Income is derived when received when the amount received becomes the absolute property of the taxpayer. This also applies when a future liability to repay the income arises because of a course of action the taxpayer chooses to take. (*Bowcock*)

26. The Taxpayer also referred to *Prices Tailors*[12] and *Country Magazine*[13] judgments to support their view that the Payment was derived upon the expiry of the possible termination event.
27. In *Prices Tailors* the court found that the payments the taxpayer received belonged to them when they had received them as there was no legal requirement to refund them. This case is also cited in *Arthur Murray* (and *Country Magazine*). TCO considered that while the Federal Commissioner relied on *Prices Tailors* in *Arthur Murray* this decision would not be persuasive law as *Arthur Murray* is the settled law.
28. *Country Magazine* accepted the general application of the *Arthur Murray* principle of delaying derivation when the taxpayer received subscriptions in advance for future magazine issues. However, in this case the Court noted that the taxpayer had not argued the matter with any substance to distinguish those principles, and TCO considered that the case provided no additional authority to that already given by *Arthur Murray*.
29. The Taxpayer referred to paragraph [65] in the Commissioner's Interpretation Statement "IS 16/06 Income tax – timing when is income from professional services derived?" to support their view that the Payment is not derived on receipt. This paragraph discusses prepayments, that is payments received in advance of any services being performed.

Application

30. TCO concluded that the Taxpayer derived the Payment at the time it was paid to them because:
    - The Payment came home to the Taxpayer on receipt, there were no restrictions on the use of the Payment. (*Carden's case*)
    - The Payment was not received in advance of the provision of services. It is not a prepayment. There is no nexus between the Payment and the Taxpayer's income from commissions, and therefore derivation cannot be deferred on that basis. (*Arthur Murray*)
    - The fact that repayment may occur at a future time does not change the character of the Payment. (*Bowcock*)
    - The risk of repayment is not entirely out of the Taxpayer's control and until a triggering event (termination of the Contract) occurs to crystallise a subsequent debt no liability exists to defer derivation of the Payment. (*Bowcock* applies; *Prices Tailors* distinguished)
    - Paragraph [65] of IS 16/06 is distinguishable from the present dispute because the Payment is not a prepayment for services, it is a one-off payment for signing the Contract. This paragraph does not suggest that derivation should be deferred because it is solely concerned with the treatment of prepayments for services.

[12] *Elson (IT) v Prices Tailors Ltd* [1963] 1 All ER 231 (ChD).

[13] *Country Magazine Pty Limited v FCT* (1968) 15 ADT 86.

TDS 24/05: Sale of bare land when intended for a subdivision

Decision date | Rā o te Whakatau: 27 November 2023

Issue date | Rā Tuku: 28 March 2024

Subjects | Kaupapa

Income tax: intention to sell; subdivision; sale of bare land; joint venture; partnership; identifiable capital asset.

Taxation laws | Ture tāke

All legislative references are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated.

Facts | Meka

1. This dispute involved three Taxpayers who held Units in an unincorporated joint venture (the Joint Venture) with other members.
2. On its formation, the Joint Venture acquired an undivided beneficial ownership interest in various assets including land.
3. Over a number of years following purchase, activities of the Joint Venture included subdividing and selling a number of residential sections from the land.
4. In the year of assessment, the Taxpayers sold their Units (including their underlying interests to the remaining undivided land). They each made a profit on the sale.
5. Land held by the Joint Venture at the time of the Unit sale comprised:
    - Undeveloped farmland that had received special housing area designation. This was being used for grazing while the Joint Venture was considering making resource management consent applications for residential section development.
    - Residential land that had nothing done to it as the Joint Venture did not consider it practicable for further development (used for grazing).
    - A large piece of rural zoned land that was also used for grazing.
6. The Taxpayers returned the proceeds from the sale as assessable income in their tax returns but, subsequently, issued notices of proposed adjustment to remove this amount. They contended, in relation to s CB 6, that while the intention was to sell subdivided land, the parties never intended to sell bare land. There was a long-term hope that as much of the land as possible could be subdivided and sold. This intention was formed at the time the Joint Venture came together.
7. Given tranches of the land had previously been subdivided and sold, and proceeds returned under s CB 12 or predecessor sections, the Taxpayers contended s CB 6 could not apply to the remainder of the land.
8. The Taxpayer also argued that the sale was a sale of the Units, an identifiable capital asset, and that the land provisions could not apply.
9. Customer and Compliance Services, Inland Revenue (CCS) considered the original assessments were correct and that the amounts received by the Taxpayers from the sale was assessable income.

Issues | Take

10. The main issues considered in this dispute were:
    - whether there was a purpose or intention of disposal at the time of acquisition of the land within the meaning of section CB 6;
    - the relationship between the subdivision provisions of ss CB 6and CB 12;
    - whether the amounts derived from the sale of the Units were a capital receipt due to the "identifiable capital asset principle" with the sale of the Units being analogous to the sale of a partnership interest.
11. There was also a preliminary issue as to whether the Joint Venture was also a partnership.

Decisions | Whakatau

12. The Tax Counsel Office (TCO) concluded:
    - the amount derived on the sale of the Units was income under s CB 6 as the Taxpayers acquired the land with a purpose or intention of sale;
    - section CB 6 can apply to the sale of the remaining land despite amounts from earlier sales of subdivided land that had been returned under s CB 12 or predecessor sections;
    - section CB 6 can apply to a taxpayer selling a joint venture interest which constitutes an interest in land.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary Issue | Take tōmua tuatahi: Partnership or joint venture

13. CCS was of the view that the Joint Venture was also a partnership. The Taxpayers did not consider they were in a partnership. This issue was identified as having potential relevance to the question of whose purpose or intention is relevant in applying s CB 6.
14. While this question appeared in preliminary correspondence, neither party included this in their statements of position - as such, full arguments were not put forward. It was not necessary, on the facts, for TCO to conclude on the matter to consider the applicability of s CB 6.

Issue 1 | Take tuatahi: Purpose or intention of disposal

15. The application of s CB 6 depends upon the purpose or intention of the taxpayers at the time of purchase. This can be summarised as follows:
    - In terms of the purpose or intention under s CB 6, it is the purpose or intention of a partnership rather than the individual partners.[1] A similar approach would likely apply to a joint venture.
    - The land in respect of which the relevant intention must be assessed is the land in respect of which amounts were derived on disposal.[2]
    - Whether the whole or part of the land originally acquired with a purpose or intention of disposal was sold, s CB 6 will still apply based on the original intention applicable on acquisition.[3]
    - The provision applies even if the land is held under different legal titles or is in a different legal form.[4]
    - Different purposes or intentions may be held on acquisition in respect of different parts of land, and where there is evidence as to how much of the land or which parts of the land were acquired with no purpose or intention of sale this land may fall outside s CB 6.[5]
    - A general acknowledgement of the possibility of sale in the future is not sufficient, but a contingent or conditional purpose or intention is sufficient to trigger s CB 6.[6]
    - Section CB 6 is satisfied by any purpose or intention to on-sell the land. It is not confined to a dominant purpose or intention. Accordingly, a taxpayer must show that none of their purposes or intentions were to resell or dispose of the land.[7]
    - Section CB 6 may apply together with, or in the alternative, to s CB 12.[8]
16. At the date of acquisition, the Taxpayers had a purpose or intention of selling subdivided sections including the remaining land. This was to be achieved over the long term.
17. There was no other obvious purpose in respect of the remaining land as the interim activities undertaken on that land ran at a loss. No other commercial activity was pursued in relation to the remaining land.

[1] *CIR v Boanas* (2008) 23 NZTC 22,046 (HC).
[2] *Case L43* (1989) 11 NZTC 1,262; *Bedford Investments Ltd v CIR* [1995] NZLR 975.
[3] *Bedford Investments Ltd v CIR* [1995] NZLR 975; section CB 23B.
[4] *Case L43* (1989) 11 NZTC 1,262
[5] *Harkness v Commissioner of Inland Revenue* (1975) 2 NZTC 61,017, *Church v Commissioner of Inland Revenue* (1992) 14 NZTC 9,1996
[6] *Case 5/2013* (2013) 26 NZTC 2-004
[7] *Case 5/2013* (2013) 26 NZTC 2-004
[8] *Case 5/2013* (2013) 26 NZTC 2-004

18. While the Taxpayers did not have a purpose or intention of selling bare land, the Joint Venture had the purpose of selling or disposing of land. This was sufficient to trigger s CB 6.
19. On acquisition, no particular area of land was identified as being unsuitable for subdivision or as being held for a purpose or with an intention outside the purpose or intention of subdivision.

Issue 2 | Take tuarua: The subdivision provisions and s CB 6

20. The interaction between s CB 6 and the subdivision provisions included considering:
    - whether s CB 6 was inapplicable where s CB 12 applied to treat as taxable some receipts from the earlier disposal of part of the land;
    - whether the application of s CB 6 is precluded by a previous classification of the land under s CB 12.
21. Section CB 12 was introduced to ensure the taxation of land where the scheme or undertaking commenced within 10 years of acquisition and did not rely upon the intention of the taxpayers at that time. If the land was acquired with a purpose or intention of selling the land, s CB 6 would apply to the land. Neither CCS nor the Taxpayers were asserting that the sale of the remaining land was taxable under s CB 12.
22. Comments recorded in Hansard[9] and the explanatory commentary on the introduction of the predecessor to s CB 12[10] do not support the view that s CB 12 prevented the application of s CB 6 if there were circumstances where both could apply. It is possible that both sections may apply.
23. TCO considered whether the cases *Simunovich*[11] and *Macfarlane*[12] cited by the Taxpayer prevented the taxation of the remaining land under s CB 6 where the amounts derived from the earlier sale of subdivided sections had been treated as taxable under s CB 12.
24. TCO concluded that these cases were not support for a broad principle that the Commissioner cannot assess differently or inconsistently from prior years. Rather, *Simunovich* supports a principle of consistency that there must be a legislative indication requiring consistent treatment. This is through a statutory link between the current characterisation and past characterisation with changes needing to be made according to the statutory method within the time bar period. There is no legislative indication in ss CB 6 and CB 12 that establishes the requisite link between the current characterisation and past characterisation of the same asset.
25. Therefore, it was concluded that s CB 6 is not precluded from applying to the remaining land just because income from the sale of some other land was earlier returned by the Taxpayers under s CB 12.

Issue 3 | Take tuatoru: Identifiable capital asset

26. The Taxpayers argued that the sale of the Units was the sale of an identifiable capital asset and, as such, the land provisions contained in ss CB 6A to CB 23B would not apply to the sale of the underlying assets to the extent they included land. Referring to s HG 1 of the ITA 2007 and s 42 of the Tax Administration Act 1994 (TAA), they argued that a person holds a partnership interest on capital account and this is analogous to a person holding a joint venture interest.
27. Section HG 1 applies to joint ventures which are not partnerships. The section provides:
    - For tax purposes there is a flow-through of income, expenses, losses, and gains to the parties in accordance with their share. Outside of the de minimis rule in subpart HG, (the de minimis being applicable where a joint venturer's net gain on disposal is less than $50,000), the usual consequences of a sale of an asset applies.
    - The tax consequences of the disposal of a joint venture interest are the responsibility of the member.
28. Section 42 of the TAA provides that where a partnership exists, partners must make a separate return of income and deductions in accordance with their share of the partnership. Similarly, for a joint venture (which is not a partnership), s 42 provides that each member is to make a separate return considering their share of income and deductions. Regardless of whether there is a partnership or joint venture, the amount on disposal must be returned by the member in their own returns of income.

[9] Hansard (14 September 1973) 386 NZPD 3653 and 3680 – 3681.

[10] Taxation in New Zealand: report of the Taxation Review Committee" [L.N. Ross, chairman] October 1967

[11] *Simunovich Fisheries Limited v CIR* (2002) 20 NZTC 456.

[12] *Macfarlane v Commissioner of Taxes* [1923] NZLR 801

29. Neither a joint venture nor a partnership is a taxpaying entity for income tax purposes. The liability for tax on partnership or joint venture activities is that of the partner or the joint venture party. This includes in relation to any disposal an interest in land.
30. Section CB 6 can apply to a taxpayer selling a joint venture interest which includes an interest in land. TCO did not need to reach a conclusion on whether the sale of the Units was the sale of an identifiable capital asset. When each Taxpayer sold their Units, they disposed of an interest in land to which s CB 6 applied.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

The Tax Counsel Office (TCO) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The TCO also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

Policy and Regulatory Stewardship

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.