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

Commentary on the Bill

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Overview of the Bill

BILL OVERVIEW

The Taxation (Annual Rates, Modernising Tax Administration, and Remedial Matters) Bill modernises the revenue system by making tax simpler and easier for individuals and simplifying rules and processes.

The flagship measures of this Bill build on the enhancements to the collection of more frequent, better quality employment and investment income information contained in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018, enacted on 29 March 2018.

The proposals in this Bill were the subject of three recent public consultation documents:

- *Making Tax Simpler – Proposals for modernising the Tax Administration Act*;
- *Making Tax Simpler – Better administration of individuals' income tax*; and
- *PAYE error correction and adjustment – an officials' issues paper*.

Submissions on these documents have helped shape the final proposals contained in this Bill.

Proposals relating to individuals mean that most people will pay what they need to and get what they are entitled to during the year without having to do anything. For instance, the changes for individuals in this Bill mean from April 2019:

- refunds will be automatically paid out – where Inland Revenue is reasonably confident it has information about all a person's income and the tax they have paid on it;
- Inland Revenue can use the better information it has to help people pay and receive the right amounts during the year; and
- Inland Revenue will automatically finalise end-of-year refunds or bills to pay for as many people as possible without them having to do anything.

It will be easier for people to understand their obligations and entitlements and will take them less time to ensure they pay and receive the right amounts.

Proposed improvements to the Tax Administration Act will help shift the tax system to be more taxpayer-focussed. The improvements range from streamlining how information is collected, used and shared, to simplifying the provision of tax advice to make it more accessible to small and medium enterprises.

Minor amendments to PAYE error correction and adjustment supplement the proposed error correction regulations aimed at simplifying and clarifying how errors can be corrected.

This Bill also enhances the new provisional tax option – the Accounting Income Method (AIM) which started on 1 April 2018. It allows taxpayers to join AIM from some other provisional tax options during an income year, making it more accessible to customers.

These legislative changes, combined with the technology improvements being made as part of Inland Revenue's business transformation, are intended to deliver significant benefits to taxpayers. They will, when transformation is complete, produce a fundamentally different revenue system that:

- is based around taxpayers' needs;
- is easy to understand and interact with;
- produces and uses near real time information;
- is digital and highly automated;
- uses systems and software do most of the work;
- is more responsive, flexible and certain for taxpayers;
- is future proofed to accommodate change; and
- delivers services with others inside and outside government.

In addition to the tax administration improvements, this omnibus Bill also introduces a number of other policy measures including:

- introducing two new contribution rates for KiwiSaver;
- opening up KiwiSaver to over 65s;
- clarifying the tax status of crown controlled companies and the tax rules for deregistered companies;
- adding 13 charities to schedule 32 of the Income Tax Act 2007 (those with overseas donee status);
- amending the definition of market interest that banks and other money lenders can elect to use for valuing the fringe benefit of a loan provided to an employee; and
- extending to the securitisations regime in the Income Tax Act 2007.

The Bill also sets the annual tax rates for 2018–19 and implements a number of minor remedial changes to existing legislation.

Modernising tax administration – Individuals' income tax

OVERVIEW

Background

The proposed changes to the administration of individuals' income tax aim to simplify individuals' year-end income tax filing obligations and ensure that more appropriate withholding rates are applied to income during the year.

The key proposals in the Bill aim to:

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

Application date

The proposed changes are expected to come into force on 1 April 2019 and the proposed end of year processes will be applied for the tax year ended 31 March 2019.

Summary of proposed amendments

The general legislative provisions set out in the following five commentary items prescribe the way in which individuals will interact with Inland Revenue in relation to the income tax system. By receiving regular income information throughout the year,[1] Inland Revenue will be able to ensure individuals are on the appropriate tax code or rate, and about the right amount of tax is withheld throughout the year. Unnecessary compliance costs will be removed from individuals, and income tax filing obligations will be simplified so that they are easily understood.

Current filing mechanisms, such as personal tax summaries and IR3 forms, will be replaced by a pre-populated account that includes all income information that Inland Revenue holds about the individual. People who only earn "reportable income" will not have to do anything unless they know that the reportable income information is incomplete. Only those people who earn income or have deductions that Inland Revenue does not already know about, will have to provide further information to Inland Revenue.

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[1] The recently enacted Taxation (Annual Rates for 2017–2018, Employment and Investment Income, and Remedial Matters) Act 2018 will require employers to provide employment information to Inland Revenue on a payday basis and investment income payers to provide investment income information on a monthly basis.

Under the proposals, individuals will fall into one of three groupings and may move between groups over time as their income profile changes. The groupings are:

- *Group A* (automated process) – the individual earns "reportable income" and Inland Revenue judges that the income information it holds for the person is correct. In these cases, the refund or tax to pay will automatically be calculated, assessed and actioned accordingly (that is, refund or tax bill issued).
- *Group B* – the individual earns reportable income, but Inland Revenue considers based on previous returns and other information that the individual may have other income or deductions. In these circumstances, the individual will be requested to provide the additional information or confirm that income information held is correct.
- *Group C* – the individual has no or very little reportable income. Individuals that fall into this category will then be required to provide income information – similar to the current IR3 process where a return of income is required.

Group B and Group C can be considered subsets of each other depending on the amount of income information Inland Revenue holds or requires.

Reporting of income information by individuals (new subpart 3B)

New subpart 3B provides the administrative settings that underpin an individual's obligations under sections BB 2, and BC 1 to BC 6 of the Income Tax Act 2007 to calculate and satisfy their income tax liability for a tax year.

This background section explains the key terms that will apply for these new rules and the information to be included in the pre-populated account. The remaining sections that make up this subpart will be canvassed in detail under the subheadings "year-end income tax obligations of individuals" and "refunds of tax and amounts of tax to pay".

Key terms (proposed new section 22D)

The key terms for these new rules are:

- *Meaning of individual* – Section 22D(1) provides that, for the purposes of this subpart, and for a number of other specified sections in the Tax Administration Act 1994 that pertain to a taxpayer's obligations, an individual means a living natural person. A natural person is deemed to include a person who is non-resident, but not a person whose only income for the corresponding income year is non-resident's foreign-sourced income.

  In the situation where a natural person dies, they will be treated as an individual and will be subject to the individual's tax rules up to and including the date of their death. Following death, their estate will be treated as a trust until it has been distributed.
- *Meaning of reportable income* – Reportable income covers sources of income that Inland Revenue receives information on by way of third party reporting during the year, or shortly after the end of the year. For the purposes of subpart 3B and

section 33, this includes all PAYE income payments and resident and non-resident passive income.

- *Meaning of other income* – Proposed new section 22D(3) provides that other income is income paid or payable to the individual for the corresponding income year that is not reportable income for the tax year. For the purposes of this subpart and section 33, the term "other income" is intended to cover all income that an individual earns that is not "reportable income".
- *Meaning of pre-populated account* – As per proposed new section 22D(4), a pre-populated account will contain details of the individual's income for that tax year that are known to the Commissioner and this will be made available to the individual. It can include both "reportable income" and "other income".
- *Meaning of adjusted account* – An adjusted account, defined in proposed section 22D(5), is a pre-populated account that contains information the individual has provided on any other income they derived for the corresponding income year and any deductions or tax credits (see proposed schedule 8 table 2). The Commissioner can also amend information in the individual's adjusted account to correct errors in the information and must inform the individual of the amendment (section 22H(2)).
- *Meaning of final account* – The final account is the set of information that in some way (whether through confirmation, the Commissioner being satisfied, or the passage of time) becomes the final set of information that the tax assessment is based on. Where the Commissioner is not satisfied that the information in an individual's account is complete, the Commissioner may issue a default assessment. Specifically, proposed section 22D(6) provides that a final account for an individual and tax year means:
  - a *pre-populated account* if the individual has confirmed it as correct and complete (section 22G(1)) or the Commissioner has notified the individual that the Commissioner is satisfied to that effect (section 22I(2)(b);
  - a *zero pre-populated* account referred to in section 22E(3), if, through the passage of time, the account is treated as an assessment under section 22I(2)(c);[2] or
  - an *adjusted account* if the individual has confirmed it as correct and complete (section 22G(2)) or the Commissioner has notified the individual that the Commissioner is satisfied to that effect (section 22I(2)(b)) or where, through the passage of time, the account is treated as an assessment under section 22I(2)(c).

Information included in pre-populated accounts (proposed new section 22E)

Under proposed section 22E(1), Inland Revenue must include in an individual's pre-populated account all information it holds for the tax year relating to any reportable or other income that it considers the individual has derived for that year. As per proposed

[2] An individual will be treated as having a "zero pre-populated account" where the Commissioner has no information on the individual's reportable or other income for the relevant tax year. For the purposes of section 22I(2)(c), an assessment will arise when the Commissioner notifies an individual that the Commissioner is not satisfied that the information contained in their pre-populated or adjusted account is correct or complete and issues a default assessment under section 106.

section 22E(2), section 22E(1) only applies where the information is available or relevant for the individual in making an assessment for the tax year.

If Inland Revenue has no information for a tax year on an individual's reportable or other income, the individual is treated as having a zero pre-populated account (proposed section 22E(3)). The zero pre-populated account gives a basis for any future adjustments that may arise.

PROACTIVE ACTIONS

(Clauses 28 and 30)

Summary of proposed amendment

Several amendments are proposed to enable Inland Revenue to proactively help people use appropriate tax rates or codes during the year to minimise year end debts and refunds. The proposed changes are:

- Inland Revenue would monitor changes in a person's earnings and identify where they may be using an incorrect or unsuitable tax code or tax rate.
- Inland Revenue would contact individuals who use an unsuitable tax rate and recommend they change it.
- Where Inland Revenue has contacted an individual regarding their use of an unsuitable tax rate for their investment income and the individual does not object within 20 working days, Inland Revenue will instruct the investment income payer to update the rate.

Application date

The proposed amendments will come into force on 1 April 2019.

Key features

Inland Revenue will use more frequently provided employment and investment income to determine whether people are using the most appropriate tax rates during the year. Where people are using tax rates that seem to be too high or too low, Inland Revenue will contact them and advise that another rate may be more suitable.[3] Inland Revenue will suggest the rate but will not require the individual to use the proposed rate as the individual has the best understanding of their likely income for the rest of the year and may therefore be happy to stay on their current rate. The exception to this is for investment income where Inland Revenue will instruct the payer to use the proposed withholding rate if the individual has not objected within twenty working days.

Background

Currently, if an individual is using a tax code which they are not entitled to use, Inland Revenue will contact their employer and instruct that the code be changed. If an individual is using a code that is not wrong per se, but does not reflect their likely year-end tax liability, Inland Revenue does not suggest corrective action. This means that individuals need to square up at the end of the year, resulting in a debt or refund.

[3] This can include the recommendation of a tailored tax rate or code. Tailored tax codes will be covered in the "Tailored (special) tax codes" section.

The recently enacted Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 will require employers to provide employment information to Inland Revenue on a payday basis and will require investment income payers to provide investment income information to Inland Revenue on a monthly basis.

By having access to this more timely information, Inland Revenue will be able to suggest corrective action when projections show that an individual is likely to end up with an under or over payment because of the withholding rate they are using.

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

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

Detailed analysis

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

Use of unsuitable tax codes (proposed new section 24DB)

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

The policy intent behind this section is to assist individuals who are not on a wrong rate per se, but would benefit from changing to a different tax rate sooner. Changing to a different rate will better approximate the individual's ultimate tax liability, and therefore reduce the size of a debt or refund position the individual would otherwise be in by year end.

Although Inland Revenue may recommend that an individual changes their tax code, Inland Revenue will not notify the employer to make a change unless the individual accepts it. This is because an individual is better placed than Inland Revenue to know about their upcoming employment plans, such as time off work or variable hours. It therefore follows that, while Inland Revenue may recommend a change in code for an individual, it is more appropriate for the ultimate decision to lie with the individual.

Example 1

James earns a salary of $45,000 per year. His current tax code is "M", which is a code that he is entitled to use. Given that James earns under $48,000, he is entitled to an independent earner tax credit of $520 per year. In order to obtain this tax credit James would need to be on an "ME" tax code, or, if he has a student loan "ME SL".

Under the proposed changes, Inland Revenue would contact James and let him know that an "ME" tax code would be a more appropriate code for him to be on. If James consents to the change, Inland Revenue will instruct his employer to update his tax code to "ME".

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

Use of unsuitable RWT rates (proposed new section 25A)

Inland Revenue may contact an individual regarding their use of an unsuitable tax rate for their investment income. If the individual accepts the suggested rate or no response is received within 20 working days, Inland Revenue will instruct the investment income payer to update the rate.

It is noted that there is a difference between the treatment of an unsuitable PAYE code and an unsuitable RWT (resident withholding tax) rate. If an individual is on an unsuitable PAYE code, Inland Revenue will recommend a more suitable code, but will not instruct the employer to update the code unless the individual accepts it. For investment income, Inland Revenue will recommend a more suitable rate to the individual, but if no response is received within 20 working days, Inland Revenue will instruct the investment income payer to update the rate. The rationale behind a 20 working day rule for unsuitable RWT rates is that the amount of money involved is usually much smaller than with PAYE and therefore there is less risk of the proposed change leading to unsuitable amounts of withholding.

Example 2

Thomas set up an interest bearing bank account ten years ago. He selected the 17.5% tax rate, which was right at the time. Thomas earns more now than he did ten years ago. In order to have tax deducted at the most appropriate tax rate he should have increased the tax rate, but he did not think of this.

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

Under the proposed changes, Inland Revenue receives information from Thomas' investment income payer and will contact Thomas and let him know that 33% is likely to be a more appropriate tax rate for his interest income and that they will instruct his bank to update it for him. Unless he objects to the rate being changed, Inland Revenue will instruct his bank to change the rate to 33%. Thomas would have no additional tax to pay at the end of the year anymore.

TAILORED (SPECIAL) TAX CODES

(Clauses 27 and 28)

Summary of proposed amendment

Several amendments are proposed to enable Inland Revenue to help individuals use tailored tax codes to ensure that the rate of withholding tax on their income, including secondary sources of income, is appropriate during the year. The proposed changes are:

- Inland Revenue would monitor changes in a person's earnings and identify where a person may benefit from using a tailored tax code.
- The process for applying for a tailored tax code would be simplified (including being able to apply online).
- Inland Revenue would proactively contact individuals who may benefit from using a tailored tax code and recommend that they change their tax code.

Application date

The proposed amendments will come into force on 1 April 2019.

Key features

Inland Revenue will modernise the tailored tax code process by:

- introducing an online application process;
- notifying an individual's employer of their updated tax code; and
- proactively recommending tailored tax codes to individuals in relevant circumstances.

This will improve the way that secondary sources of income, particularly employment income, are taxed by helping people to use an appropriate tax code so that about the right amount of tax is deducted during the year. The proposed legislative changes enable this by allowing Inland Revenue to contact individuals to suggest a tailored tax code and, in certain circumstances, contact the individual's employer to advise them of this change.

Background

Under the current law, an individual with multiple jobs, or working while receiving a benefit from the Ministry of Social Development, should use either a secondary tax code or a special tax code. Secondary tax codes are intended to ensure that income from another job is taxed at the appropriate marginal rate.

Example 3

John

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

Mary

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

Example 3 demonstrates that secondary tax codes will work as intended when an income tax threshold has not been crossed. However, as we have a progressive personal tax scale, secondary tax codes can result in more tax being withheld during the year than is necessary to satisfy the individual's tax liability. This occurs when income from a second job takes a person's total income over a tax threshold.

Example 4

Sophie

Sophie earns $35,000 from her main job and $18,000 from her second job ($53,000 total). She will pay $10,454 in tax each year. This comprises $1,470 tax paid on the first $14,000 at 10.5%, $3,675 from $14,001–$35,000 taxed at 17.5% and then, because a secondary tax code is applied at a tax payers marginal rate, the $18,000 from her second job will be taxed at 30%, resulting in $5,400.

Sophie will be entitled to receive a refund of $1,534 at the end of the tax year.

Example 4 results in an overpayment of tax because, by taxing at a person's marginal tax rate, secondary tax codes prevent multiple claims of the lowest (or lower) tax rates for people with concurrent sources of PAYE income, which would result in tax owing at the end of the tax year.

In order to limit instances of incorrect withholding, individuals that work multiple jobs who are able to estimate their likely annual income could opt for a special tax code. This would give them a withholding rate tailored to their personal circumstances.

The disadvantages of the current rules on special tax codes are that an individual:

- needs to know about special tax codes;
- needs to realise that using one would benefit them; and
- needs to be able to estimate their likely annual income.

The process for obtaining a special tax code is also administratively burdensome. The individual must fill out an application and post it to Inland Revenue. Inland Revenue

will then calculate the appropriate withholding rate and grant the individual a special tax code and a certificate that is only valid until the end of the tax year. The individual then has to advise their employer that they want the special tax code applied to their income. As a consequence, only about 8,000 individuals used a special tax code for the 2016 year (compared to about 570,000 secondary tax codes that were used).

The proposed amendments aim to modernise special tax codes (to be replaced by "tailored tax codes") and make them more accessible. This will largely be achieved by introducing an online application process, Inland Revenue proactively recommending tailored tax codes to individuals in relevant circumstances and informing their employers of the change.

Tax codes provided by the Commissioner (amended section 24D)

The section has been amended to allow the Commissioner to recommend a tailored tax code to an employee. This gives effect to the policy intent by helping people with uneven earnings throughout the year and/or secondary forms of income to use an appropriate tax code during the year, thereby minimising the extent of incorrect withholding.

Consequential amendments have also been made to this section to indicate the terminology change from a "special tax code" to a "tailored tax code". A "special tax code" under the old law, and a "tailored tax code" under the new law, both serve the same function of ensuring that a tax payer is on the most appropriate tax code during the year to minimise the extent of incorrect withholding.

Use of unsuitable tax codes (proposed new section 24DB)

This proposed amendment has been discussed under the "proactive actions" commentary item above but the section is also intended to apply to tailored tax codes. This section provides that if an individual who receives PAYE income is on an unsuitable tax code, Inland Revenue may recommend a change to the code, and with consent of the individual, notify the employer of this change.

This section has been drafted broadly and allows the Commissioner to recommend a "more suitable or more accurate tax code". If the more "suitable or accurate tax code" in any particular instance is a tailored tax code, then it is intended that the Commissioner may recommend a tailored tax code under this section.

THE YEAR-END INCOME TAX OBLIGATIONS OF INDIVIDUALS

(Clauses 5(3), (21), (25), (26), (37), (43), (49), (60–62), 21, 69, 70 and 102)

Summary of proposed amendment

A number of amendments are proposed to set out the end of year income tax obligations of individuals and some of the processes that will be undertaken by Inland Revenue. The proposed changes are:

- Inland Revenue will make a pre-populated account available to each individual containing the income information that Inland Revenue holds for the individual.
- Where an individual confirms or Inland Revenue is reasonably satisfied that the information in the pre-populated account is all of the relevant information Inland Revenue would calculate the refund or tax to pay without the individual needing to provide any additional information. (Group A).
- Individuals will be required to provide any income information other than reportable income to Inland Revenue subject to some *de minimis* rules. (Groups B and C).
- Individuals will be able to provide other relevant information such as deductible expenses and tax credit information to Inland Revenue.
- Individuals will be required to provide or correct reportable income where they know or have reason to know that the reportable income information provided to Inland Revenue is incorrect.
- An individual's tax assessment will occur when they have confirmed the tax information is complete, when Inland Revenue is reasonably satisfied that the information is complete, or when Inland Revenue is not satisfied that the information is complete and issues a default assessment.
- Individuals and Inland Revenue will be able to make corrections to the information held where they become aware that it is incorrect or incomplete and there will be error correction processes for adjustments made before and after an assessment has occurred.
- The end of year income tax process will replace the current personal tax summary and will replace the IR3 tax return processes over time as the paper IR3 is phased out.

Application date

The proposed amendments will come into force on 1 April 2019 and will apply for the tax year-end processes for the tax year ended 31 March 2019.

Key features

The end of year income tax process changes will mean that Inland Revenue provides as much information about an individual's income[4] and tax credits as it can to form a basis for the calculation of the individual's tax position (refund or tax to pay). Where Inland Revenue is reasonably satisfied that this is all of the relevant information for an individual this information will be treated as forming the individual's self-assessment and their tax position will be calculated.

Individuals will be required to provide information on their other income (income other than their reportable income) and will be able to provide information on deductions and tax credits. This additional information will be added to the individual's pre-populated account (now their adjusted account) and will become the individual's self-assessment.

New error correction provisions will allow individuals and Inland Revenue to adjust the information where they become aware that it is incorrect. This can be done before an assessment has occurred and Inland Revenue can also make changes after the assessment subject to the time-bar rules. Changes can also be requested by an individual after the assessment under section 113 of the Tax Administration Act 1994.

Background

The current year-end processes involve Inland Revenue determining whether people who earn PAYE income should be issued with a personal tax summary (PTS) containing their PAYE income information or not. If people are not sent a PTS by Inland Revenue they can request one. If they do not get a PTS or do not file a tax return their tax position will not be squared up and any refund available will not be paid out. If they are issued with a PTS and their refund is less than $600 then it will be treated as confirmed after two months and the refund will be paid out. If the refund is greater than $600 then it will not be paid out unless they confirm their tax position with Inland Revenue.

The PTS only includes wage and salary information so individuals need to add in income from other sources such as interest income or dividend income. They may need to gather this information from several payers and these payers may also be providing this information to Inland Revenue directly.

Individuals are likely to have to file an IR3 tax return to provide this information if they have other types of income such as business income or foreign sourced income, or they wish to claim deductions or tax credits.

A large number of individuals have chosen to interact with Inland Revenue through PTS Intermediaries mainly because of a lack of awareness of how to directly claim any available refund directly from Inland Revenue. These businesses assist taxpayers with refund claims and typically charge a percentage of the refund or a fixed fee for the service they offer. If people did not use a PTS intermediary but instead applied directly to Inland Revenue, they would receive the full amount of their refund.

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[4] This will be the income that is required to be reported to Inland Revenue by a third party within the year or shortly after the year end and known as "reportable income".

Individuals can also work out whether they are due a refund or whether they would have tax to pay before they request a PTS by requesting a summary of earnings. Generally, they are not required to request the PTS if they are in a tax-to-pay position and as such are able to cherry pick refunds.

Detailed analysis

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

Inland Revenue to provide pre-populated accounts (proposed sections 22D(4) and 22E contained in new subpart 3B)

Proposed new section 22D(4) defines a pre-populated account as an account provided by Inland Revenue to an individual for a tax year containing the information held by Inland Revenue on the reportable or other income derived by the individual. Proposed new section 22E requires Inland Revenue to include all of the information that Inland Revenue holds on reportable or other income derived by the individual for the tax year in the individual's pre-populated account for the tax year. This requirement is limited to where the information is available and is relevant to the individual for the tax year.

Section 22E(3) provides that where Inland Revenue holds no income information for an individual they will have a zero pre-populated account for the year. This is intended to provide a basis for adjustments should the individual or Inland Revenue become aware of further relevant information.

When a pre-populated account becomes a self-assessment (proposed sections 22D(6), 22G(1) and 22I contained in new subpart 3B) (Group A individuals)

Where Inland Revenue is satisfied that the information contained in the pre-populated statement is complete and correct, it will become a final account under proposed section 22D(6)(a)(ii) and therefore an assessment under proposed section 22I(1) when Inland Revenue notifies the individual (proposed section 22I(2)(b)). These individuals will not have to interact with Inland Revenue in any way for this to occur.

Proposed new section 22G(1) allows an individual who only has reportable income for a tax year to confirm that their pre-populated account is full and complete at any time during the assessment period. It will become a final account under proposed section 22D(6)(a)(i) and therefore an assessment under proposed section 22I(1). Proposed section 22I(3) provides that the assessment period begins on 1 April immediately following the tax year and ends on 7 July of the year following the tax year or at a later date in the next tax year if the individual has an extension of time to file a return.

Proposed section 22I(2) deems the assessment to arise when the individual confirms the pre-populated account is correct and complete. This allows an individual to make the confirmation sooner than Inland Revenue might or in circumstances where Inland Revenue has not initially been able to satisfy itself that the information in the pre-populated account is complete and correct.

The assessment will determine whether an individual has a refund due or has to pay tax. The treatment of refunds or amounts of tax to pay is explained in the next commentary item (Refunds of tax and amounts of tax to pay).

Obligations to provide other income information: (proposed sections 22D(3) and (5), 22F, 22J, 22K and 22L contained in new subpart 3B and proposed schedule 8 table 1) (Group B and C individuals)

Proposed new section 22F requires individuals to provide other income information to Inland Revenue (for all income that is not reportable income) subject to some *de minimis* rules discussed below. Proposed section 22D(3) defines other income as the income paid or payable to an individual for an income year that is not reportable income.

Proposed new section 22K(1) specifies that a list of other income items is set out in proposed schedule 8 table 1. This table identifies these items as being included in other income:

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

Proposed new section 22J sets out the circumstances in which an individual will not have to provide other income information to Inland Revenue. Section 22J(1) provides that an individual will not have to provide information for a tax year if the individual derives other income of less than $200 (the *de minimis* rule).

Section 22J(2) provides a list of exempt categories where a person will not have to provide income information to Inland Revenue for:

- income derived by a non-resident seasonal worker;
- income derived as a provider of standard-cost household services (that is exempt income under section CW 61(1) of the Income Tax Act 2007;
- income derived from providing personal services for which personal service rehabilitation payments are made when the taxable income of the individual is not more than $14,000 for the income year and tax has been withheld from the personal service rehabilitation payment at 10.5%; or
- non-resident passive income described in section RF 3 of the Income Tax Act 2007 and derived by a non-resident individual.

These exceptions already exist under the current law, but have been codified in section 22J(2) to make it clear that the proposed changes do not create any unintended obligations for these types of income.

Proposed section 22L requires Inland Revenue to establish an electronic form and means of communication as well as a non-electronic form or mode of delivery for the delivery of other income information to Inland Revenue. This will enable people to submit information either electronically or manually.

Where an individual has provided information on their other income to Inland Revenue the income information will be added to the pre-populated account along with any tax deduction and tax credit information provided by the individual to form the individual's adjusted account as defined in proposed section 22D(5).

Provision of tax deduction and tax credit information (proposed sections 22D(5) and 22F(3), and proposed schedule 8 table 2)

Proposed section 22F(3) provides that an individual may provide the following information to Inland Revenue on tax deductions and tax credits as set out in schedule 8 table 2:

- deductions;[5]
- tax credits carried forward under section LE 3 of the Income Tax Act 2007;
- tax loss balances, or tax loss components, other than a tax loss component under section LE 2 of the Income Tax Act 2007;
- donations tax credits; or
- amounts of income protection insurance.

Under proposed section 22D(5) this information will be added to the information in the pre-populated account, and any other income information provided to form the individual's adjusted account.

Knowledge based requirement to correct missing or incorrect reportable income (proposed section 22F(2))

Proposed section 22F(2) confirms that an individual has no obligation to provide reportable income information that has not been included in their pre-populated account to Inland Revenue unless they know or might reasonably be expected to know that the information in their pre-populated account is incomplete or incorrect. This section confirms that individuals are entitled to rely on the information in their pre-populated account unless they know it is wrong or they ought to have known that it was wrong.

When an adjusted account converts into a self-assessment (proposed sections 22D(6)(c), 22G(2) and 22I contained in new subpart 3B)

Under proposed section 22D(6)(c), an adjusted account will become final (and therefore an assessment under proposed section 22I(1)) when:

- the individual has confirmed the adjusted account as correct and complete under proposed section 22G(2); or

[5] A person is unable to claim a deduction for an expense or loss incurred in deriving income from employment, except if the expenses relate to determining one's tax liability.

- Inland Revenue has notified the individual under proposed section 22I(2)(b) that Inland Revenue is satisfied that their adjusted account correctly and completely records their income for the corresponding income year.

The assessment will determine the individual's tax position as either a refund due or an amount of tax to pay. This treatment is explained in detail in the next commentary item.

Assessments when Inland Revenue is not satisfied that information is correct and complete (proposed section 22I(2)(c) and amended section 106)

Proposed section 22I(2)(c) provides that an assessment arises when Inland Revenue advises an individual that it is not satisfied that their information in their pre-populated account or their adjusted account is correct and complete and issues a default assessment under the proposed amended section 106.

Proposed new section 106(1A) gives Inland Revenue the power to make an assessment of the amount of income subject to tax where Inland Revenue considers that the information provided in the individual's final account for a tax year is not likely to be correct. Proposed section 106(1B) provides that tax assessed under proposed section 106(1A) is payable by the individual unless the individual disputes the assessment under section 89D.

The proposed amendment to section 89D that replaces subsection 89D(2B) requires an individual to dispute a default assessment as described in 22I(2)(c) by making an adjustment to their final account for the tax year.

Error correction before an account is confirmed or an assessment is made (proposed sections 22F(4) and 22H(2))

Proposed section 22F(4) allows an individual to change the information contained in their pre-populated or adjusted account at any time before the individual has confirmed the account under proposed section 22(G), or an assessment is made under section 22I(2). This assessment would occur where:

- Inland Revenue was satisfied the information was correct and complete and notified the individual; or
- where Inland Revenue was not satisfied that the information was correct and complete and issued a default assessment.

Under proposed section 22H(2), Inland Revenue can amend information in the individual's pre-populated account, or adjusted account for the tax year, to correct errors in the information and must immediately notify the individual of the amendment.

Error correction after an assessment is made (proposed sections 22H(3)and (4), and section 108(1))

Proposed section 22H(4) provides that an individual can ask Inland Revenue to amend the information contained in their final account under existing section 113 where they discover an error once an assessment has been made. Section 113 allows Inland Revenue to amend an assessment when it is necessary in order to ensure its correctness.

Proposed section 22(H)(4) allows Inland Revenue to amend the information in an individual's final account to correct errors in the final account at any time up to the end of the time bar period in section 108(1) and requires Inland Revenue to notify the individual of the amendment.

Section 108(1) restricts Inland Revenue from amending a return if four years have passed since the end of the tax year in which the return was filed. However, this does not apply where the return is fraudulent, wilfully misleading, or omits all mention of income of a particular nature or derived from a particular source.

REFUNDS OF TAX AND AMOUNTS OF TAX TO PAY

(Clauses 21, 44, 97, 98 and 206)

Summary of proposed amendment

Amendments are proposed to improve the process for issuing refunds and advising individuals that they have tax to pay, or are due a refund. This should remove unnecessary compliance costs currently being incurred by individuals. The proposed changes are:

- Inland Revenue would calculate whether people who are not expected to be required to provide information to Inland Revenue were entitled to a refund or had tax to pay.
- Refunds would be paid out without individuals having to request them.
- Inland Revenue would issue income tax refunds by direct credit, unless that would result in undue hardship or is not practicable.
- Amounts of tax to pay arising from withholding tax regimes where tax was withheld in accordance with the PAYE rules, or where tax was withheld at the rate corresponding to the individual's marginal tax rate, would not have to be paid.
- Amounts of tax to pay arising from a withholding tax regime where less than $200 of income was taxed incorrectly would not have to be paid.

Application date

The proposed amendments will come into force on 1 April 2019, and will apply for the tax year-end processes for the tax year ended 31 March 2019.

Key features

Inland Revenue will automatically calculate whether an individual is entitled to a refund where it is reasonably satisfied that it has the necessary information. If the individual is entitled to a refund Inland Revenue will pay it out by direct credit automatically, regardless of the amount due. Similarly, amendments are proposed that will enable Inland Revenue to simplify compliance obligations for individuals with tax to pay who are subject to withholding tax regimes.

Background

Under the current law, individuals are responsible for determining whether they are required to file a return, or whether they need to take any action to finalise their tax

position.[6] Taxpayers who are not required to file returns do not have their tax positions squared up automatically. If these taxpayers want to determine whether they have tax to pay or are due a refund, they must interact with Inland Revenue (for example, by requesting a personal tax summary). Non-filing taxpayers can be selective and, based on their summary of earnings, request a personal tax summary only in years where a refund is due. The current approach does not accord with the Government's objective of making tax simpler for individuals, and there is an integrity issue with taxpayers being able to "cherry pick" refunds.

The proposed amendments will simplify the rules so that more individuals can understand their obligations and meet those obligations with minimal effort. If an individual who is not required to provide additional tax information is due a refund or has tax to pay, then Inland Revenue will calculate this automatically. Refunds will be paid out without an individual having to interact with Inland Revenue to request them and Inland Revenue will contact individuals and inform them of any outstanding tax to pay.

Amounts of a tax to pay arising from income of $200 or less that has been incorrectly taxed under a withholding tax regime will not have to be paid. Any amounts of tax to pay arising from withholding tax regimes where tax was withheld in accordance with the PAYE rules, or where tax was withheld at the rate corresponding to the individual's marginal tax rate, would also not have to be paid.

Detailed analysis

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

No obligations to provide information: de minimis and certain other amounts (section 22J contained in new subpart 3B)

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

Section 22J(2) provides a list of exempt categories where a person will not have to provide income information to Inland Revenue (for example, income derived by a non-resident seasonal worker). These exceptions already exist under the current law, but have been codified in section 22J(2) to consolidate the rules for individuals into Part 3B.

Power of Commissioner in relation to refunds or tax payable (section 174AA(b) amended)

The proposed amendment to section 174AA(b) removes the $5 refund threshold. Refunds will now be paid out by direct credit regardless of the amount. The proposed amendment also provides that the Commissioner will not require amounts of tax payable to be paid where the tax was withheld in accordance with the PAYE rules or where the

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

tax was withheld at the individual's marginal tax rate. Amounts of tax to pay arising from a withholding tax regime where less than $200 of income was taxed incorrectly would also not have to be paid.

The following examples demonstrate what would occur under the proposed amendment if an individual had the incorrect amount of tax withheld, but the tax was withheld in accordance with the PAYE rules.

Example 5

Sam

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

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

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

Sam would not be required to provide any income information to Inland Revenue. Inland Revenue would consider what it knows about Sam. It would have no reason to believe that he needs to provide any information to Inland Revenue. As Sam's tax has been withheld in accordance with the PAYE rules, he would not be required to pay the $175 tax shortfall.

Ellis

Ellis is an employee earning a salary of $75,000 and also during the year receives $500 of income from his employee share scheme. His employer deducts PAYE and other deductions from his salary each pay day but has not elected to deduct PAYE from the employee share scheme income.

Inland Revenue will have available both salary and employee share scheme income information and it has no reason to believe that Ellis needs to provide any additional information to Inland Revenue. As PAYE has not been withheld from the employee share scheme income and the amount of income is over $200, Ellis will be issued a notice of tax to pay. While Ellis' tax has been withheld in accordance with the PAYE rules, he has received income that was not subject to withholding.

Section 174AA(b) also ensures that those receiving certain payments from the Ministry of Social Development (MSD) are not subject to overpayments of tax. For example, if MSD make a lump-sum back payment to a client, but do not correctly gross up the tax payment to Inland Revenue, it will show at year-end that there is an underpayment of tax, despite the individual receiving the correct net entitlement. In this situation the client would not be liable for the amount of tax to pay.

This section also preserves the current law in relation to payments to non-resident seasonal workers and providers of standard-cost household services. Similarly, the threshold set out in section 174AA(a), which provides that amounts of tax to pay of less than $20 will not have to be paid, will also be retained.

Refund of tax paid in excess made by direct credit to bank account (section 184A amended)

Section 184A(2) will be amended to reflect that taxpayers will no longer need to claim refunds, as they will be issued automatically.

Section RM 5 of the Income Tax Act 2007 abolished (overpayment on income statements)

This section applied where an income statement (personal tax summary) had been provided to a person and there was an amount of tax to be refunded exceeding $600. The section provided that the Commissioner could refund this amount only after the person confirms that the income statement was correct.

It is proposed that this section is repealed as all refunds, regardless of amount, will now be issued automatically once an account is deemed final in accordance with section 22D(6) and has become an assessment.

Section 43 – Income tax returns and assessments by executors or administrators

Section 43(4) and 43(5) of the Tax Administration Act 1994, which establish obligations on an executor for a deceased taxpayer's tax liabilities, will also be repealed. These sections provided that the executor must request an income statement in some cases (section 43(4)), and may request an income statement if the taxpayer would have met the requirements of section 33AA(1) (section 43(5)).

REPEAL OF INCOME STATEMENT RULES AND OTHER CONSEQUENTIAL AMENDMENTS

(Clauses 6, 13, 34, 35, 39, 40, 41, 43, 47, 48, 51, 52, 68, 69, 71, 74, 89, 92, 93, 94, 101, 127, 187, 188, 189, 200, 239, 240, 244 and 265)

Summary of proposed amendment

As a consequence of the changes to individual's income filing, some of the current law governing individual's income tax obligations will be repealed. Consequential amendments are also proposed to align the current law with the proposals in the Bill. The proposed changes are:

- Part 3A (Income statements) of the Tax Administration Act 1994 will be repealed.
- Section 33AA of the Tax Administration Act 1994 will be repealed.
- Sections 33C, 33D along with 15B(h) and 15B(i) of the Tax Administration Act 1994 will be repealed.
- A number of consequential amendments will be made to give effect to the new reporting of income rules for individuals in Part 3, subpart 3B of the Tax Administration Act 1994. These consequential amendments will be made to the following Acts:
  - Tax Administration Act 1994;
  - Income Tax Act 2007;
  - Child Support Act 1991;
  - Student Loan Scheme Act 2011; and
  - Accident Compensation Act 2001.

Application date

The proposed amendments will come into force on 1 April 2019.

Background

The proposed legislative changes set out in the previous five commentary items prescribe the way in which individuals will interact with Inland Revenue in relation to the income tax system. This means that current mechanisms of filing, such as income statements (personal tax summaries) and IR3 forms, will be replaced by a pre-populated account that includes all information that Inland Revenue knows about the individual. People who only earn "reportable income" will not have to do anything, and only those people who earn income that Inland Revenue does not know about, will have to provide further information to Inland Revenue. In order to give effect to these changes some of the current law will need to be repealed and amended.

Detailed analysis

The following section provides an overview of the law in the Tax Administration Act 1994 that is proposed to be repealed.

Part 3A repealed (income statements)

Part 3A sets out the law on income statements and comprises of sections 80A to 80I inclusive. It is proposed that Part 3A is repealed.

Sections 33AA repealed (exceptions to requirement for return of income)

Section 33AA provides that an individual will not be required to file a return if they, in addition to satisfying a number of other criteria, derive $200 or less of certain types of income from which tax has not been withheld or not withheld incorrectly.

It is proposed that section 33AA is repealed. Under the new proposals in subpart 3B, an individual who earns reportable income will not have to provide income information to Inland Revenue, and only those who earn income that Inland Revenue does not know about ("other income") will be obliged to provide information to Inland Revenue. This information will be used for the purposes of determining a final account under proposed section 22D(6)(a)(ii), and therefore an assessment under proposed section 22I(2)(c).

Proposed section 22J(1) replaces section 33AA(2) and provides that an individual will not have to provide information for a tax year if the individual derives other income of less than $200 (the *de minimis* rule).

Section 15B (h) and (i) repealed (taxpayer's tax obligations)

Section 15B(h) and (i) imposes obligations on taxpayers in relation to income statements. These sections are proposed to be repealed.

Sections 33C and 33D repealed (returns not required for certain providers of personal services and for non-resident seasonal workers)

Section 33C and 33D exempts certain categories of income earners from filing a return. These sections are proposed to be repealed. These exempt categories are now provided for in proposed section 22J(2) under new subpart 3B.

Consequential amendments

This section lists consequential amendments that are proposed to support the substantive changes on individual's income tax in the Bill.

Tax Administration Act 1994

Section 4A amended (Construction on certain provisions)
Section 33 amended (Returns of income)
Section 37 amended (Dates by which annual returns to be furnished)
Section 38 amended (Returns to annual balance date)
Section 41 amended (Annual returns by persons who receive family assistance credit)
Section 42C amended (Income tax returns by undischarged bankrupt)

Section 80KM amended (Summary of instalments paid)
Section 89C amended (Notices of proposed adjustment required to be issued by Commissioner)
Section 89D amended (Taxpayers and others with standing may issue notices of proposed adjustment)
Section 92 amended (Taxpayer assessment of income tax)
Section 106 amended (Assessment where default made in furnishing returns)
Section 110 amended (Evidence of returns and assessments)
Section 111 amended (Commissioner to give notice of assessment to taxpayer)
Section 120C amended (Definitions)
Section 139A amended (Late filing penalty for certain returns)
Section 141JA amended (Application of Part 9 to non-filing tax payers)
Section 143 amended (Absolute liability offences)
Section 143A amended (Knowledge offences)
Schedule 5 amended (Certain tax codes and rates)

Income Tax Act 2007

Section CX 27 amended (Assistance with tax returns)
Section RA 13 amended (Payment dates for terminal tax)
Section RB 3 amended (Schedular income tax liability for filing taxpayers for non-resident passive income)
Section RC 3 amended (Who is required to pay provisional tax?)
Section RD 22 amended (Providing employment income information to Commissioner)

Child Support Act 1991

Section 35 amended (Adjusted taxable income)
Section 81 amended (Notification requirement of parents)

Student Loan Scheme Act 2011

Section 34 amended (Repayment codes for New Zealand-based borrowers)
Section 35 amended (Borrowers with "SL" repayment code must notify employers)
Section 36 amended (Employer or PAYE intermediary must make standard deductions from salary or wages)
Section 57 amended (Consequences of exemption from standard deductions)
Section 60 amended (Where exemption from standard deductions ceases to apply)
Schedule 2 amended (Application of PAYE rules for purposes of section 70)

Accident Compensation Act 2001

Schedule 4 amended (Deductions on account of earner levies)

THE ADMINISTRATION OF DONATION TAX CREDITS

(Clause 42)

Summary of proposed amendment

Several amendments are proposed to enable Inland Revenue to simplify the administration of donation tax credits. The proposed changes are:

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

Application date

The proposed amendments will come into force on 1 April 2019.

Key features

Inland Revenue will simplify the process for claiming donation tax credits by updating its operational practice to accept donation receipts which are submitted electronically via myIR, and submitted during the year. People will still be able to file a separate donation tax credit claim if they choose to do so.

Background

Currently, credits for donations can be claimed at the end of the tax year by filling in a tax credit claim form (IR526), or during the year through Payroll Giving, where the credits are received immediately. An IR526 is a paper based form, and paper versions of receipts must be saved and submitted with this form at the end of the year.

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

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

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

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

A consequential amendment has also been made to section 41A(5). The phrase "be signed by a person" has been omitted to reflect the fact that receipts can now be submitted electronically.

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

Section 41A(6) provides that all of the above changes for section 41A will take effect for the 2018–19 and later income years.

Modernising tax administration – Core aspects of the Tax Administration Act

OVERVIEW

The Tax Administration Act 1994 sets out the rules and processes for collecting and disbursing the revenue and payments administered by Inland Revenue. It plays a significant role in ensuring the right incentives are in place to influence compliance with tax laws. The efficiency and effectiveness of tax administration rules and processes is critical to maintaining fairness in the tax system.

Inland Revenue's Business Transformation programme provides an opportunity to step back and review the core settings in the Tax Administration Act 1994 to ensure they are continuing to operate in the most efficient and effective manner. The work to review and modernise these settings focuses on the core dimensions of the Tax Administration Act 1994, namely the roles of the Commissioner, taxpayers and intermediaries (such as tax agents), as well as the rules around information collection, use and disclosure. These core aspects of the Tax Administration Act 1994 have been the subject of two Government discussion documents, *Making Tax Simpler – Towards a new Tax Administration Act* (November 2015) and *Making Tax Simpler – Proposals for modernising the Tax Administration Act* (December 2016).

Making Tax Simpler – Towards a new Tax Administration Act provided a high level view of the future framework for tax administration focusing on the core concepts and roles set out in the Act as they relate to the "right from the start" concept and Inland Revenue's new compliance model both of which aim to ensure a faster, more efficient yet flexible tax system. Through the development of *Making Tax Simpler – Towards a new Tax Administration Act* it became clear that the issues were wide-ranging and complex, and would require further detailed discussion. This would also provide the opportunity to take public submissions into account when developing detailed proposals.

Two key themes that emerged from public submissions on *Making Tax Simpler – Towards a new Tax Administration Act* were that:

- while there is a need for the Commissioner to have some flexibility in the application of the law, this should not be at the expense of transparency in her decision-making; and
- the need for greater information-sharing within government was understood but this should not be detrimental to taxpayers' rights to privacy and confidentiality.

A second document, *Making Tax Simpler – Proposals for modernising the Tax Administration Act,* was released in December 2016. This document detailed legislative proposals for a wider application of the Commissioner's care and management function and more relevant information-sharing and confidentiality rules. It also outlined measures to provide taxpayers with better tools to ensure the correctness of their tax affairs and to allow a greater range of intermediaries to interact with Inland Revenue's systems.

Following the proposals set out in the second discussion document, the proposed legislative changes in this Bill are grouped into four key areas:

- Collection, use and disclosure of information – in particular, modernising the rules around confidentiality and information-sharing.
- In keeping with the "right from the start" framework, allowing greater taxpayer access to binding rulings with a new short process rulings system and improving the process for taxpayers to deal with minor errors.
- Permitting a wider group of intermediaries to have access to new services provided by Business Transformation.
- Subject to clear safeguards in keeping with the rule of law, allowing the Commissioner some flexibility under care and management responsibilities to respond to obvious legislative anomalies.

Following the receipt of submissions, further consultation was carried out with representatives from key stakeholder groups Chartered Accountants Australia and New Zealand, the New Zealand Law Society and the Corporate Taxpayers Group. This further consultation, together with the submissions received on both discussion documents, informed the final policy recommendations for the proposed amendments.

The merits of the proposed changes are analysed in the regulatory impact assessments, available at http://taxpolicy.ird.govt.nz/publications/2018-ria-armtarm-bill/overview:

- *Making Tax Simpler: Proposals for modernising the Tax Administration Act – collection, use and disclosure of information*;
- *Making Tax Simpler: Proposals for modernising the Tax Administration Act – rulings, amendments and tax intermediaries*; and
- *Making Tax Simpler: Proposals for modernising the Tax Administration Act – flexibility for dealing with legislative anomalies.*

Each area is covered in more detail in the following sections of this commentary.

INFORMATION COLLECTION, USE AND DISCLOSURE

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

Inland Revenue's information collection powers are long-established, and generally work well. There is an established standard that where the Commissioner is using compulsory powers, this is only for information considered "necessary or relevant" to the Commissioner's functions. This gives an assurance that Inland Revenue will only use its powers to obtain information that is needed. This Bill proposes to rewrite the information collection provisions in order to make them clearer and more navigable, however, there are no proposed changes of substance with the exception of two areas:

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

For taxpayers to be comfortable providing their information, they need to feel the information requested is reasonable and is treated appropriately by Inland Revenue. Currently, this assurance is given by what is often referred to as the "tax secrecy" rule, set out in section 81 of the Tax Administration Act 1994 – which essentially states that information provided to Inland Revenue will only be used for revenue purposes. Rules about the confidentiality of tax (and taxpayer) information are common across revenue agencies internationally.

For most public sector agencies the primary rules governing collection, use and disclosure of information are set out in the Privacy Act 1993 and the Official Information Act 1982. However, for Inland Revenue, the Tax Administration Act 1994 provides the primary rules.

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

- It is seen as a balance for Inland Revenue's information gathering powers. Revenue agencies are generally granted wide information-gathering powers so they can ensure that taxpayers are meeting their obligations.
- Confidentiality has traditionally been considered necessary to promote compliance – taxpayers will be more willing to provide information to Inland Revenue if they are assured it will go no further.
- Taxpayer privacy has also more recently been referred to by the Courts – and the right of taxpayers to have their affairs kept confidential is also recognised in

section 6 of the Tax Administration Act 1994 in defining the integrity of the tax system.

"Tax secrecy", or at least the part that relates to the confidentiality of a taxpayer's individual affairs, is seen as a critical component of the integrity of the tax system, as reflected in the definition of integrity in section 6 of the Tax Administration Act 1994.

However, the current rules can lead to tensions, particularly between:

- confidentiality and wider government objectives, including the more efficient operation of government and the provision of services that can be achieved through increased cross-government information sharing; and
- confidentiality and the Official Information Act 1982 principle of open access to information held by government.

Inland Revenue already shares considerable amounts of information with other agencies. The aim of the proposed amendments is to modernise and clarify the rules, to better provide for confidentiality and sharing in the future, and more clearly balance the trade-offs inherent in decision about whether information should be shared. The key proposed amendments relating to confidentiality comprise:

- Narrowing the confidentiality rule from its current coverage of all matters relating to the Inland Revenue Acts, to more clearly target information about taxpayers.
- Providing a clearer exceptions framework, grouping the exceptions into categories and improving the navigability of the legislation.
- Introducing a more flexible regulatory framework for information sharing to assist with the provision of public service (building on existing rules).
- Allowing Inland Revenue to enter into agreements for information-sharing without need for regulations where the sharing will be done with customer consent. Again this is linked to information-sharing for public service provision.

The next six commentary items (Information collection, Information use, Confidentiality, Confidentiality exceptions framework, Information sharing, Penalties for misuse for information) improve the framework by which Inland Revenue can collect, use and disclose information.

INFORMATION COLLECTION

(Clauses 15, 99 and 102)

Summary of proposed amendments

The proposed amendments modernise the existing information collection provisions by updating the language and removing some existing repetition. These amendments do not represent a policy change with the exception of one aspect, detailed further below. A transitional provision is included to make clear there is no policy change intended by the rewrite of these provisions.

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

Application date

The proposed amendments will come into force on the date of enactment.

Key features

As part of the modernisation of the Tax Administration Act 1994, provisions governing the collection use and disclosure of information are proposed to be brought together in a new subpart 3A and rewritten in a more modern, navigable style. Overarching purpose and principle sections have also been added to improve navigability and clarity. These new purpose and principle sections do not represent any policy change, rather they draw together the purpose and principles already contained in the existing provisions.

One new provision is included within the proposed changes – introducing a regulation-making power where information is to be sought on a regular, repeating basis, as distinct from using existing powers to collect information on an ad hoc basis.

Background

Inland Revenue’s existing powers to collect information generally work well and no significant change is proposed. Broadly, Inland Revenue has the ability to collect information to carry out its various functions and, where necessary, to compel the provision of information that is considered “necessary or relevant”. This is a long-established standard and gives the assurance that Inland Revenue will only use its information-gathering powers to obtain information that is needed.

The current rules, while currently generally working well, were designed for a time when information was stored and exchanged in paper format. The rules, however, continue to work well in most situations where information is collected on a one-off or

ad hoc basis. This applies equally to individual taxpayer data and wider datasets comprising information about many taxpayers.

As the digitisation of the economy increases, so too does the availability and usefulness of large datasets. Data matching is becoming increasingly common in both the public and private sector. In the tax context, the use of large datasets for compliance and educative work has been part of the toolkit for revenue agencies around the world for some time. Such data is used for a range of purposes, including education, targeted publicity and support, targeting compliance work to high risk cases, pre-populating returns, and tailoring service approaches.

In New Zealand, the existing information-gathering powers in the Tax Administration Act 1994 have been recognised by the Courts as enabling the collection of large datasets. However, it is proposed to provide more specific rules for situations when such information is required on a regular, repeating basis. This will provide greater transparency about those situations where data is being routinely and regularly collected. The proposed new provision is a clarification for specific circumstances and therefore does not affect the existing information collection powers set out in the Tax Administration Act 1994.

Detailed analysis

Clause 15 inserts a proposed new subpart 3A into the Tax Administration Act 1994, containing provisions relating to collection, use and disclosure of revenue information. This, combined with clause 102 inserting a proposed new schedule 7, would replace the existing sections 16–21 and Part 4 of the Act.

Proposed new section 16 sets out the purpose of the subpart, which is to:

- provide the Commissioner with the necessary powers to carry out her duties and collect all the taxes under the Inland Revenue Acts;
- enable the Commissioner to collect revenue information, including accessing property, removing, retaining, copying and reviewing documents;
- require the production of documents or access to information;
- set out the Commissioner's powers in relation to documents;
- provide a regulation-making power for regular collection of bulk data (new);
- describe how revenue information may be used (new);
- protect the confidentiality of sensitive revenue information; and
- facilitate efficient and effective government administration and law enforcement through permitted disclosures of sensitive revenue information for certain purposes.

Proposed new section 16B then sets out the principles upon which the subpart is based, in particular:

- the purposes for collecting revenue information;

- that accessing property or documents may occur only where it is necessary or relevant;
- that revenue information must be protected with appropriate security safeguards; and
- that sensitive revenue information may not be disclosed otherwise than in accordance with the permitted disclosure rules set out in the subpart and proposed new schedule 8.

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

Proposed new sections 17–17K then set out, in rewritten format, the information collection rules currently contained in sections 16–19 and 21 of the Act. This is a drafting improvement rather than a policy change. Proposed new section 227F is included to make clear that there is no change of meaning with regard to these sections.

New regulation-making power for datasets

Proposed new section 17L inserts a new regulation-making power into the Tax Administration Act 1994. This would enable regulations to be made by Order in Council, authorising the collection, on a regular basis, of bulk data, where that collection is necessary or relevant for revenue purposes. A regulation would specify:

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

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

- the regulations are necessary for the administration or enforcement of any of the Inland Revenue Acts or any other function lawfully conferred on the Commissioner;
- the proposed use of the information is consistent with the Inland Revenue Acts; and
- a consultation process has been undertaken with those the Commissioner considers it is reasonable to consult, including consultation with the Privacy Commissioner. Consultation would include provision of draft regulations and an explanation of why they are considered necessary and how the proposed use of the information is consistent with the Inland Revenue Acts.

The proposed provision also contains a statutory review requirement. This would require the Commissioner to conduct a review of the operation of the proposed provision, in

consultation with the Privacy Commissioner. This review would be required to be carried out five years after the proposed provision comes into force.

INFORMATION USE

(Clause 15)

Summary of proposed amendment

The proposed amendment provides an express clarification that information gathered for one revenue purpose can be used for any other revenue purpose.

Application date

The proposed amendments will come into force on the date of enactment

Detailed analysis

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

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

To make it clear that information gathered for the purpose of one revenue function is also able to be used for any of Inland Revenue's other functions, the proposed amendment includes this principle in proposed new section 17M. A similar approach is taken in the equivalent United Kingdom legislation which expressly provides that "information acquired by the Revenue and Customs in connection with a function may be used by them in connection with any other function".[7]

The principle that information obtained under the Tax Administration Act 1994 or any other Inland Revenue Act can be used for any revenue purpose includes reuse of information and use of the information in permitted disclosures pursuant to Inland Revenue's various information sharing provisions.

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

CONFIDENTIALITY

(Clause 15)

Summary of proposed amendment

Proposed amendments to the current "tax secrecy" rule more clearly focus on the core information to be protected, namely information that identifies, or relates to, taxpayers. It is also proposed to modernise and restructure the confidentiality rules to improve the clarity and navigability of the legislation.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

Under the proposed amendment the confidentiality rule is reframed from covering all matters relating to revenue legislation, to being clearly focused on information about, or relating to, taxpayers.

Background

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

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

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

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

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

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

Detailed analysis

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

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

The rule therefore aims to protect information about taxpayers, including where it might be commercially or personally sensitive.

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

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

CONFIDENTIALITY EXCEPTIONS FRAMEWORK

(Clauses 15 and 102)

Summary of proposed amendment

The proposed amendments restructure the existing exceptions to confidentiality into a clearer framework. Under the proposed new structure the overarching rules would be contained in the main provisions (proposed sections 18C–18J) and the detail of most exceptions set out in proposed new schedule 7.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The proposed amendments set out the categories of exceptions to the proposed new confidentiality rule. The legislation is restructured to contain the main rules within the primary sections and the detail of the exceptions within these categories in proposed new schedule 7. Other than as specifically identified in the following sections of this commentary, the exceptions are merely restating existing rules rather than introducing new ones.

Background

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

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

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

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

Detailed analysis

Proposed new sections 18C–18J contain the overarching framework for exceptions to the rule of confidentiality or "permitted disclosures". Further detailed rules regarding each category of exception are set out in proposed new schedule 7.

Carrying into effect

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

Information sharing

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

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

Further detail about each of the proposed information-sharing methods is contained in the next commentary item (Information sharing).

Disclosures to persons or their representatives

Proposed new section 18G authorises disclosures to the taxpayer themselves or their representative(s). Further detail is contained in schedule 7 part B. The relevant clauses in the schedule replicate existing exceptions in section 81(4), specifically 81(4)(j) (statistical information), 81(4)(l) (disclosure to the taxpayer or their representative), 81(4)(lb) (tax pooling intermediaries) and 81(4)(ld) (software packages). Clause 16 brings together and broadens the existing exceptions in 81(4)(lb) and 81(4)(lc) (information regarding tax agents) to include the wider class of representatives covered by the proposed intermediary changes in clause 79 of this Bill (see the commentary item Third party providers and intermediaries on pages 64–68).

This category also contains a proposed new exception for disclosures to digital services providers. New clause 18, schedule 7 would enable customers to use digital services to communicate with Inland Revenue, where the digital service is one that the Commissioner has listed as an accepted provider. This proposed new provision is similar to the existing software clients provision (proposed new clause 17, schedule 7, currently

section 81(4)(ld)) in that it permits disclosure to the provider of the service (in that case an accepted software package) as a consequence of a customer using that package or service to communicate with Inland Revenue.

Disclosures to other agencies

Proposed new section 18H and schedule 7 part C set out specific legislative exceptions involving disclosures to other agencies. The exceptions set out in the schedule mirror those in the current Part 4 of the Act with no changes other than:

- minor changes for flow to combine provisions where an exception was contained in both section 81(4) and a subsequent section in Part 4;
- minor amendments to the sharing provision with Statistics New Zealand (proposed new schedule 7, clause 21). This exception has been updated to modernise the language, as unlike most other agencies, it is considered appropriate to retain this sharing arrangement in legislation, rather than moving to a regulatory model. Retaining this as a legislative exception reflects the quantity and breadth of information shared, the nature of the sharing (for statistical and research, rather than operational purposes) and the statutory independence of both the Government Statistician and the Commissioner of Inland Revenue;
- two proposed new authorisations arising from previously legislated rules. In both cases Parliament has already legislated for the information sharing in other statutes and the proposed amendments insert a parallel authorisation into the Tax Administration Act 1994:
  - Proposed new schedule 7, clause 24 would enable the Commissioner to disclose information to a government agency or an Anti-Money Laundering and Countering Financing of Terrorism supervisor for the purpose of ensuring compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (see section 140(1) and 140(2)(k), (l) and (v) of that Act).
  - Proposed new schedule 7, clause 25 would enable the Commissioner to disclose information to the New Zealand Customs Service in relation to a transfer price arrangement for the purpose of assessing the suitability of any such arrangement in relation to the use of provisional values under the Customs and Excise Act 2018 (see section 102(8) of that Act).

Disclosures for international purposes

Proposed new section 18I and schedule 7 part D set out existing exceptions (sections 81(4)(k) and 88) for international disclosures. The exceptions set out in the schedule relate to double taxation agreements and reciprocal arrangements and are unchanged from the current legislation.

Disclosures for risk of harm purposes

Proposed new section 18J contains an exception not currently expressly set out in the Tax Administration Act 1994. The proposed section replicates the disclosure exception set out in the Privacy Act 1993 for situations where there is a serious threat to health and safety. The proposed exception applies to allow disclosure where it is necessary to

prevent or lessen a serious threat to public health or public safety, or to the life or health of a person. The degree of how serious threat is, considers takes the event's likelihood, severity and immanency.

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

An example given by the Office of the Privacy Commissioner is a situation where a staff member is dealing with a customer who has made comments or threats leading the staff member to think the customer may harm themselves or others. In such a situation, information could be disclosed to Police so they can take appropriate steps to prevent the harm.

INFORMATION SHARING

(Clause 15)

Summary of proposed amendment

Proposed new sections 18E and 18F relate to information sharing for public service provision. These would enable information sharing in three ways:

- Under an Approved Information Sharing Agreement pursuant to Part 9A of the Privacy Act 1993 (current section 81A).
- Under an agreement between agencies where information is to be shared with the consent of the taxpayer to whom it relates (new provision).
- Under regulations made under proposed new section 18F – this proposed section is a modified version of the regulation-making power currently contained in section 81BA.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

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

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

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

Background

Taxpayers are compelled to provide their information to Inland Revenue for reasons of public good – the administration of the tax system and other social policy provisions. In considering the broader use of data, the Government is essentially balancing private rights (in the privacy or confidentiality of information) against the wider public good of efficient government, upholding the law and ensuring that people receive the correct entitlements at the appropriate time.

Legislation already permits a considerable amount of cross-agency information sharing. However, it might be argued that there is no readily apparent consistent principle to these exceptions. Some are narrow, others broader, and in many cases legislative change has been made for the avoidance of doubt, even for minor changes to information exchanges.

The newer exceptions (in current sections 81A and 81BA) are broader and allow sharing that meets certain conditions to be authorised by order in council. These exceptions allow a greater degree of transparency, as the Order in Council and underlying agreement are generally published. Such arrangements can also provide for public reporting on the information transfers.

The proposed amendments build on these broader regulation-making exceptions, and aim to make information sharing for public service provision more flexible, principled and transparent. Regulatory models allow greater flexibility and timeliness of implementation and amendment of information sharing arrangements. Consideration was given as to whether the new rules should require an order in council or simply be managed by agreements between agencies. Given the importance of taxpayer confidentiality, the regulatory model was considered more appropriate as it will retain Cabinet and Regulations Review Committee oversight of proposed agreements. The one exception to this is agreements for information sharing where the consent of the customer concerned will be obtained prior to sharing – in that case it is proposed that an agreement model (without need for an Order in Council) would be appropriate.

Detailed analysis

The proposed amendments would provide for information sharing arrangements for the provision of public services to be entered into in three alternative ways:

- An approved agreement under Part 9A of the Privacy Act 1993 (proposed section 18E(2)). This replicates an existing provision in the Tax Administration Act 1994 authorising the use of the Privacy Act rules. This provision would generally be used where the information to be exchanged is primarily personal information.
- An agreement between agencies under proposed section 18E(3) where consent will be obtained from the customer for the sharing – no Order in Council or regulation is required under this proposed provision. This form of sharing could be used for situations where the agency receiving the information from Inland Revenue is providing services to a customer and, in the course of doing so, the customer consents to their information being obtained from Inland Revenue. This could also be used for optional services such as initiatives to simplify updating contact details across government agencies.

- A regulation, made by Order in Council, pursuant to proposed new section 18F, authorising information sharing. This is a proposed update to the regulation-making power currently in section 81BA. This provision would generally be used in situations where the information to be shared was primarily non-personal (entity) information or the Privacy Act 1993 Part 9A rules were otherwise not considered suitable.

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

Consent agreements

In many cases information sharing is undertaken to improve the services offered by Government to New Zealanders, and the expectation is that those affected would consent to their information being shared. Under the Privacy Act 1993, individuals may authorise their information being shared, as privacy is theirs to waive. In contrast, confidentiality of tax information is an obligation imposed on Inland Revenue officers and the consent of the person to whom the information relates is no defence to breaching the obligation of confidentiality.

In the discussion document *Making Tax Simpler – Towards a new Tax Administration Act* it was proposed that taxpayers be able to consent to the disclosure of their information to other government agencies. This proposal was supported by most submitters, provided it was limited to within government.

It is important to note that such arrangements do not mean that all information sharing requires consent – non-consented sharing would continue to occur where alternative legislative or regulatory authority exists. It is important that this is clear for customers and might suggest that consented arrangements should generally only be used where there is not also the possibility of non-consented sharing occurring under a different arrangement. Alternatively it should be made very clear to customers the situations in which information-sharing could occur independently of the consented agreement.

Consent agreements under proposed section 18E(3) must set out the conditions for security and use of the information provided under the agreement. The agreement must also stipulate a process to ensure consent is properly obtained and recorded.

Regulations under proposed new 18F

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

- the sharing is for public service provision, rather than the current limit to sharing with "government agencies" (new);

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

Regulations under the proposed new section would prescribe the classes or types of information to be shared, how it would be provided, accessed, stored, secured, disposed of, and used. They would also specify whether any further disclosure of the information was permitted, and whether the agreement was subject to review requirements, including where any breaches occur.

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

PENALTIES FOR MISUSE OF INFORMATION

(Clause 96)

Summary of proposed amendment

These proposed amendments restate the existing penalty provisions relating to collection and use of information that apply to persons other than Inland Revenue officers.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

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

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

RULINGS AND AMENDING ASSESSMENTS

A key objective in modernising the tax administration system is to make tax compliance simpler, especially for the small businesses sector. The objective can at least in part be met by adopting the OECD's "right from the start" framework which suggests a more proactive rather than merely reactive approach to tax administration. One goal under the "right from the start" framework is first time accuracy so that the need to make subsequent adjustments to a return is reduced.

The ability for a wider range of taxpayers to obtain reliable advice from Inland Revenue on their tax positions will assist in the goal of first time accuracy. Therefore, the Bill proposes to extend the ability to obtain private binding rulings to a wider range of taxpayers who are in practice excluded from this because of the complexity of the process and the fees charged for obtaining a binding ruling.

While the focus of the modernised tax administration is based on the right from the start concept, there will still be situations when the taxpayer or the Commissioner will seek to amend or correct an assessment. The current process for amendment is complicated and does not align with taxpayers' accounting processes for dealing with minor errors. Having to adopt a different process for tax purposes for minor errors imposes compliance costs. The Bill will provide a larger and more certain threshold for making adjustments in a current return rather than the return in which the error arose combined with a new materiality threshold.

The next three commentary items (Short process rulings, Extending the scope of binding rulings, and Amending assessments) improve the ability of Inland Revenue to help taxpayers get their tax obligations right from the start.

SHORT PROCESS RULINGS

(Clauses 61 and 272–276)

Summary of proposed amendment

The Bill extends the ability to obtain private binding rulings to a wider range of taxpayers by simplifying the requirements for applying for a binding ruling and by allowing Inland Revenue to reduce the fees for smaller entities and/or transactions.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The key features of the proposals are:

- a person with annual gross income below a prescribed level ($5,000,000) and a tax question involving tax below a prescribed level ($1,000,000) can apply for an abbreviated ruling;
- removal of the requirements in applying for a binding ruling to state the taxation laws and the propositions of law for which the ruling is sought; and
- the application and hourly rate fees for private binding rulings will be lower for short process rulings at rates determined and published by the Commissioner.

Background

The binding rulings system is a fee-based service provided by Inland Revenue and governed by Part 5A of the Tax Administration Act 1994. There are a number of different types of binding ruling, most commonly private and public rulings and, once issued, the Commissioner (but not the taxpayer) is bound by their outcome. The Bill's proposals concern private binding rulings.

The binding rulings system is intended to provide certainty to taxpayers usually on commercial arrangements they have either entered into or are contemplating.

The main problem that the Bill seeks to address is that, in practice, rulings are generally only available to large taxpayers as SME taxpayers are priced-out because of the advisor costs and the fees involved.

The fees charged for rulings are determined on a cost-recovery basis but the overall cost can be reduced at Inland Revenue's discretion. Since the introduction of the regime in the mid-1990s these have involved an application fee of $280 (plus GST if any) for the costs of receiving and reviewing the ruling application and a fee of $140 (plus GST if any) per hour spent by Inland Revenue in research and analysis. In the year ended

30 June 2017, the average fee charged was $11,200 which reflects that most of the rulings issued are for large taxpayers involved in large, complex transactions.

The Government discussion document *Making Tax Simpler – Proposals for modernising the Tax Administration Act* contained proposals to make binding rulings easier to obtain, especially for SMEs, by simplifying the process for applying for a ruling and reducing the fees.

Submissions on the discussion document welcomed these changes although views differed about how much the simpler rulings regime would be used and it is therefore difficult to estimate the likely level of use in advance.

Detailed analysis

It is proposed in the Bill (clause 61), proposed sections 91EK–91ET, that the Tax Administration Act 1994 be amended to allow a person to apply for a short process ruling if:

- their annual gross income for the tax year before that in which the application is made is $5,000,000 or less; and
- the person is seeking the ruling on a matter concerning a tax (other than provisional tax), duty, or levy that is expected to amount to less than $1,000,000.

Application for and issue of short process ruling

The application must be in a form prescribed by the Commissioner and must:

- identify the person applying for the ruling;
- describe the circumstances on which the ruling is sought;
- disclose all relevant facts and documents; and
- state the general tax outcome in relation to which the ruling is sought.

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

Other requirements for obtaining a binding ruling or obligations on Inland Revenue when considering or issuing a short process ruling largely mirror the current rules for private rulings. These include:

- an exclusion from ruling on an issue that is the subject of a dispute under the tax disputes process;
- the ability for Inland Revenue to provide conditions on which the ruling is based;
- the content that the ruling must include and the period or tax year for which the ruling applies;

- a requirement that Inland Revenue provide the applicant with a reasonable opportunity to be consulted if the content of the proposed ruling differs from that for which the application is made; and
- the ability for Inland Revenue not to apply a ruling if there has been a material omission or misrepresentation in the application.

Fee reduction

Clauses 272–276 amend the Tax Administration (Binding Rulings) Regulations 1999 by providing that, for a short process ruling, an application fee and further fees are payable at rates that are lower than the current rates – $280 and $140 per hour, plus GST if any, – as determined and published by the Commissioner.

As it is difficult to accurately estimate the level of demand for short process rulings it is preferable to allow the Commissioner to set the lower rates than to prescribe them in the regulations. In this way, the lower rates can be set and adjusted once the levels of demand for short process rulings, and the time taken by Inland Revenue to prepare the rulings, are more established.

Currently Inland Revenue will provide an applicant with an estimate of the cost of a ruling and this is expected to continue if required for short process rulings.

EXTENDING THE SCOPE OF BINDING RULINGS

(Clauses 54–60 and 64–67)

Summary of proposed amendment

Consistent with the "right-from-the-start" framework, greater up-front certainty will also be available for taxpayers through proposals in the Bill to extend the scope of matters that can be ruled on – both under the current binding rulings processes and for short form rulings. These extensions include:

- removing the prohibition on ruling on a taxpayer's purpose under certain provisions;
- allowing more factual questions, such as a person's residence status, to also be able to be ruled on; and
- expanding the ability to rule on financial arrangements.

Aligned to these expansions will be clarifications on the role of conditions and assumptions in the rulings processes.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The key features of the proposals are:

- allowing rulings to be made on a taxpayer's purpose in certain circumstances, such as whether the taxpayer has the purpose of selling a property when they acquire it;
- allowing more factual questions not involving "arrangements", such as whether a person is a New Zealand resident, to be ruled on;
- allowing the Commissioner to rule on a financial arrangement question for which she can currently only issue a determination; and
- clarifying the difference between an assumption and a condition and when a ruling ceases to apply because a condition or assumption is breached.

Background

As noted earlier, the binding rulings system is currently more accessible to larger or more sophisticated taxpayers with more complex transactions. This can be attributed to the costs of the system, including both the complexity of the application process and the fees involved. However, the system was also to some extent designed with complex

transactions in mind which is why it is restricted to "arrangements" and largely legal rather than more fact-based questions.

Under the "right-from-the-start" framework it is appropriate that a wider range of matters should be able to be ruled on, in order to provide more up-front certainty for taxpayers.

Detailed analysis

Section 91C sets out a broad range of matters on which the Commissioner may issue any form of binding ruling (public, product or private). Section 91C also contains a limited number of exclusions. A private ruling can only be made, however, for a taxpayer and an "arrangement" which precludes applications for rulings on matters that are about the taxpayer's status such as their residence status or the taxpayer's purpose such as their intent when land is disposed of. Clause 55, proposed section 91CB, will allow these sorts of rulings – whether regular or short process – to be made.

Proposed section 91CB(1) contains a comprehensive list of matters on which a private ruling and a short process ruling can be made, including whether a person is:

- resident in New Zealand or has a permanent establishment in New Zealand;
- an income-earning trustee or society or institution for charitable purposes;
- a look-through company;
- a portfolio investment company;
- a public authority; or
- an associated person.

In the same way as proposed section 91CB(1) but for things rather than persons, proposed section 91CB(2) allows the Commissioner to rule on whether an item of property is trading stock or revenue account property.

Proposed section 91CB(3) allows the Commissioner to rule on a person's intention with regards to disposing of personal property or land or with regards to making taxable supplies under certain GST provisions.

Proposed section 91CB(4) reiterates that an "arrangement" is not required for a ruling to be made under any of these new provisions.

Proposed section 91CC allows the Commissioner to make binding rulings on these matters relating to financial arrangements:

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

Clauses 54, 56–60 and 62–67 contain some further clarifications to the binding rulings legislation including:

- that the date a private ruling ceases to apply is the date the event (misrepresentation, material omission or incorrectness) that causes cessation occurs unless the ruling expressly provides otherwise; and
- the term “assumption” is in most places replaced with the term “condition” as this is more reflective of practice.

AMENDING ASSESSMENTS

(Clause 73)

Summary of proposed amendment

It is proposed to replace the current criteria that determine whether an error can be included in a later tax return with a combination of a monetary threshold and a materiality threshold.

Taxpayers would have the option of including an error in a subsequent return if the amount of the error is equal to or less than both $10,000 and two percent of the taxpayer's taxable income or GST output tax liability. The current $1,000 threshold would be retained but apply without qualification as to the type of error involved.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The Bill repeals and replaces section 113A relating to the correction of minor errors in subsequent returns so that:

- taxpayers can include an error in a subsequent return if the total amount of errors for the relevant return are equal to or less than $10,000 and two percent of the taxpayer's taxable income or GST output tax liability; and
- taxpayers can automatically include an error in a subsequent return if the total errors for the return (including a fringe benefit tax as well as an income tax or GST error) are equal to or less than the current threshold of $1,000.

Background

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

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

However, the reasons for requiring amendments to be made to the original assessment are not so relevant when the error is minor. In those cases, the compliance costs can outweigh the benefits of requiring taxpayers to amend the original assessment.

The proposal to extend and simplify the process for minor errors will provide better alignment with taxpayers' accounting processes and will also complement the simplified process under Inland Revenue's new computer system (START).

Detailed analysis

Clause 73 repeals and replaces section 113A of the Tax Administration Act 1994. Currently, if a person has made one or more errors in an assessment for an income tax, FBT or GST return and:

- the error was caused by a clear mistake, simple oversight or mistaken understanding; and
- for a single return the resultant total discrepancy in the assessment is $1,000 or less;
- the error can be corrected in the next return following discovery of the error.

Proposed new section 113A allows taxpayers to make an adjustment in a later return to an income tax or GST return if the total errors in the original return are equal to or less than $10,000 and two percent of the taxpayer's taxable income or output tax liability. It retains the current $1,000 total discrepancy amount, but now makes this automatically available – as the requirement that the error be caused by a clear mistake, simple oversight or mistaken understanding is removed.

THIRD PARTY PROVIDERS AND INTERMEDIARIES

(Clauses 5(36), 5(59), 14, 36, 79 and 213(27))

Summary of proposed amendment

The amendments clarify the types of third party service providers (in addition to tax agents) that Inland Revenue may offer "special" or extended service offerings to in order to assist with their clients' tax and social policy obligations, or with claiming entitlements to social policy assistance administered by Inland Revenue. The Bill does this by setting out the eligibility requirements that a person must satisfy in order to be approved by Inland Revenue as a "representative".

The amendments would also allow Inland Revenue to withhold approval or disallow a person as a representative or nominated person when this action is necessary to protect the integrity of the tax system.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

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

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

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

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

status as another's nominated person where continuing to allow the person to be a nominated person would adversely affect the integrity of the tax system.

Background

As part of Inland Revenue's modernisation programme, Inland Revenue intends to offer more online services to tax agents as well as to other third party providers of tax services. A concern is protecting the revenue base and the integrity of the tax system against any potential risks arising from providers' use of these services.

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

The statutory definition of a "tax agent" is used to determine who can access these services. This means that other tax service providers (such as those who only file GST returns and employer monthly schedules for their clients, or who provide budget advice and assist with tax return preparation and claiming social policy entitlements) are not at present given access these services, even though it would be desirable in many cases to do so.

These providers can still look after their clients' tax and social policy affairs as "nominated persons" (with similar access to the client through Inland Revenue's online services, including return filing), but without the services specifically for tax agents.

Restricting additional services to persons who are listed as tax agents is not required by law, but is an administrative decision that has been made by the Commissioner of Inland Revenue. The Commissioner can offer these services as widely or narrowly as she considers appropriate. However, it is not clear that Inland Revenue can revoke a nominated person's access to these services after such access has been granted, even if the nominated person had previously been removed from the list of tax agents or had criminal convictions for fraud.

This is because a person who is nominated by a taxpayer to act on their behalf is the agent of the taxpayer under common law. Therefore, even if Inland Revenue has reasonable tax integrity concerns about allowing a person to act for other taxpayers, Inland Revenue can neither refuse to deal with that person nor disallow their access as a taxpayer's nominated person because it is up to the taxpayer whether the nominated person should act (or continue to act) on their behalf.

The amendments would allow Inland Revenue to withhold approval, or disallow a person as a representative or nominated person when the action is necessary to protect the integrity of the tax system.

Detailed analysis

Clause 79 of the Bill inserts new Part 7B into the Tax Administration Act 1994. Proposed Part 7B sets out the classes of persons who may:

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

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

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

The amendments are not intended to restrict a person's ability to appoint an agent to only the classes listed in proposed section 124B.

For example, a tax advisor (who is not the tax agent, representative or nominated person of the applicant) may prepare and submit a binding ruling application for a taxpayer. The tax advisor would not be required to become a tax agent, representative or nominated person in order to be able to discuss the details of the arrangement covered by the ruling or other relevant matters with Inland Revenue on behalf of the applicant.

Existing provisions for various third party providers

In addition to the proposed new sections for representatives and nominated persons (sections 124D and 124F), the Bill re-numbers or re-drafts a number of existing sections in the Tax Administration Act 1994 so that these provisions come within new Part 7B:

- Sections 15C to 15M, dealing with PAYE intermediaries and listed PAYE intermediaries, are re-numbered as sections 124H to 124R.
- Section 15N, dealing with RWT proxies, is re-numbered as section 124ZF.
- Sections 15O to 15T, dealing with tax pooling intermediaries, are re-numbered as sections 124S to 124X.

- Sections 15U to 15Z, dealing with approved AIM providers, are re-numbered as sections 124Y to 124ZE.
- Section 34B, dealing with tax agents, is re-drafted as proposed sections 124C, 124E and 124G, where section 124E also deals with representatives and section 124G deals with the Commissioner's ability to remove a person's status, or to refuse to approve or allow a person as a tax agent, representative or nominated person.

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

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

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

This information is also required if it has not previously been provided to Inland Revenue at the time of making the application, or, where the information was previously provided, is no longer accurate. This extends the existing information requirements for tax agents who are non-natural persons to representatives that are not natural persons.

Nominated persons

Proposed section 124F sets out that a person may nominate another person to act for them in relation to their tax affairs or social policy entitlements by informing Inland Revenue of the nomination and providing the following information (requested by the IR597 form *Elect someone to act on your behalf*):

- the name of the person making the nomination, along with their contact address and IRD number;
- the name, contact address, IRD number, and date of birth of the nominated person;
- the relevant tax types or social policy entitlements and obligations in relation to which the nominated person will act on behalf of the person making the nomination; and
- the relevant start and end dates, as applicable, between which the nominated person will act in relation to the named tax types and social policy entitlements and obligations.

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

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

Consistent with existing section 34B(7), proposed section 124G(1) requires the Commissioner to refuse to list a person as a tax agent if the Commissioner is satisfied that:

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

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

Similarly, proposed subsection (3) states that the Commissioner may disallow a person's status as a nominated person if she considers that:

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

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

Notification of refusal, disallowance or removal from list

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

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

COMMISSIONER OF INLAND REVENUE'S CARE AND MANAGEMENT ROLE

(Clause 9)

Summary of proposed amendments

The Commissioner of Inland Revenue is responsible under the Tax Administration Act 1994 for the care and management of the Inland Revenue Acts. The Commissioner's care and management responsibility has been interpreted as limited to providing her with administrative flexibility regarding allocating her resources to fulfil her statutory duties. It does not provide her with administrative flexibility when there is a legislative anomaly that does not reflect the clear policy intent of the legislation.

At times, however, both Inland Revenue and taxpayers have a clear understanding of the policy intent of a provision and have applied that intent in practice. If a legal interpretation determines that the legislation does not in fact reflect this outcome because there is an anomaly or gap in the relevant provision, significant compliance and administrative costs can be involved before the situation is rectified.

Consistent with the aim of Inland Revenue's business transformation of reducing compliance costs through a faster, more efficient tax administration, the Bill proposes some new processes that can be adopted to address these situations where no other option is available. Among other safeguards for taxpayers, the outcomes of these processes are limited to a three year application period and cannot be unfavourable to taxpayers.

The Bill proposes to extend the Commissioner's care and management role by providing more tools for addressing gaps or inconsistencies in the legislation that do not reflect the clear policy intent of a provision. These are:

- an Order in Council process;
- a Commissioner determination-making process; or
- a Commissioner administrative action process.

The aim of these tools is to allow for such anomalies to be addressed more quickly and thus provide earlier certainty to taxpayers until legislative amendments can be made.

Taxpayers will not be disadvantaged by the proposal as it will include a number of safeguards including limiting the application period of the regulation, determination or administrative action to three years and providing the option for the taxpayer to apply or not apply the measure.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The key features of the amendments are:

- they apply to a "legislative anomaly" as defined;
- they allow a modification to be made to address the legislative anomaly in the form of either an order-in-council, a Commissioner's binding determination or a Commissioner's administrative action;
- the Commissioner must be satisfied about the necessity for the modification including its impact on tax integrity and the compliance cost burden on the affected class of taxpayers of not taking the action;
- the modification is limited to a three year application period during which Inland Revenue must consider if legislative change is required; and
- the taxpayer may choose whether or not to apply the modification.

Background

A key aspect of care and management of the tax system is applying and explaining the law to taxpayers. Generally, tax law can be interpreted in a way that is consistent with the policy intent – the discussion document *Making Tax Simpler – Towards a new Tax Administration Ac*t noted that usually adopting a purposive approach to interpreting the relevant provision(s) will result in an interpretation consistent with the policy intent. However, it also noted that there will be occasional cases when this is not possible.

The consultation on this and a second discussion document *Making Tax Simpler – Proposals for modernising the Tax Administration Act,* have led to a recommended extension to the care and management provision to deal with these occasional situations by allowing for an Order in Council process or Commissioner determination-making or administrative action process all of which would be based on specific criteria and guidelines.

Examples of when the discretion could be used include when a drafting error means that the provision is inconsistent with the intended policy and when a gap in the legislation is discovered that creates uncertainty about whether the legislation is consistent with the policy intent. In these situations the amendments would provide a temporary bridge to allow taxpayers to adopt an approach that is consistent with the intended policy. This would avoid the Commissioner and taxpayers having to commit resources to the unintended outcomes until a law change can be progressed to address the anomaly.

The Commissioner's discretion would not be able to be used to modify the application of a tax law for a particular taxpayer, but rather limited to groups or classes of taxpayers. This will ensure that the discretion is used to remedy objectively determined legislative anomalies and will prevent it from being used in an arbitrary or inconsistent way.

Detailed analysis

Proposed section 6C(4) defines a legislative anomaly as an unintended outcome caused by a gap or inconsistency in the legislation that arises in relation to either the purpose or the object of a specific provision/s or by a gap or inconsistency between the legislation and Inland Revenue practice which produces the result that the wording does not sufficiently reflect the purpose of the legislation; and does not materially affect the intended scope or the operation of the legislation.

Proposed section 6C(5) provides that in determining the intended purpose of the legislation regard may be had to extrinsic material that is not part of the legislation itself and primacy is not required to be given to the text of the legislation.

The proposed processes for an interim response to a legislative anomaly (called modifications in the legislation) are set out in proposed section 6C(1). These are:

- an Order in Council as recommended by the Minister of Revenue;
- a binding determination by the Commissioner of the treatment to be applied; and
- an administrative action by the Commissioner either notifying a class of persons of a proposed treatment, an exemption for a class of persons to remove a compliance burden or a declaration of the validity of an established administrative practice.

Before seeking to apply one of these processes, the Commissioner must be satisfied about a range of matters including that the action does not cause any detriment to the tax system, the impact of the action on the public and the relevant class of taxpayer, the cost of complying with the unmodified legislation and whether the issue can be addressed in any other way.

Once the modification is made, proposed section 6F provides that the document relating to the modification must:

- include a statement explaining the reason for the modification;
- be expressed to apply for a period of not more than three years;
- be reviewed by the Commissioner during the three year period to determine if it should be proposed as a legislative amendment; and
- be tabled in Inland Revenue’s annual report to Parliament.

Proposed section 6H states that a modification must conform to any relevant determination of a hearing authority and that a person can choose whether to apply a modification.

Modernising tax administration – Other items

OVERPAID PAYE INCOME NOT REPAID

(Clauses 119, 194–198, 213(24) and 213(33))

Summary of proposed amendments

This amendment provides that an overpayment of employment income subject to PAYE which is not repaid remains taxable as PAYE income.

Application date

The proposed amendment will come into force on 1 April 2019.

Key features

Proposed amendments include overpayments of employment income subject to PAYE that are not repaid in the scope of sections CE 1 of the Income Tax Act 2007 (amounts derived in connection with employment) and RD 3 (PAYE income payments). An "unrepaid PAYE income overpayment" is defined in proposed new section RD 8B.

A further amendment is proposed to section CE 1 to make it explicit that where a PAYE-related overpayment is repaid it is not income of the person.

Background

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

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

While the current legal position is that overpayments not repaid are not amounts derived in connection with employment and should be treated as a tax free windfall many overpayments arise from anticipated leave which may be a condition of employment. The proposed amendment is intended to clarify the taxable status of all employment overpayments in a way which minimises employer compliance costs and accords with the common-sense view that overpaid salary or wages, extra pays or schedular payments, were paid in connection with employment. This is understood to be how some employers already treat overpayments which are not repaid. As a consequence of the proposed changes, the employer would be unable to recover PAYE on overpayments

not repaid and the unrepaid amounts will remain on the employee's record of income for social policy purposes.

Detailed analysis

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

Under current law, an overpayment of employment income subject to PAYE is not considered to be an amount derived in connection with employment. It is therefore neither employment income under section CE 1 employment income under section RD 3.

An amendment is proposed to the scope of section CE (1)1 so that an unrepaid employment income overpayment is income of the person. The proposed amendment also states that a repaid overpayment is not income of the person.

A proposed amendment to section RD 3 includes an "unrepaid PAYE income overpayment" as a PAYE income payment, to which the PAYE rules apply.

Amendments are proposed to each of sections RD 5 (Salary or wages); RD 7 (Extra pay) and RD 8 (schedular payments) to include in the scope of the provision an unrepaid PAYE income overpayment that was originally treated as a payment in the relevant category.

A PAYE-related overpayment is defined in proposed new section RD 8B as an amount paid in error to which the employee is not entitled or, an advance payment to which the employee does not subsequently become entitled (such as can happen with anticipated leave if the employee leaves before being entitled to the leave). The definition also requires that the amount was originally paid as salary or wages, an extra pay or a schedular payment.

An unrepaid employment income overpayment is defined in proposed section RD 8B(3) as a PAYE-related overpayment that has not been repaid to the employer. Employer's superannuation contributions, other than those the employee has chosen to have treated as salary or wages, are excluded from this definition as are amounts that are income of the person under section CB 32 (property obtained by theft).

OVERPAYMENTS AND EMPLOYMENT RELATED LOANS

(Clause 126)

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

Summary of proposed amendments

The Bill proposes to amend section CX 10 so that an overpayment of employment income subject to PAYE does not amount to an employment-related loan on which a fringe benefit arises.

Application date

The proposed amendment will come into force on 1 April 2019.

Background

Frequently, when an overpayment is made the employer and employee will agree that it will be repaid over time.

Technically an overpayment could be regarded as a loan to the employee until it is repaid. The amendment clarifies that the scope of employment related loans which give rise to a fringe benefit excludes a PAYE-related overpayment.

Key features

An amendment is proposed to add new section CX 10(2)(bb). The amendment would exclude a PAYE-related overpayment from the scope of "employment-related loans" in section CX 10(1).

Under the proposed amendment no liability for fringe benefit tax would arise because of the overpayment, even if the employer allowed an interest free period for it to be repaid.

MID YEAR ENTRY TO THE ACCOUNTING INCOME METHOD

(Clauses 190–192)

Summary of proposed amendment

Currently taxpayers who are otherwise eligible to pay provisional tax under the accounting income method (AIM) can only elect to use AIM prior to their first payment date under AIM. Once the income year has commenced this is likely to mean they will have to wait until the next income year to use AIM. This amendment allows those taxpayers who currently use another provisional tax method (other than the estimation method) to switch to AIM at any time during an income year prior to the final payment due under AIM for that person.

Application date

The proposed amendment will apply from the start of the 2019–20 income year.

Key features

The proposed amendment allows a taxpayer, who otherwise meets the criteria to use AIM to switch to that method from either the standard or GST ratio method at any time during the income year prior to the final due date for AIM for that taxpayer as long as they have made the required payments under that prior method.

Background

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 inserted a new provisional tax method into the Income Tax Act 2007. The accounting income method (AIM) allows taxpayers who meet the requirements within section RC 5(5B) to calculate their provisional tax payments on a pay-as-you-go basis.

Where a taxpayer who meets the criteria of section RC 5(5B) elects to use AIM they must make that choice "on or before the first instalment date for them under the AIM method". This allows new businesses to commence using AIM during an income year (as long as they choose to do this prior to their first AIM payment due for that year). Existing businesses must wait until the following income year to choose to use the AIM method.

In order to make the transition to AIM more attractive to taxpayers, it is proposed to allow those, who otherwise meet the criteria to use AIM, to switch to AIM during the income year rather than having to wait until the following income year.

Detailed analysis

Taxpayers who otherwise meet the criteria in section RC 5(5B) of the Income Tax Act 2007 will be permitted to switch to the AIM method at any time prior to the final AIM payment where:

- they use another concessionary provisional tax method (that is, either the standard or the GST ratio method); and
- they have made all payments due under those methods prior to the date of switching to the AIM method.

Example 6

McGarrett Enterprises Limited (McGarrett) is the maker of flower leis for tourist operators. McGarrett has historically made their provisional tax payments under the standard method. After talking with a number of other small business owners Steve, McGarrett's owner, decides that because of the seasonality of the lei business it would be better using the AIM method. McGarrett is part way through its 2020–21 income year. It has a March year end and has made its first two provisional tax payments totalling $5,000 on the 7th of August and 15th of January in full and on time.

McGarrett has already been using an AIM capable software product but has not turned the AIM function on. He does that at the end of January. This will mean his first AIM payment is due on the 28th of February. McGarrett switches on the AIM calculation part of his accounting software and it calculates that at the end of January McGarrett owes $6,200 in provisional tax. McGarrett makes an AIM payment of $1,200. Because McGarrett is switching from the standard method to AIM and has made all its payments due under the prior method, it can then make the switch to the AIM method during the year. McGarrett meets all the other requirements to use the AIM method.

Example 7

Dr Max's Malasadas Limited (DMM) is the manufacturer of specialty Hawaiian donuts. It has a turnover of $3.5m and uses accounting software to maintain its business records. That software is AIM capable and because of the volatility of DMM's sales, Dr Max, the owner, decides that it would be better to use the AIM method for provisional tax rather than the current standard method. DMM is part way through their 2021–22 income year and is just completing the September month end. It has a March balance date and DMM's first instalment of provisional tax was due on 7th of August. Unfortunately because of some cashflow issues DMM did not make that payment. DMM decides to switch to the AIM method and turns on the AIM capability in the software. However, as DMM has not made the payments required under the standard method it will be prohibited from switching to AIM during the year and will need to wait until the following income year to make the switch.

Taxpayers who pay, or fund their provisional tax through a tax pooling intermediary will need to transfer any funds from the pooling entity to Inland Revenue prior to the switch from the previous method to the AIM method.

Example 8

Kono Kameras Limited (Kono) sells travel cameras which take photos that make the subjects always look like they are on Waikiki beach. This is a limited market but can be volatile as people see photos taken by a Kono Kamera on the internet and then want a Kamera rather than actually travelling to Waikiki. Because of cashflow difficulties Kono uses a tax pooling intermediary to finance its provisional tax payments. During the 2020–21 income year Kono decides that using the AIM method would better suit its cashflow situation and decides to make the switch. Kono already uses accounting software to keep its accounts in order and that software is AIM capable.

Kono has financed its first instalment of provisional tax which was due on the 7th of August 2020, those funds have not yet been credited to Kono's account at Inland Revenue. Prior to making the switch to AIM, Kono will need to transfer those funds to Inland Revenue as otherwise it will appear that Kono has not made the payments required under the prior method and it will not be permitted to switch.

AMENDING THE PAYMENT ALLOCATION RULES

(Clause 75)

Summary of proposed amendment

This amendment alters the current payment allocation rules to allow Inland Revenue to continue to apply payments towards use-of-money interest (UOMI) first but to the oldest debt within a period first. This method will result in a larger proportion of payments being allocated to core tax liabilities which will reduce any overall UOMI cost to taxpayers. It is required to facilitate a change to the way in which Inland Revenue's computer system allocates billing items within a period.

In no case will the new method of allocation result in a greater charge for UOMI than under the current allocation rule.

Application date

The proposed amendment will apply from 17 April 2018, the date when the second tranche of Inland Revenue's processes transition to its new technology platform.

Key features

This proposed amendment requires the Commissioner to allocate payments in a specific order first towards UOMI and then core tax but clearing the oldest UOMI and debt first within a tax period. The amendment allocates a larger proportion of payments to core tax liabilities than UOMI when compared to the current rule.

Background

The Tax Administration Act 1994 contains a payment allocation rule in section 120F which deals with how a taxpayer's payment is allocated to amounts payable within a period. This rule requires that where the taxpayer has unpaid tax and they are liable to pay UOMI on that unpaid tax then payments are allocated to interest liabilities first and then core tax and penalties.

This is primarily driven by the fact that UOMI is charged on a "simple" basis in that interest is not compounding (that is, interest does not accrue on interest). If there were a balance of UOMI outstanding on a taxpayer's account, there is little incentive to pay that amount as it is "interest free" debt.

This payment allocation rule works well when you consider tax liabilities within a period balance in that there is one liability within a period. Where there are multiple liabilities within a period this allocation rule can be problematic.

Inland Revenue's current technology platform uses a reverse and replace model for reassessments. When a taxpayers' assessment of tax is amended, the current system reverses the old assessment and replaces that with the new assessment.

This means there is only one liability within a period for a taxpayer. A decision has been made to move away from this reverse and replace model to a new method termed a "delta" model. Instead of replacing the original assessment it adds the difference, or delta, as an additional billing item within the tax period. The delta model only applies to debit (or additional) assessments. The reverse and replace method continues for credit (or reduced) assessments.

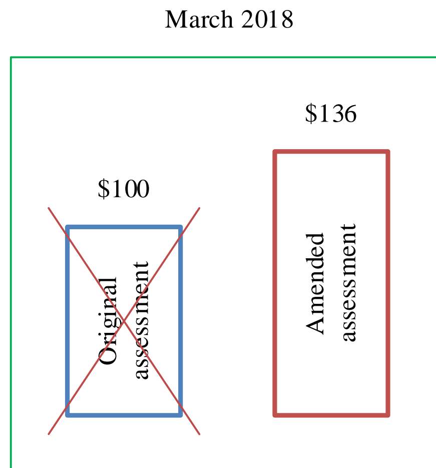
For billing purposes taxpayers will not necessarily see these delta amounts as they will appear as a combined liability within a period. This change to a delta model necessitates a change in the way that payments are allocated to avoid any billing issues for taxpayers.

Detailed analysis

The difference between the "reverse and replace" and the "delta" models is that instead of the initial assessment being "reversed and replaced" with the new assessment amount under the delta model, the original assessment is left in the period and the additional amount, or delta, is added to the period. This amount may have the same or a different due date than the original assessment.

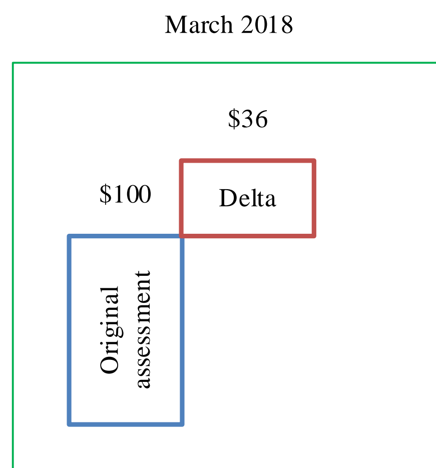
Example 9

A taxpayer files their return for the March 2018 goods and services tax period which has a tax payable amount of $100. In April the Commissioner amends that return and increases the tax payable amount to $136. Under a reverse and replace model the following occurs.



The original assessment in blue is replaced with the new assessment in red within the March 2018 period.

Under a delta model the following occurs:



The original assessment remains with the additional assessment (in red) added. This additional amount may, or may not, have a different due date but is treated as a separate billing item within the system.

In either scenario the taxpayer will see an assessment amount for $136 (although that amount may have sub-amounts due at different dates which will be stated).

Under the reverse and replace method there is only one billing item per tax period and the current payment allocation rules work well to ensure there is no leftover UOMI. Also the billing to taxpayers is simple to understand as it displays one amount payable.

The delta model can have presentational and billing issues where payments received are not allocated to the oldest billing item within a period balance first. The result can be multiple statements issued for separate billing items with small balances within a period which can cause confusion for the taxpayer. It can also result in amounts changing because of payment reallocations to reflect the "interest first" rule.

This could, in certain circumstances, result in an increased amount of interest being charged to taxpayers over the current position.

An amendment is required to the payment allocation rule that continues with the concept of interest first but within billing items rather than the period balance. This essentially means a first-in-first-out system whereby the oldest billing item is settled first.

This model will simplify the system design and also the impact on the taxpayer as the recalculation of interest, where there are multiple adjustments, will be eliminated. The payment allocation will continue to ensure there is no balance of "interest only" within a tax period as the payment will still apply to interest first within a billing item rather than the period.

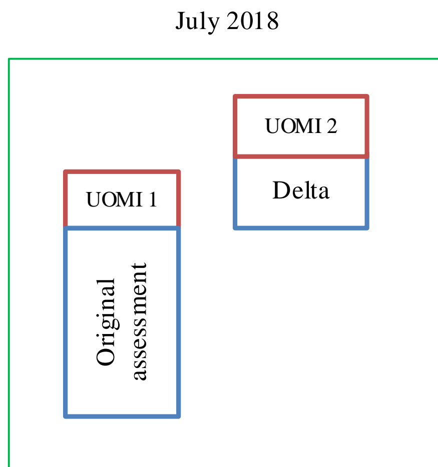
Example 10

Dannos Drivers Limited (Danno) is a New Zealand ride sharing company. Danno has been in business for a few years and files its July 2018 GST return to Inland Revenue.

During a routine review of Danno's tax return, Inland Revenue finds than Danno has under declared the GST owing for the period. Inland Revenue issues Danno with a reassessment for that amount. Danno has already paid the amount of the original assessment a few days late and pays the remaining GST and resulting UOMI by the due date required by Inland Revenue.

Under the delta model the reassessment delta is illustrated as follows:

July 2018



Under the proposed payment allocation model the payment order would be:

UOMI 1
Original assessment
UOMI 2
Delta

The current rule would require the following payment allocation:

UOMI 1 and UOMI 2
Original assessment and Delta

Clause 75 replaces existing section 120F(1) which provides for a rule as to how payments are allocated. The current section provides for payments to be allocated to UOMI first and then core tax debt.

With the change to a delta model the current payment allocation rule can create some difficulties with billing which could be confusing to taxpayers. The new section 120F(1) will continue with the general rule of applying payments to UOMI first but will do this to the oldest debt within a period first. For most taxpayers there will be no difference from the change in the payment allocation method but for some it will result in less UOMI being charged than currently. This is because of a larger portion of a payment being allocated to core tax rather than UOMI. The new provision also includes an example to illustrate how the new rules will work.

Example 11: New section 120F(1)

On 1 September 2019, an assessment of $100 tax to pay is raised for the 2018–19 tax year. This amount incurs $5 use-of-money interest. On 1 September 2020 a re-assessment of $120 tax to pay is raised for the 2018–19 tax year along with an additional amount of $3 UOMI. The taxpayer pays the balance of $128. Payments are applied against the $5 use-of-money interest (that is, interest on the earliest unpaid amount), then against the $100 tax. Next, payments are applied against the $3 use-of-money interest on $20 tax to pay, then against the $20 tax.

CORRECTION OF UNINTENDED CHANGE IN THE PROVISIONAL TAX AND USE-OF-MONEY INTEREST RULES

(Clause 76)

Summary of proposed amendment

This amendment corrects an unintended change to the application of the use-of-money interest (UOMI) rules to taxpayers who are not new provisional taxpayers but who are only required to pay provisional tax in one or two instalments. This amendment restores the intended policy position to that prior to the unintended change and includes a savings provision for a very limited number of taxpayers who have requested and received cancellation of UOMI under the unintended legislation.

Application date

The proposed amendment will apply from 1 October 2007 – the date the unintended change was enacted.

Key features

The amendment restores the correct policy position on the application of UOMI to taxpayers who are not new provisional taxpayers but pay tax in one or two instalments instead of the usual three instalments. It was always intended that UOMI would apply across the three instalments of provisional tax notwithstanding a taxpayer may only have one or two instalments.

Background

An unintended change to the policy intention of the rules which calculate UOMI was made when the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Bill 2005 was enacted that may have had the effect of changing the well-established position that UOMI was charged over an entire income year for all but new provisional taxpayers. This amendment clarifies the legislation to ensure it continues to reflect the correct policy intent.

Detailed analysis

The Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Bill 2005 included changes to align the payment dates for provisional tax and goods and services tax with effect from 1 October 2007. As part of that Bill, section 120K of the Tax Administration Act 1994 was repealed and replaced with sections 120KB–KE. Section 120K(1) clearly stated a general rule for the calculation of UOMI on provisional tax which applied unless any of the subsections within it modified that position. It read:

"Except where this section requires otherwise, in a tax year, other than a transitional year, a provisional taxpayer's residual income tax is due and payable in equal instalments on each of the 3 instalment dates for the year"

There were a number of exceptions to this rule and in particular new provisional taxpayers, safe harbour taxpayers and those in a transitional year had their own special rules.

Section 120K was essentially replaced with section 120KB(2) which reads:

"A provisional taxpayer's residual income tax is due and payable as set out in RC 9 of the Income Tax Act 2007"

Again this general rule does not apply to new provisional taxpayers, safe harbour taxpayers or those in a transitional year.

For most taxpayers this change in wording has no impact in that most provisional taxpayers will pay their provisional tax over three instalments. However, for a small subset of taxpayers who have not yet furnished their tax return for a prior income year, because of an extension of time, and who in the year previous to that year had residual income tax of less than $2,500 (and consequently were not a provisional taxpayer in that year) may interpret the wording differently. This wording change can arguably be read as suggesting that their residual income tax should only be apportioned over the number of instalments given by section RC 13 or 14 rather than over three instalments as intended.

At the time of the change there was no discussion of the change in policy for those particular taxpayers in any consultation process, nor was any change to that policy indicated in any *Taxation Information Bulletin* at the time. In addition, Inland Revenue systems were not altered to reflect any policy change at that time.

This amendment clarifies the legislation to reflect the intended policy position of residual income tax being due and payable over three instalments where, because of those criteria, a person only has one or two instalments of provisional tax due. From the 2018–19 year, when changes were made to the standard method of provisional tax, which in most cases will result in taxpayers only being subject to UOMI from their final instalment date, the scope of this issue arising has reduced but it is not eliminated.

As this change in the wording of this section was untended, the amendment to clarify the wording will apply at the same date the wording was changed. However, officials are aware of a very limited number of cases where taxpayers have challenged this position and may have had UOMI cancelled to reflect this alternative interpretation. Therefore, for those taxpayers who have received a cancellation of UOMI, a savings provision will be inserted to preserve that treatment for taxpayers who have challenged that position prior to the introduction of this Bill and received a cancellation of UOMI.

Example 12

Kamekona Shrimp Trucks Limited (Kamekona) owns a fleet of shrimp trucks that sell world famous garlic shrimp and poke around New Zealand using a fleet of trucks. Kamekona started business in the 2010 year, and it struggled to earn substantial amounts and thus was never a provisional taxpayer in those years. In 2014 its residual income tax was $2,200 for example.

In the 2015 income year, as Kamekona's poke won the prestigious Chin Ho award for the best Hawaiian cuisine outside the Hawaiian Islands, sales from the trucks took off and the company had residual income tax of $120,000 for the 2015 year, making it a provisional taxpayer for that year. Kamekona uses a tax agent to manage its tax affairs and the company has an extension of time to file its tax return for the 2016 year.

Kamekona is not a new provisional taxpayer (as they had derived income from a taxable activity in the four years prior to the 2017 year) and it has an extension of time which means it does not need to file its 2016 tax return until 31 March 2017. Section RC 9(4)(c) of the Income Tax Act 2007 states that Kamekona does not need to pay provisional tax in three instalments. Section RC 9(10) then says that Kamekona can pay provisional tax in one instalment following the rules in section RC 14. Kamekona pays $200,000 in provisional tax on 7 May 2018 (the third instalment date) for the 2017 income year.

For the 2017 income year Kemekona's residual income tax actually works out to be $300,000. This amount should be apportioned over the three provisional tax instalment dates (Period 1 to Period 3) for the 2017 year and UOMI should be charged accordingly. At Period 1 and Period 2 UOMI should be calculated on $100,000 less the amount paid of zero from the respective payment dates through to Period 3 and then on $100,000 from Period 3 being the difference between the $300,000 residual income tax and the $200,000 paid.

It is arguable the current wording of the legislation would only apportion the residual income tax to Kamekona at Period 3, although this was not the policy intent as UOMI is a use of money charge and the taxpayer had the use of those funds throughout the entire year. The amendment clarifies the policy intent.

UPDATE OF OBSOLETE CROSS-REFERENCES

(Clauses 207–210)

Summary of proposed amendment

This amendment corrects some cross-references in the Income Tax Act 2007 which refer to repealed section 120K of the Tax Administration Act 1994. The amendment references those sections more generally to Part 7 of the Tax Administration Act 1994.

Application date

The proposed amendment will apply from 1 October 2007 – the date section 120K was repealed. There are no adverse implications that officials can see from this application date for taxpayers.

Key features

The following four sections in the Income Tax Act 2007 refer to section 120K of the Tax Administration Act 1994, which has been repealed:

- RM 16(3);
- RM 22(5);
- RM 25(3); and
- RM 31(3).

The amendment references these sections to Part 7 of the Tax Administration Act 1994.

Other policy matters

ANNUAL SETTING OF INCOME TAX RATES

(Clause 3)

Summary of proposed amendment

The Bill sets the annual income tax rates that will apply for the 2018–19 tax year. The annual rates to be confirmed are the same that applied for the 2017–18 tax year.

Application date

The provision will apply for the 2018–19 tax year.

Key features

The annual income tax rates for the 2018–19 tax year will be set at the rates specified in schedule 1 of the Income Tax Act 2007.

KIWISAVER ENHANCEMENTS

(Clauses 216 and 231–237)

Summary of proposed amendments

A number of enhancements are proposed to KiwiSaver legislative settings, based on recommendations made in the Retirement Commissioner's December 2016 review of retirement income policies.

Application date

The proposed amendments to allow over 65 year olds to opt-in to KiwiSaver and the repeal of the lock-in period apply on and from 1 July 2019.

All other proposed amendments apply on and from 1 April 2019.

Key features

The proposed amendments give effect to the following changes to the KiwiSaver Act 2006 by:

- introducing additional KiwiSaver contribution rates of 6% and 10%;
- reducing the maximum contributions holiday period from five years to one year;
- changing the name of the "contributions holiday" to "savings suspension";
- allowing over 65 year olds to opt-in to KiwiSaver; and
- removing the lock-in period (which currently affects members who join KiwiSaver between the ages of 60 and 65).

Background

The Retirement Commissioner reviews retirement income policies every three years. Her most recent review, published in December 2016, included recommendations aimed at improving the effectiveness of KiwiSaver in helping New Zealanders save for their retirement and to make KiwiSaver accessible to more New Zealanders. The proposed amendments to the KiwiSaver Act 2006 are based on recommendations made in this review.

Detailed analysis

Additional 6% and 10% KiwiSaver contribution rates

An employee can choose to contribute 3%, 4%, or 8% of their gross salary and wages to their KiwiSaver account. This is provided for in section 64 of the KiwiSaver Act 2006.

It is proposed this section be amended to introduce additional 6% and 10% rates that employees can choose to contribute at.

The additional 6% and 10% rates are intended to give KiwiSaver members more flexibility to self-select onto a contribution rate more specifically aligned with their particular circumstances and the retirement outcomes they want to achieve.

Reducing the maximum contributions holiday period and changing the name of the contributions holiday

Section 104(3)(b)(i) of the KiwiSaver Act 2006 provides the maximum contributions holiday a member can take is the shorter of the period specified in the contributions holiday application, or five years. The effect of this provision is the maximum period a member can take a contributions holiday for is five years.

Taking a five year contributions holiday can have significant impact on members' long-term savings. For many members five years is longer than necessary for their financial position to improve to a point where they could resume contributing to KiwiSaver.

It is proposed that section 104(3)(b)(i) of the KiwiSaver Act 2006 is amended so the maximum permitted contributions holiday period is reduced from five years to one year. This would apply to all contributions holiday applications made after the change comes into effect (that is, 1 April 2019). This means that an existing contributions holiday would continue until it expires.

It is proposed the KiwiSaver Act 2006 is amended to replace all references to "contributions holiday" with "savings suspension". This name change more accurate describes what actually happens when a member takes a break from contributing to their KiwiSaver account.

Allowing over 65 year olds to opt-in to KiwiSaver

The law does not currently permit over 65 year olds to join KiwiSaver. It is proposed section 33(a) of the KiwiSaver Act 2006 is repealed, so that over 65 year olds would no longer be prevented from opting-in to KiwiSaver. This amendment would give over 65 years the benefit of access to KiwiSaver as a provider of low-cost managed funds. No changes would be made to the existing law relating to automatic enrolment in KiwiSaver or the upper age of eligibility for the member tax credit and compulsory employer contributions.

Consequential amendments to the KiwiSaver invalid enrolment rules (in sections 59A and 59B of the KiwiSaver Act 2006) will provide that an over 65 year old opting-in to KiwiSaver under section 33 of the KiwiSaver Act 2006 would no longer be an invalid enrolment. A consequential amendment to schedule 28 of the Income Tax Act 2007 will remove the rule that complying funds are required to prevent over 65 year olds from joining.

Removing the lock-in period

Excluding other permitted withdrawals, members are eligible to withdrawal their savings when they reach the KiwiSaver end payment date referred to in schedule 1 clause 4(2) of the KiwiSaver Act 2006. The end payment date is the later of the date the member reaches the New Zealand Superannuation qualification age (which is 65 years old) or the five year qualification date.

The five year qualification date (referred to commonly as the lock-in period) only affects members who join KiwiSaver after the age of 60 (and therefore have not been a member for five years when they reach the New Zealand Superannuation qualification age).

The purpose of the lock-in period was to prevent people in the 60–65 age bracket from joining KiwiSaver to receive the $1,000 kick-start payment and then withdrawing their funds soon after. As the kick-start was repealed as part of Budget 2015, the lock-in period is no longer necessary. Allowing over 65 year olds to opt-in to KiwiSaver provides a further catalyst for removing the lock-in period, as over 65 year olds joining KiwiSaver may require access to their funds within the first five years of joining (such as if they become unable to support themselves through paid employment, or to address age-related needs).

It is proposed that schedule 1 clause 4 of the KiwiSaver Act 2006 enables members to withdraw their funds when they reach the New Zealand Superannuation age, regardless of how long they have been a KiwiSaver member (therefore effectively repealing the lock-in period).

Transitional provisions provide that over 60 year olds who join KiwiSaver prior to the repeal of the lock-in period (that is, 1 July 2019) would remain locked-in for the duration of the five year period. As over 65 year olds remain entitled to compulsory employer contributions and the member tax credit while they are locked-in to KiwiSaver, this would ensure these members are subject to the same conditions and entitlements as they were when they joined KiwiSaver.

TAX STATUS OF PUBLIC PURPOSE CROWN CONTROLLED COMPANIES AND PUBLIC AUTHORITIES

(Clauses 33, 124, 213(26), 213(27), 222, 224 and schedule 2)

Summary of proposed amendment

It is proposed to give certain Crown controlled companies listed in schedule 4A of the Public Finance Act 1989 their own income tax exemption, and a goods and services tax (GST) provision comparable to that of public authorities to help ensure that GST input credits can be claimed back.

The qualifying public purpose Crown controlled companies (PPCCCs) will be listed in a new schedule to the Income Tax Act 2007, and there will be an Order in Council mechanism to facilitate amendments to this schedule.

For similar reasons, it is also proposed to explicitly include a number of Crown/Parliamentary entities in the definition of "public authority" in the Income Tax Act 2007 and Goods and Services Tax Act 1985.

The purpose of these amendments is to effectively reinstate the tax outcome that the companies had before a Crown Law interpretation reduced who qualifies as a "public authority". This reinstatement will reduce compliance costs without reducing government revenue or creating economic distortions.

Application date

The proposed amendments will come into force on the date of enactment. In the interim, Inland Revenue is applying its administrative discretion to treat the companies as if they were still public authorities until the legislative changes have been made.

Background

Based on advice from Crown Law, in 2015 Inland Revenue revised its interpretation of the definition of "public authority" for tax purposes. This resulted in fewer entities qualifying as public authorities, including most of the Crown controlled companies listed in schedule 4A of the Public Finance Act 1989.

For a company to be listed in schedule 4A, it must meet all of the following criteria:

- the Crown holds more than fifty percent of the company's issued ordinary shares;
- the company's shares are not listed on a registered market; and
- the company is not a Crown entity or a State Owned Enterprise.

In response to the revised interpretation, tax policy officials undertook to review whether the schedule 4A companies should be given their own income tax exemption, and a GST provision comparable to that of public authorities to help ensure that GST

input tax can be claimed back. This review concluded that it was appropriate to have such provisions when the companies, or their subsidiaries, also meet the following requirements:

- The only other shareholders, if any, in the company are local authorities, that is, there are no private sector shareholders; and
- Their primary purpose is to carry out one of the Government's public policy objectives. This does not preclude their making a profit, but any profit has to be subsidiary to the public policy objective. This requirement distinguishes such companies from state-owned enterprises (SOEs), whose primary purpose is to make a profit.

Eleven companies meet these criteria. In addition, a number of other entities were identified as warranting being deemed to be public authorities.

Key features

Public purpose Crown controlled companies amendments

Proposed new section CW 38B provides a specific income tax exemption for those companies listed in the proposed new schedule 35 of the Income Tax Act 2007. The schedule lists the following eleven companies that are either fully Crown owned or Crown controlled, shareholding being measured through the standard voting interest test:

- City Rail Link Limited;
- Crown Asset Management Limited;
- Crown Infrastructure Partners Limited;
- Education Payroll Limited;
- Otakaro Limited;
- Research & Education Advanced Network New Zealand Limited;
- Southern Response Earthquake Services Limited;
- Tamaki Redevelopment Company Limited;
- Tamaki Regeneration Limited;
- THA GP Limited; and
- The Network for Learning Limited.

Nine of these companies are listed on schedule 4A of the Public Finance Act 1989, with the remaining two being subsidiaries of a section 4A company.

To expedite future changes, companies will subsequently be added to or removed from the schedule by Order in Council, which is consistent with the way companies are added to and removed from schedule 4A of the Public Finance Act 1989. Section CW 38B includes a power to make such Orders in Council. The policy criteria for an Order in

Council will still be that the company is listed in schedule 4A or it is a subsidiary of a schedule 4A company, has no private sector shareholders and its primary purpose is to carry out one of the Government's public policy objectives.

An amendment is also being made to the Goods and Services Tax Act 1985 to extend section 6(1)(b) to include PPCCCs, so as to ensure a GST treatment comparable to that for public authorities. This will help ensure that the companies can claim back the GST paid on their purchases.

Finally, a consequential amendment is proposed to section 32E(2)(k) of the Tax Administration Act 1994 so that PPCCCs will, like public authorities, be eligible for a RWT exemption certificate.

Public authority amendments

The definition of "public authority" in the Income Tax Act 2007 is being extended to specifically include:

- The New Zealand Lottery Grants Board;
- The Office of the Clerk of the House of Representatives;
- The Ombudsman;
- The Parliamentary Commissioner for the Environment; and
- The Parliamentary Service.

For the purposes of the definition of "public authority" in the Goods and Services Tax Act 1985, it is only necessary to amend that definition to include the Lottery Grants Board.

SCHEDULE 32 OVERSEAS DONEE STATUS

(Clause 218 and schedule 32)

Summary of proposed amendment

The Bill proposes that 13 charities are added to the list of donee organisations in schedule 32 of the Income Tax Act 2007.

Application date

The proposed amendment will apply from 1 April 2018.

Key features

It is proposed that 13 charitable organisations are added to schedule 32 of the Income Tax Act 2007. Donors to these charities will be eligible for tax benefits on their donations.

Background

Donors to organisations listed in schedule 32 are entitled as individual taxpayers, to a tax credit of $33^{1}/_{3}$% of the monetary amount donated, up to the amount of their taxable income. Companies and Māori authorities may claim a deduction for donations up to the level of their net income. Charities that apply funds towards purposes that are mostly outside New Zealand must be listed in schedule 32 of the Income Tax Act 2007 before donors become eligible for these tax benefits.

Detailed analysis

The 13 charitable organisations being added to schedule 32 are engaged in the following activities:

Books for Cambodia Trust

Books for Cambodia Trust was established in 2007 to promote literacy and develop a culture of reading in Cambodia with a view to improving educational outcomes for children. The Trust's activities include establishing/refurbishing libraries in schools, purchasing books to ensure libraries are adequately stocked, and provide training and support for librarians.

Children of the Light

Children of the Light has been active in Ghana's eastern region since 2005, and in 2010 its New Zealand founder formalised the operation by registering a New Zealand charitable trust. The charity runs year-round educational programmes, including one-on-

one and small group tuition, with a strong emphasis on developing literacy and numeracy skills. The charity has, unusual for the region, an extensive library to assist developing reading skills. The charity's activities are primarily directed at children who, because of reasons of poverty, are not achieving proficiency in reading, writing or mathematics. The Trust is registered as an international non-governmental organisation (NGO) with the Ghanaian government.

Effective Altruism New Zealand Charitable Trust

The Effective Altruism New Zealand Charitable Trust was established in 2015 and is based on the international effective altruism social movement. Effective altruism organisations seek to use evidence to determine the most effective way to benefit others. Acting as a conduit, the Trust is primarily focused on alleviating global poverty by identifying effective international charities and directing New Zealand donor support to them.

Flame Cambodia

Flame Cambodia was set up in 2016 to assist children and young persons affected by poverty and living in the slum environments in Cambodia. The charity is active in Phnom Penh, and its objective is to integrate children affected by poverty into formal school education and maintain school attendance over the longer term. The charity also supports tertiary and vocational training for school leavers. It is registered as an international NGO with the Royal Government of Cambodia.

Forgotten Sherpas of Nepal

The Forgotten Sherpas of Nepal (the Trust) has been operating informally since 2001 and was formally set up in 2013 with the objective of improving the health and well-being of the people living in the Nepal Himalayas. The Trust funds primary healthcare services (particularly maternal and child health), education in hygiene and sanitation, and general improvements in living conditions (for example, safe lighting, smoke-free houses, clean water and access to schools). The Trust sends volunteers to Nepal who work in close association with members of a registered local NGO formed by villagers in the area. The Trust is registered as an international NGO with Nepalese central and local governments.

Global Development Group Limited

Global Development Group Limited was set up in 2015 as the New Zealand member of a wider group of charitable companies across the world that carry out humanitarian projects to provide aid and relieve poverty for the world's poorest people. As well as providing relief in some emergency situations, they work on long-term community development projects that address the causes of poverty and help people move towards self-sufficiency.

Good Trust

The Good Trust was established in 2009 (initially under the name Rich Trust) to provide funds and resources to projects that improve accessibility to water, sanitation and hygiene in developing countries. Projects are proposed by partner charities, and Good Trust carries out fundraising activities in order to make financial grants or provide

resources (such as, volunteer labour). Most of the charity's funds are directed at projects in Africa and Asia, with some in Central and South America also supported.

INF Humanitarian Aid Trust

INF Humanitarian Aid Trust (the INF Trust) was set up in 2015 and is a sister trust of the International Nepal Fellowship (New Zealand) which was established in 1952. The INF Trust carries out humanitarian works in Nepal primarily for the benefit of the poor and marginalised by providing these communities targeted medical care for infectious diseases – such as tuberculosis and leprosy. The INF Trust also provides malnutrition care and prevention, and treats serious injury accidents. It is active in western and mid-western regions of Nepal.

NVADER

NVADER was founded in 2011. It is an anti-human trafficking non-government organisation with operations centred in Thailand. NVADER's purpose is to combat sex trafficking, child begging trafficking and child sex tourism, by working internationally to facilitate the prosecution of perpetrators and bolster deterrence. NVADER also assists Thai law enforcement to locate and rescue victims, and provides those victims with social welfare support and legal representation. It also pursues court proceedings against offenders for compensation.

Nyingje Trust

The Nyingje Trust was set up in 2015 to raise funds for those in need in Mungod, India. The charity's specific focus is on relieving the effects of poverty in the area by raising money to support the purchase of education resources for students, and equipment and supplies for the local public hospital.

Rwenzori Special Needs Foundation (NZ)

The Rwenzori Special Needs Foundation (NZ) (the Foundation) was set up in 2015 to assist children with developmental needs in the Fort Portal region of Uganda. The Foundation formalised a support relationship that existed between the trustees and in-country partners in Fort Portal since 2010. The charity helps children in need by funding surgical interventions for conditions such as cleft lip and palate, birth deformities, eye problems and other treatable conditions. The Foundation also promotes and supports school attendance for children with disabilities.

St Columban's Mission Society Trust Board

The purposes of St Columban's Mission Society Trust Board (the Society) are directed at the relief of poverty, and the Society seeks to work across all boundaries of culture and religion. The Society has been operating in New Zealand since the 1940s, and its work is directed towards humanitarian purposes world-wide, with particular emphasis on seeking social justice and dignity for those denied their rights.

Talkingtech Foundation Trust

Talkingtech Foundation Trust (the Foundation) was set up in 2008. It is involved in a number of projects in India and Cambodia. The objective of these projects is to assist

communities affected by severe poverty. It also makes a number of grants to New Zealand charities. The Foundation's core values centre on activities and projects that improve healthcare and education outcomes in developing countries, including projects that have an innovation or technology component.

FRINGE BENEFIT TAX ON EMPLOYMENT RELATED LOANS – MARKET INTEREST RATE

(Clause 201)

Summary of proposed amendment

This amendment would provide an alternative definition of market interest that banks and other money lenders can elect to use for valuing the fringe benefit of a loan provided to an employee. The new definition of market interest for a given employee and loan type would be the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee. The amendment is intended to address the over-taxation of employment related loans that occurs under the status quo definition of market interest.

Application date

The proposed amendment will come into force for FBT payment periods beginning on or after 1 April 2019.

Key features

The amendment will add a second option to the current market interest definition. Banks and other employers eligible to use the market interest rate for calculating FBT on employment related loans will be able to use either the current definition or the new definition of market interest.

The new definition of market interest for a given employee and loan type would be the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee.

Background

A fringe benefit arises when an employer provides a loan to an employee. There are two ways in which the benefit of an employment-related loan can be valued. Employers not in the business of lending money are required to use a prescribed interest rate provided by legislation to value the benefit of employment related loans. However, banks and other money lenders may instead elect to value the benefit of employment related loans using the market interest rate as they have the data to accurately calculate the market rate readily available.

The market interest rate for a group of employees is currently defined as the rate their employer would offer to an arm’s length group of persons with a comparable credit risk to the group of employees. Different money lenders will therefore have different market rates as the market rate is based on the rates a given lender offers to its customers.

The market interest rate rules were based on the practices banks and other lenders were using at the time the rules were developed. Money lenders would advertise rates and, in general, customers would receive these rates if they met the necessary conditions for a loan. However, some lenders would also offer discounts to certain groups of customers. For example, a bank may have offered employees of a local respected employer a discount of 0.3 percentage points below the advertised rates. The market interest rate rules would allow either the advertised rates or the group discount rates to be offered to employees as the market interest rate without banks and other similar lenders incurring FBT.

However, it is now common practice for banks and other similar lenders to individually negotiate loan rates with customers. Individually negotiated loans cannot be used for determining the market rate as the rates received by customers through this process have not been offered to a group.

As such, the true market rate, being the interest rate an arm's length customer receives, is likely lower than the market rate calculated under the current legislation. This can result in the over-taxation of employment related loans. Furthermore, because of this over-taxation many employees of banks and other money lenders may be able to receive better loan rates from lenders other than their employer.

Detailed analysis

The proposed amendment would give employers the choice between using the existing market interest definition or a new market interest definition. The existing definition would be contained in section RD 35(5)(a) of the Income Tax Act 2007 and the new definition would be contained in section RD 35(5)(b).

As noted above, the new definition of market interest for a given employee and loan type would be the lowest rate given around the same time by their employer in the ordinary course of business to a customer with a similar profile to the employee. The various aspects of this definition are explained below.

Similar profile

The amendment would only allow loans made to customers with similar profiles to the given employee receiving a loan to be used for calculating market interest. An employee and a customer would have similar profiles if, on the factors considered by the money lender as relevant to the interest rates it offers to customers, they have similar characteristics. Factors a money lender may consider when offering loans include, but are not limited to, a customer's risk profile, amount of security or loan to value ratio.

Ordinary course of business

The amendment would only allow loans given to customers in the ordinary course of business to be used for calculating the market rate. Whether a particular loan has been made in the ordinary course of business will always be a matter of fact and degree. However, some examples of what constitutes the ordinary course of business are detailed below.

Example 13: Loan made in the ordinary course of business

Carlos, an employee of Third Man Bank, wants to receive a fixed rate home loan from his employer. The lowest rate Third Man Bank has offered on this type of loan to customers who meet similar lending criteria as Carlos is 4%. Only one customer has received this rate, however, a number of other customers with similar profiles have all received loans close to this rate (4.01–4.05%). The loan made at the rate of 4% will therefore be considered as having been made in the ordinary course of business. As such, the market rate for Carlos will be 4% and FBT will only be payable if Carlos receives a rate below this.

Example 14: Loan not made in the ordinary course of business

Fernanda, a customer of Square Leg Bank, has received a home loan rate of 2% as part of a special promotion giving one lucky customer an extraordinarily low interest rate. The rate received by Fernanda has therefore not been given in the ordinary course of business and cannot be used for determining the market interest rate.

Example 15: Loan made in the ordinary course of business

Caroline, a customer of Mid-Wicket Bank, has received an interest rate of 3.5%. No other customers with a similar profile to Caroline have received a rate that low or close to it. However, the loan was made using Mid-Wicket Bank's ordinary processes and Caroline received no special treatment compared to other customers. This loan has therefore been made in the ordinary course of business.

Around the same time

The amendment would require employers to calculate the market rate based on loans given to customers around the same time a loan was given to an employee. In calculating the market rate for a given employee, employers would generally be required to use loans given to customers in the same quarter that a loan was given to the employee. However, if the employer lacks the ability to calculate the market rate using loans given to customers in the same quarter that a loan was given to the employee, they would instead be able to calculate the market rate using loans given to customers in the quarter immediately prior to the quarter in which the loan was given to the employee.

SECURITISATIONS

(Clauses 169–173, 213(9), 213(13) and 213(20))

Summary of proposed amendment

These amendments will extend the current securitisation regime in the Income Tax Act 2007 beyond financial institutions to other corporate securitisations, with appropriate modifications, and extend the scope of the regime for financial institutions.

Application date

The proposed amendments will come into force on the date of enactment.

Key features

The amendments will extend the securitisation regime so it does not just apply to financial institutions. The aim of the amendments is to reduce compliance costs and tax disincentives to undertaking securitisations, by taxing them in accordance with their economic substance – treating qualifying securitisation special purpose vehicles (SPVs) as transparent. The key features of the amended regime are:

- it will cover securitisations involving financial arrangements as well as other assets;
- the consolidation requirement will be met if the securitised assets are recognised in the consolidated financial statements of the either the originator or another company in the same wholly-owned group; and
- the regime will be elective.

Background

A securitisation is a funding mechanism that involves issuing marketable securities that are backed by the expected cash flows from specific assets. Securitisations can have a number of commercial benefits compared with other funding mechanisms, such as risk management, balance sheet improvement, and lower cost of funding.

New Zealand businesses with assets such as large books of trade credits or other receivables may wish to raise funding by way of securitisations. To undertake a securitisation, a company (referred to as the originator) that owns income-producing assets transfers those assets to an SPV. The SPV (typically a trust in New Zealand) is usually structured to be bankruptcy remote from the originator, so that the SPV's assets cannot be accessed by the originator's creditors. The SPV then borrows from third parties on the strength of the assets that have been transferred to it.

An important commercial objective of a securitisation is maintaining tax neutrality while ensuring the SPV is bankruptcy remote from the originator. It is particularly important to

ensure that the vehicle itself is not exposed to a tax liability, as this can affect its credit rating.

There is a concern that the current tax rules for trusts may not achieve tax neutrality for the vehicle, and so may discourage securitisations. The financial arrangement rules can also trigger a tax liability on any receivables transferred into the vehicle. There is also concern about the compliance costs the tax rules impose on securitisations.

There is currently a securitisation regime in the Income Tax Act 2007 (sections HR 9 – HR 10) that applies for certain securitisations undertaken by financial institutions. Those rules were introduced as a result of the Reserve Bank of New Zealand's response to the global financial crisis. The effect of the rules is that no tax consequences arise from the securitisation transactions between the financial institution and the vehicle used in the securitisation. The proposed amendments will extend this securitisation regime to other corporate securitisations.

Detailed analysis

Under the proposed rules, the securitisation SPV would simply be treated as part of the originator for tax purposes. This would mean that the transfer of assets to the SPV would be ignored, and the SPV itself would not be subject to tax (with any tax on its activities being payable by the originator instead). This would remove a disincentive to securitisations, in that transfers to an SPV that is economically within a wholly-owned group of companies would not have tax implications.

Extension to assets that are not financial arrangements

Given the context in which the current rules were developed, the current regime is limited to particular financial arrangements – New Zealand residential mortgages or loans secured by such mortgages.

Non-financial institution securitisations may involve a broader range of assets, and indeed assets that are not financial arrangements, such as trade receivables and operating leases. The amended regime will, therefore, apply to securitisations irrespective of the assets that are securitised.

Consolidation requirement

The current rules for securitisations by financial institutions require that the securitised assets are treated as held by the originator (the financial institution) in its consolidated financial statements under IFRS. While this requirement is suitable for securitisations involving the financial arrangements covered by the current rules, it would be too restrictive for other securitisations.

Often in corporate securitisations the securitised assets are de-recognised by the originator but are recognised in the consolidated financial statements of another group company.

Therefore, under the expanded rules, the consolidation requirement will be met if the securitised assets are recognised in the consolidated financial statements of the originator or another company in the same wholly-owned group. Also, if the group

entity that recognises the securitised assets in its consolidated financial statements is separate from the originator, the transfer of the receivables by the originator will also be disregarded. These settings will mean the benefits of the regime can apply more broadly.

Elective regime

The current regime is not framed as being elective; however, there is no particular policy reason why it should not be as it removes a tax barrier. The proposed expanded regime will be elective for financial institutions and other corporates alike.

LAND TAINTING AND HOUSING NEW ZEALAND CORPORATION

(Clauses 105–109, 120, 121, 154 and 155)

Summary of proposed amendment

The Income Tax Act 2007 is being amended to exclude the Housing New Zealand Group (HNZ) from the land tainting rules.

Application date

The proposed amendments will apply from 1 July 2017.

Key features

Land tainting

Proposed new section CB 15D of the Income Tax Act 2007 will mean Housing New Zealand Corporation and companies in the same wholly-owned group as Housing New Zealand Corporation are excluded from the land tainting rules in sections CB 9(2), CB 10(2) and CB 11(2).

Wholly-owned and consolidated groups

Amendments are proposed to section CV 1 and proposed new section CB 15D to ensure that income does not arise under the wholly-owned group rules for transactions that would otherwise be exempt under section CB 15D(1).

A similar amendment is proposed to sections CV 2, FM 9 and proposed new section CB 15D to prevent income from arising under the consolidated group rules.

Transactions between associated persons

Proposed new section CB 15D excludes Housing New Zealand Corporation and companies in the same wholly-owned group as Housing New Zealand Corporation from the application of section CB 15(1).

Amortising property and revenue account property

An exclusion from section FM 15 is proposed for Housing New Zealand Corporation and companies in the same consolidated group as Housing New Zealand Corporation.

Background

Land tainting

The land tainting rules in sections CB 9(2), CB 10(2) and CB 11(2) provide that land owned by an associate of a person who deals in, develops, subdivides, or improves land is "tainted" if the land is acquired or improved at the time the dealer, developer, sub-divider or builder was in business. The "taint" means that this land will be taxable if disposed of within 10 years of acquisition or improvement, despite not ordinarily being taxable. The rules were introduced to prevent taxpayers from undermining the land sale rules, but are leading to an incorrect policy result for the HNZ group by imposing tax on sales that are not a policy concern. For example, a sale of a property in HNZ's rental portfolio may become taxable under the land tainting rules because of the development or building activities of another group member, despite not being ordinarily taxable under the land sale rules and there being no concern that HNZ is trying to undermine the rules. This could impede HNZ's ability to implement the Government's building programme, as well as distorting the decision-making of the group and imposing excessive compliance costs.

Wholly-owned and consolidated groups

Section CV 1 applies to treat an amount as income when a company that is part of a wholly-owned group derives an amount that would not ordinarily be income of the company but would be income of the wholly-owned group if it were one company.

Section FM 9 does the same thing as section CV 1, but for consolidated groups. The amount is then income of the company under section CV 2.

These provisions are intended to prevent intra-group arrangements where assets are transferred and re-characterised to avoid tax.

The effect of these sections is that any land sold by an entity in the Housing New Zealand Group (wholly-owned group or consolidated group, as applicable), even if excluded from the land tainting rules under proposed new section CB 15D, would be taxable to the group because of the development or building activities of another group member. The amendments to these sections outlined above prevent this from happening.

Transactions between associated persons

Section CB 15 governs the transfers of land between associated persons. It was introduced to ensure that the substantive provisions which render land disposals taxable are not circumvented by transfers between associated persons.

It provides that where there is a transfer of land between associated persons, any amount that the transferee of the land derives from its subsequent disposal (if that amount is greater than the cost of the land to the transferee) will be taxed to the transferee under whichever of sections CB 6 to CB 14 would have applied to the transferor had the intermediate transfer not taken place.

In May 2018, HNZ established a subsidiary, called Housing New Zealand Build Limited, to undertake its building activities. Without this proposed amendment, all capital gains derived by HNZ since the purchase of social housing properties from

Housing New Zealand Build Limited would be subject to tax on disposal under sections CB 7 (business relating to land) and/or CB 11 (building business), despite not being taxable if HNZ purchased the properties from a non-associated party.

Amortising property and revenue account property

The consolidated group rules in subpart FM are intended to ensure that a consolidated group of companies are treated as a single company for tax purposes. This enables tax-free intra-group asset transfers to take place and is designed to simplify the tax administration of a group of companies.

Section FM 15 provides that where property is transferred between two companies in a consolidated group, the transferee is treated as acquiring the property at the original acquisition cost and acquisition date of the transferor.

Without an amendment, capital gains accrued by HNZ would effectively become taxable in the hands of the group's building company (New Co) on a later disposal of that property by New Co to a third party. This is because the deduction available to New Co on land acquired from HNZ and held on revenue account will be limited by section FM 15 to HNZ's original acquisition cost of the land.

AMENDMENT TO THE BANK ACCOUNT REQUIREMENT – APPLICATION DATE

(Clause 46)

Summary of proposed amendment

An amendment made by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 gives the Commissioner discretion to issue an IRD number to an offshore person without a New Zealand bank account if she is satisfied with their identity and background. The amendment replaced section 24BA of the Tax Administration Act 1994 with new section 55B. This amendment was primarily made to assist taxpayers with meeting their New Zealand tax obligations. This Bill proposes to change the application date of this amendment to 15 October 2015, the date of the original requirement that offshore persons need to provide the Commissioner with their New Zealand bank accounts to obtain an IRD number.

Application date

The proposed amendment will apply for applications for IRD numbers made by or for offshore persons on or after 15 October 2015, under section 24BA or 55B of the Tax Administration Act 1994.

NOISE MITIGATION EXPENDITURE

(Clauses 115, 130, 139–143, 213(6) and 215)

Summary of proposed amendment

The proposed amendment will ensure that the expenditure incurred by businesses for remediating noise is deductible under section DB 46 of the Income Tax Act 2007, on the same basis as other pollution remediation expenditure.

Application date

The proposed amendment will apply to expenditure incurred from the 2018–19 and later income years.

Background

Section DB 46 states that certain expenditure incurred for pollution is deductible. Currently, noise pollution is not included – as a result, businesses incurring expenditure to remediate the effects of noise cannot use this provision to deduct such expenditure. This effect is created through the combination of section DB 46, schedule 19 and the definition of "contaminant" in section YA 1 of the Income Tax Act 2007. Additionally, the expenditure may not create an asset for the taxpayer, so would not be depreciable.

Therefore, noise remediation may result in "black hole" expenditure, being business expenditure that taxpayers are unable to deduct for income tax purposes, either immediately or over time.

Key features

To remedy this inconsistency between noise and other pollution remediation expenditure, it is proposed to amend sections CB 28, DB 46, EK 2, EK 11, EK 12, EK 20, EK 23, YA 1 and schedule 19 of the Income Tax Act 2007.

In accordance with current section DB 46, the proposed deduction will be spread over the expenditure's useful life under the pollution remediation rules. Taxpayers using the provision will be required, from the application date, to spread the cost of new remediation expenditure.

REPEAL OF ADVERSE EVENT SCHEME

(Clauses 114, 128, 131, 135–138, 152, 185 and 213)

Summary of proposed amendment

The proposed amendments repeal the adverse event scheme and transfer existing balances in the scheme to the main income equalisation scheme.

Application date

The proposed amendments will apply to the first income year that commences after the date of enactment.

Key features

The adverse event scheme is a tax relief mechanism for farmers who are forced to dispose of livestock as a result of a localised adverse event (for example, damage caused by a flood on a farming unit).

The scheme is based entirely on the action of a farmer (person carrying on a farming or agricultural business on land in New Zealand) that involves the farmer:

- self-assessing that a localised adverse event has occurred; and
- disposing of livestock because of that self-assessed adverse event and does not replace that livestock in the same "accounting year" (a defined term).

A review of the provisions of the adverse event scheme relating to deposits and withdrawals indicted they are inflexible when compared to the corresponding provisions in the main scheme.

As a result, few farmers have used the adverse event scheme, instead preferring to make income equalisation deposits into the main scheme to take advantage of its more flexible terms for deposits and withdrawals.

The amendments propose that:

- future deposits as a result of forced sales be made under the main scheme from the application date;
- existing deposits in the adverse event scheme be transferred to the main scheme on the application date; and
- some minor clarifications be made to the mechanics of the main income equalisation scheme for certain deposits and withdrawals that relate to the replacement of livestock following a localised adverse event.

Remedial items

PIE AND UNIT TRUST REMEDIALS

(Clauses 167, 213(18), 214 and 217)

Summary of proposed amendment

The Bill makes two remedial amendments to the portfolio investment entity (PIE) rules and a remedial amendment to the public unit trust rules.

Application date

The proposed amendments to the PIE rules will come into force on the date of enactment.

The proposed amendment to the public unit trust rules will apply for the 2008–09 and later income years to align with the start of the Income Tax Act 2007.

Key features

Wind-up of a listed PIE

A listed PIE is an entity type for companies that are listed on a recognised exchange in New Zealand and meet a number of other requirements. Like other types of PIEs, a listed PIE has a number of benefits over a non-PIE, such as the ability to distribute income, including capital gains, without further tax in the hands of the investor.

The eligibility requirements to become a listed PIE include a two-year transitional period for an entity intending to become a listed PIE. This transitional period allows an entity that is not listed on a recognised exchange to become a listed PIE provided it:

- has 100 shareholders or more;
- has resolved to become a company listed on a recognised exchange in New Zealand if it were to obtain the required consents;
- has applied to the Financial Markets Authority for an exemption from disclosing in a product disclosure statement its intention to become a listed company; and
- satisfies the Commissioner that the company would apply to become a listed company if it were to obtain the required consents.

If the company becomes a listed PIE under these criteria but is not listed on a recognised exchange within two years, it will lose its listed PIE status unless the Commissioner of Inland Revenue considers it is reasonable to grant an extension.

The listed PIE rules do not include an equivalent provision for a listed PIE delisting as part of the process of winding up. The consequence of this is a distribution by a listed PIE while it is listed on a recognised exchange and a distribution by a former listed PIE once it is delisted will be subject to different tax rules.

It is not possible for a PIE to remain listed on a recognised exchange until after it has made its final distribution.

For a listed PIE that seeks to continue without being listed on a recognised exchange, there are other options available, such as becoming a multi-rate PIE. However, compliance with the multi-rate PIE rules requires systems and investor information that would not typically be available to a listed PIE so this option is not practical for a listed PIE that intends to wind-up.

The Bill proposes to allow a listed PIE to retain its PIE status for up to two years, or longer if the Commissioner considers it reasonable, after it ceases to be listed on a recognised exchange if this cessation is part of the wind-up process. This would be achieved by replacing section HM 28 so that a listed PIE can elect under existing section HM 29, prior to delisting, that it will cease to be a PIE at a future date. This will provide the PIE with up to two years, or longer if the Commissioner considers it reasonable, to distribute its remaining assets.

PIE status for a listed PIE using this method will be lost at the earlier of:

- two years (or longer) from the date the listed PIE is delisted;
- the date specified in the HM 29 election; or
- when the number of shareholders reduces below 100.

The Bill also proposes two changes to the definition of a listed PIE in section YA 1:

- paragraph (a) is extended to include a listed PIE going through the wind-up process described above; and
- paragraph (c) and (d) are to be repealed as they duplicate conditions that are already covered by section HM 7. This change is not intended to alter how the rules operate.

These amendments are proposed to apply to listed PIEs removed from a registered exchange after the date of enactment.

PIE maximum investor interest exemption for Northland Regional Council

The Bill proposes to add Northland Regional Council to schedule 29 of the Income Tax Act 2007. This will allow the council to own up to one hundred percent of a PIE without the PIE breaching their minimum number of investor or maximum investor interest requirements, which are normally 20 investors and no investor with more than twenty percent respectively. Northland Regional Council invests for the benefit of Northland ratepayers and therefore it's holding of a majority interest in a PIE is equivalent to the PIE itself being widely held. Schedule 29 already includes a number of similar vehicles including Auckland Council and Quayside Holdings Ltd which is the investment arm of Bay of Plenty Regional Council.

This amendment is proposed to apply to investments by Northland Regional Council after the date of enactment.

Notional single person concession for public unit trusts

Minimum shareholder continuity requirements are imposed on companies, including unit trusts, for the carry forward of tax losses and imputation credits. Exemptions to these continuity requirements apply when shareholding changes are between less than ten percent holders and a number of other requirements apply – referred to as the notional single person concession.

A public unit trust is a defined term that covers unit trusts meeting one of a number of criteria indicating the unit trust is widely-held by unassociated persons. This definition was introduced to further extend the shareholder continuity exception to unit trusts by treating a public unit trust as being held by a notional single person that:

- is not a company;
- exists as long as the unit trust exists; and
- holds nothing other than the shares in the unit trust.

However, the notional single person concession applies only where the public unit trust chooses to apply it. This optionality was included so that a public unit trust would not be disadvantaged by introducing the concession, for example if the existing unit holders in the public unit trust were deemed as selling all their units to this notional single person and therefore breaching shareholder continuity.

The current legislation assumes that a public unit trust will choose to apply the notional single person concession where it is advantageous to do so. However, the notional single person concession is also intended to apply to a chain of companies (or other entities) owned by that public unit trust including where the public unit trust is not a New Zealand tax resident. In this circumstance the public unit trust may not have chosen to apply the notional single person concession as they do not have a New Zealand tax liability and obtain no direct benefit from making this choice even though an entity they own would benefit.

Example 16

A widely-held unit trust meets the definition of a public unit trust but has no association with New Zealand other than wholly owning a New Zealand incorporated company. During a certain period, there have been no ownership changes in the New Zealand incorporated company but the unit trust has had a number of ownership changes. The New Zealand company can rely on being owned by a public unit trust that is owned by a notional single person, and therefore not forfeiting losses or imputation credits because of a breach of shareholder continuity, but only if the public unit trust chooses to apply the notional single person concession. As the unit trust has no dealings with the New Zealand tax system they have not chosen to apply the notional single person concession even though there is no disadvantage in doing so.

The Bill proposes to allow a taxpayer who is, directly or indirectly, wholly or partially owned by a public unit trust to choose the treat the public unit trust as applying the notional single person concession without the public trust having to separately choose to apply it.

As this change is consistent with the existing policy intent and some taxpayers owned by public unit trusts may have already been applying the rules in this manner, the amendment is proposed to apply for the 2008–09 and later income years to align with the start of the Income Tax Act 2007.

WORKING FOR FAMILIES ABATEMENT RATES AND THRESHOLDS

(Clauses 179, 183, 184, 260 and 261)

Summary of proposed amendment

The average abatement rate, threshold and family tax credit rate should be repealed as they are no longer required.

Application date

The proposed amendment will apply from 1 July 2018, the date the changes to Working for Families take effect.

Key feature

The Working for Families tax credit average abatement rate, threshold and family tax credit rates for the 2019 tax year would be repealed.

Background

The Families Package legislation increased the Working for Families tax credit abatement rate from 22.5% to 25% and the abatement threshold from $36,350 to $42,700 a year from 1 July 2018. The family tax credit rates for most children also increase from 1 July 2018.

The changes are effective part way through the 2018–19 tax year. The Act sets out an average abatement rate, threshold and family tax credit rates for that year. The average rates assume that the family earns income evenly across a year and claims tax credits for the whole year. The end-of-year reconciliation (or square up) ensures the correct amount of tax credits have been paid relative to the family's actual income and circumstances over the year and uses the average annual figures.

However, the end-of-year process is being built in START, Inland Revenue's new computer system. This means that it is possible to make the reconciliation process more accurate. It is proposed that the actual income earned before 1 July will be reconciled using the old abatement rate and threshold and the income earned from 1 July will be reconciled using the new rate and threshold. This means that the average annual rates are no longer required.

INTERACTION BETWEEN BEST START AND PAID PARENTAL LEAVE

(Clause 178)

Summary of proposed amendment

A clarification is proposed to ensure that a person can receive paid parental leave and the Best Start tax credit for the same child.

Application date

The proposed amendment will apply from 1 July 2018, the date the Best Start tax credit takes effect.

Key feature

It is proposed when a person receives paid parental leave for a child, they would also be entitled to receive any Best Start payments for that child.

Background

The Families Package legislation includes the introduction of the new Best Start tax credit. It was intended that a person could receive paid parental leave and once it ceases to be payable, Best Start payments should be made for the rest of the eligible period. This prevents a person getting paid Best Start and paid parental leave at the same time for the same child. However, as currently drafted, if a person receives paid parental leave, they are not entitled to receive any Best Start payments for that child. It is proposed that the legislation be amended to reflect the policy intent.

PARENTAL TAX CREDIT CLARIFICATION

(Clauses 180–182, 263, 264 and 269)

Summary of proposed amendment

A minor retrospective technical amendment is required to enable the parental tax credit to be paid on a pro-rata basis to qualifying persons to reinstate the original policy intent.

Application date

The proposed amendment will apply from 1 July 2002, the date the amendment took effect.

Key feature

The parental tax credit would be paid on a pro-rata basis to qualifying persons.

Background

In implementing the Families Package, an issue has been identified with the current wording of the parental tax credit. The Families Package repeals the parental tax credit for children born on or after 1 July 2018 but is still available for children born before that date. The issue is an unintended consequence of an earlier amendment.

In 2002, an amendment inadvertently resulted in the removal of the ability to pay the parental tax credit on a pro-rata basis. The parental tax credit is not available if the person is in receipt of a specified payment (for example, a Ministry of Social Development benefit), or has a suspended entitlement to such a benefit, or if they claim paid parental leave.

However, the original policy intent was to permit the payment of the parental tax credit for the days when there was no such payment of a Ministry of Social Development benefit. Inland Revenue has continued to make pro-rata payments to qualifying persons inadvertently, contrary to the effect of the 2002 amendment.

A minor retrospective technical amendment is recommended to enable the parental tax credit to be paid on a pro-rata basis to qualifying persons to reinstate the original policy intent.

GST REMEDIAL AMENDMENTS

(Clauses 223 and 225–228)

Summary of proposed amendment

A number of minor amendments to the Goods and Services Tax Act 1985 are proposed where the legislation does not technically give effect to the policy intent, or where there are obvious errors.

Application date

The proposed amendments will come into force on the date of enactment, with the exception of clauses 228 and 225. Clause 228 will apply on and after 1 April 2011. Clause 225 will apply on and after 1 October 2016.

Key features

The following proposed amendments clarify the relevant legislation, or correct a clear error.

Exemptions to the requirement to make an adjustment (clause 226)

Section 21(2) currently states that a person is not required to make an adjustment if one or more of the criteria listed in paragraphs (a) to (d) apply. Inland Revenue's interpretation of this current drafting is that it prohibits a person from making an adjustment if any of the criteria listed apply. However, it is possible that some are interpreting the section as meaning that it allows but does not require adjustments when any of the criteria listed apply.

The amendment clarifies that a person may not make an adjustment if one or more of the criteria listed in section 21(2) apply, consistent with Inland Revenue's interpretation of the current drafting.

Notification to the Commissioner of a change in company constitution (clause 227)

A registered person is required to notify the Commissioner within 21 days of a change in status. Changes in status include changes to a registered person's name, address, constitution or principal taxable activity or activities.

The amendment will remove the requirement for a registered person to notify the Commissioner of a change in constitution, as this information is generally not necessary or relevant to Inland Revenue's operations and it would only be in extremely rare circumstances where a change in a company's constitution may have an impact on its GST position.

Outdated references to the former principal purpose test in section 55(7) (clause 228)

Section 55(7) of the Goods and Services Tax Act 1985 contains the rules for GST groups. Under the previous apportionment rules (which were based on the "principal purpose" test for deducting input tax), section 55(7)(db) treated a change in use as having occurred when a member of a group of companies (not being a member of the GST group at that time):

- acquired or produced goods or services for the "principal purpose" of making taxable supplies;
- later joined the GST group; and
- any other member of the GST group subsequently used the goods and services for non-taxable purposes (that is, for private purposes or for the making of exempt supplies).

Section 55(7)(dc) treated a change of use as having occurred in the reverse situation when a group member acquired or produced goods or services which they principally intended to use for non-taxable purposes, joined the GST group, and any other member of the GST group used the goods and services for making taxable supplies.

The apportionment rules in the Goods and Services Tax Act 1985 were significantly reformed in 2011 to allow input tax deductions "to the extent" that goods and services are used for (or are available for use in) making taxable supplies. The amendment therefore removes the outdated references to the former "principal purpose" test, clarifying that a change in use adjustment is required to be made by the representative member of a GST group when:

- a person (the "new member") who previously acquired goods and services for their business or private use joins the GST group; and
- the extent of taxable use of those goods and services by any group member differs from the new member's previous percentage of taxable use of those inputs.

Cross-references

Finally, the Bill will address two cross-referencing errors and oversights:

- Sections 10(3C) and (3D) link to services treated as being made in New Zealand by section 8(4B). Services treated as being made in New Zealand by section 8(4B) are subject to a reverse charge under section 5B. However, sections 10(3C) and (3D) are not linked to zero-rated remote services that are instead subject to a reverse charge under section 20(3JC). The amendment inserts this cross-reference (clause 225).
- Section 2A(4) aggregates the interests of two associated people for the purposes of paragraphs 2A(1)(a) and (b). However, section 2A(4) does not aggregate the interests of two people associated under paragraph 2A(1)(bb). The amendment inserts this cross-reference (clause 223).

FINANCIAL ARRANGEMENT RULES – TREATMENT OF FOREIGN CURRENCY AGREEMENTS FOR THE SUPPLY OF GOODS AND SERVICES

(Clause 149)

Summary of proposed amendment

The taxation of financial arrangements broadly follows accounting principles which can occasionally produce results outside the policy intent. This can happen when a foreign exchange denominated agreement for the sale and purchase of goods and services (ASAP) (being a business combination under NZ IFRS 3) has a contingent amount (an amount payable or receivable depending on a future event, say future performance). Accounting treats adjustments for these as being on revenue account, and as a result contingent payments are automatically treated as "interest" under the Income Tax Act 2007 (and assessable or deductible). This outcome is inconsistent with policy intent and changes are proposed so these adjustments have regard to the underlying transaction.

Application date

The proposed amendments will come into force for existing agreements on the date of enactment, with savings provisions for taxpayers who have taken tax positions relying on the current law.

Key features

The proposed amendments will:

- exclude amounts recognised in the Income Statement of purchasers and sellers from contingent payments for businesses acquired from being treated as interest for tax (being deductible or assessable) under the financial arrangements rules;
- for purchasers, exclude the amounts from the value/cost of property acquired under the business acquisition, except when the property is the shares of an entity acquired to obtain the business. The amounts excluded from the value of property are effectively positive or negative goodwill on acquisition; and
- for sellers the contingent amounts increase/decrease the sale price of the assets/liabilities or shares sold, which may result in adjustments to depreciation on sale of assets or income/expenditure for assets held on revenue account.

Background

The taxation rules for foreign ASAPs were substantially amended in 2014 to follow their accounting treatment. Subsequent analysis of the accounting treatment by officials has revealed the unintended tax treatment of contingent payments under foreign ASAPs. We are unaware of any transactions that have been subject to the unintended treatment.

RESIDENTIAL AND MAIN HOME EXCLUSIONS

(Clauses 110–113)

Summary of proposed amendment

Remedial amendments to the residential and main home exclusions from the land sale rules in the Income Tax Act 2007 will:

- ensure that the residential exclusion in section CB 17(2) applies whether or not the taxpayer has a family member living with them, and align the wording in the various residential exclusions; and
- ensure that the "regular pattern" carve outs from the residential exclusion in section CB 16 and the main home exclusion in section CB 16A operate as intended, so that a pattern of transactions will only prevent the exclusions being available if it involves buying and selling, or building and selling, houses that were the person's residence or main home.

Application dates

The proposed amendments to sections CB 16, CB 17, and CB 18 will apply from the start of the 2008–09 income year, the first year to which the Income Tax Act 2007 applies.

The proposed amendment to section CB 16A will apply from 1 October 2015, when the bright-line test came into force.

Background

Family members

Prior to the rewrite of the income tax legislation, the wording of what is now section CB 17(2) would clearly have allowed a person without a family member living with them to use the residential exclusion. However, this is not clear on the rewritten wording of the provision. The amendment to section CB 17(2) reinstates the pre-rewrite position, restoring the original policy intent. The rewrite also inadvertently introduced slight wording differences between the various residential exclusions, and these are being amended for consistency.

"Regular pattern"

The residential exclusion in section CB 16 cannot be used if the person has engaged in a regular pattern of transactions. Prior to the rewrite, it was clear from the legislation that to be disqualified from using the exclusion, the transactions in the regular pattern had to involve dwellings used mainly as the taxpayer's residence. This is not apparent from the wording of the rewritten legislation, which suggests that regular pattern of buying and

selling houses or building and selling houses, whether or not they were the taxpayer's residence, would disqualify the taxpayer from using the exclusion.

The amendment to section CB 16 restores the original policy intention that the regular pattern carve out will only apply if the taxpayer has a regular pattern of buying and selling or building and selling dwellings that they occupied mainly as a residence.

The above issue was inadvertently replicated in the wording of the main home exclusion (section CB 16A) from the bright-line test, when those rules were introduced, as the wording in the main home exclusion was based on the residential exclusion in section CB 16, which contained the unintended rewrite change discussed above.

The amendment to section CB 16A is to clarify that the regular pattern carve out will only apply if the taxpayer has a regular pattern of buying and selling residential land that was used predominantly, for most of the time the taxpayer owned the land, for a dwelling that was their main home.

FIF COST METHOD

(Clause 151)

Summary of proposed amendment

The cost method in the foreign investment fund (FIF) rules is being amended to ensure it works as intended, so the ability for a person to reset their cost base every five years through independent valuation is optional not mandatory.

Application date

The proposed amendment will apply from 1 April 2007, when the cost method provisions came into force.

Background

The FIF rules provide for the taxation of equity investments that New Zealand tax residents hold in foreign entities they do not have a controlling interest in. There are five different calculation methods for determining the amount of FIF income a person has for the year. The starting point is that the "fair dividend rate" method must be adopted. But if that method is not practical to apply because the market value of the FIF can only be determined by an independent valuation, a person may use the "cost method".

Generally an independent valuation is required on entry into the cost method. The cost method then taxes 5% of the "opening value" of the person's interest in the FIF, plus an adjustment for shares bought and sold within the same income year. The "opening value" is uplifted by 5% each year as a proxy for an increase in the value of the investment.

It was intended that investors in FIFs who use the "cost method" for calculating their FIF income would have the ability to reset their cost base (the "opening value") once every five years through an independent valuation. It was intended that such a revaluation would be optional.

However, the legislation as enacted appears to make the five-yearly revaluation mandatory, not optional. This outcome is not consistent with the policy intent, so an amendment to section EX 56(3)(b) will ensure the legislation operates as intended.

RESETTLEMENTS OF TRUSTS

(Clauses 159, 160(1), 161(3) and 161(6))

Summary of proposed amendment

The proposed amendments relate to a resettlement of property by the trustee of one trust (the head trust) onto a new trust (the sub-trust). The proposed amendments clarify:

- the relationship between foreign sourced trustee income derived by the sub-trust and the exempt income rule in section CW 54;
- if the head trust is a foreign trust, the extent to which the value of the resettled property is corpus of the sub-trust; and
- if the head trust is a foreign trust, the classification of gains deemed to be derived by the trustee of the head trust, as a result of the rules applying to distributions, transmissions, and gifts of property.

The proposed amendments do not affect the general operation of the settlor definition. In addition, the proposed amendments do not affect the requirement that a settlor of a foreign trust must not have been resident in New Zealand since the current trust rules were originally enacted.

Application date

The proposed amendments will come into force on the date of enactment.

A transitional provision is also proposed to validate tax positions taken prior to the date of enactment, but only for those tax positions taken that are consistent with the outcome given by the amendments.

Key features

The amendments propose to clarify that a resettlement of property by the trustee of a head trust on another trust does not affect the entitlement of that sub-trust to the exemption from tax under section CW 54 for foreign sourced trustee income if:

- at least one trustee of the head-trust is resident in New Zealand;
- the head trust has only non-resident settlors at the time of the settlement; and
- the sub-trust satisfies the requirements of sections CW 54 and HC 26 when it derives the foreign sourced trustee income.

In addition, the amendments propose to clarify that a resettlement of property by a foreign trust on a sub-trust is included in corpus of the sub-trust (and consequently not treated as trustee income). However, if the head trust is a foreign trust and the settlor was a controlled foreign company, but no New Zealand resident is deemed to be a settlor

of that trust (section HC 28(3), (4)), part of the value a resettlement of property may be excluded from corpus of the sub-trust.

Background

The proposed amendments address some technical issues relating to a trustee of a foreign trust that settles property of that trust (the head trust) onto a sub-trust (a resettlement). Under current law, the trustee of the head trust is treated as a settlor in relation to the resettled property. If there are multiple trustees of the head trust and at least one trustee of the head trust is resident in New Zealand, the sub-trust will be taxable on its world-wide trustee income under the settlor regime. This is an unintended outcome as it is intended that the settlor of the head trust would be the settlor of the sub-trust. The proposed amendments clarify the law.

In addition, an administrative review of the trust rules identified that the valuation rules for distributions, transmissions and gifts of property in subpart FC of the Income Tax Act 2007 result in:

- the trustee of the head-trust being treated as having disposed of the resettled property at market value; and
- the trustee of the sub-trust being treated as having acquired the resettled property at market value.

The application of these valuation rules to a resettlement can result in a capital gain being deemed to be derived from an associated person. A capital gain derived by a foreign trust from an associated person can result in part of the resettlement being excluded from the corpus of the sub-trust and also treated as trustee income of the sub-trust.

Detailed analysis

Under the current income tax rules, there can be some unintended consequences when there is a resettlement of trust assets by the trustees of a foreign trust on a sub-trust.

Exempt income for trusts which do not have a New Zealand resident settlor

Under current income tax law, a resettlement of trust property of a trust will result in the trustee of the head trust being treated as a settlor of the sub-trust. Prior to the resettlement, if the head trust is a foreign trust, foreign-sourced income derived from that trust property would be exempt income of the foreign trust under section CW 54 of the Income Tax Act 2007.

Consequently, after the resettlement, if at least one trustee of the head-trust is a New Zealand resident, the sub-trust will have a New Zealand resident settlor. This will result in trustee income derived by that sub-trust being taxable in New Zealand on a world-wide basis. The resettlement of property of a foreign trust on a sub-trust is not intended to have this outcome.

The proposed amendments ensure that where a resident trustee of a head-trust resettles property on a sub-trust and no settlor of that head trust is resident in New Zealand at the time of resettlement:

- the trustee of the head trust is not treated as a settlor of the sub-trust; and
- the settlors of the head trust are treated as the settlors of the sub-trust;
- the trustees of the sub-trust will be entitled to the exemption from tax for foreign-sourced trustee income from the time of resettlement, provided the sub-trust meets the ongoing requirements of sections CW 54 and HC 26.

Resettlements and the valuation rules applying to distributions

A valuation rule (in subpart FC) applies to a resettlement of property on a sub-trust. For income tax purposes, this rule treats the resettlement of property on a sub-trust as a disposal and purchase at market value. If the head trust is a foreign trust, this could result in the head trust:

- deriving a capital gain from an associated person (a tainted gain) for the purpose of the definition of taxable distribution for a foreign trust; and
- to the extent the value of resettlement includes such a tainted gain, that gain would be excluded from the corpus of the sub-trust and taxed as trustee income in the sub-trust.

The proposed amendments ensure that, in most circumstances, when a foreign trust resettles property on a sub-trust, the valuation rules applying to a resettlement of property on a sub-trust:

- do not result in a tainted gain being included in the value of the resettlement; and
- provide that the full value of the resettlement is corpus of the sub-trust.

BINDING RULINGS AND RECORD-KEEPING REQUIREMENTS

(Clause 54)

Summary of proposed amendment

The proposed amendment clarifies that the Commissioner of Inland Revenue may make a binding ruling for any record-keeping requirement in the Tax Administration Act 1994.

Application date

The proposed amendment will come into force on the date of enactment.

Key features

The Commissioner of Inland Revenue has a power to rule on the record-keeping requirements of the Goods and Services Tax Act 1985. However, no such explicit power exists in the Tax Administration Act 1994 for other revenue types.

For consistency, the amendment proposes that the Commissioner be able to rule on record-keeping requirements for all tax types.

TRUST RULES

(Clauses 158, 160(2) and 162–164)

Summary of proposed amendment

The proposed amendments:

- ensure there is internal consistency within the Income Tax Act 2007 in relation to the tests for tax residence and some trustee elections;
- correct unintended legislative changes arising from the rewrite of the Income Tax Act 2007; and
- clarify internal cross-references and relationships with other parts of the Income Tax Act 2007.

Application date

The proposed amendments will come into force on the date of enactment.

Background

The proposed amendments relate to some matters identified in an administrative review of a 1989 *Tax Information Bulletin* item on the taxation of trusts.

Key features

Transitional residence and election to be a complying trust

A foreign trust loses its status as foreign trust when a settlor of that trust migrates to New Zealand. That trust may then choose to become a complying trust. If that choice is not made, the trust becomes a non-complying trust, which affects the taxation of distributions made from the trust that are not beneficiary income.

A period of time is given to make this election (a grace period). There is an inconsistency between two provisions referring to this grace period. This inconsistency results in uncertainty about the correct starting date of the grace period if the migrating settlor is a transitional resident. The policy intent is that the start of that period is:

- if the migrating settlor is a transitional resident, the first day following cessation of the transitional residence status; or
- if the migrating settlor is not a transitional resident, the first day of residence in New Zealand.

The proposed amendment clarifies that the start date for a transitional resident is the first day the migrating settlor ceases to be a transitional resident.

Transitional residence, ordering rules, and distributions

At present, the law is unclear about the tax treatment of distributions from trustee income derived by a foreign trust in the year in which a migrating settlor ceases to be a transitional resident. This uncertainty could result in such a distribution being subject to economic double taxation because:

- the foreign trust becomes taxable on world-wide trustee income from the beginning of the income year in which the migrating settlor ceases to be a transitional resident; and
- if the distribution is a taxable distribution to a New Zealand resident beneficiary, that distribution is taxed at the marginal rate of the beneficiary with no credit for the New Zealand tax paid for income derived in the part-year before the settlor ceases to be a transitional resident.

The policy intent is that a distribution from such accumulated income in that part-year period should not be subject to economic double taxation. The proposed amendments clarify this by treating a distribution from this part-year period as being from a complying trust (that is, not taxed to the beneficiary).

Election to be a complying trust

The proposed amendments to section HC 16:

- relate to the election for a foreign trust to become a complying trust when a settlor migrates to New Zealand; and
- correct an unintended legislative change arising from the rewrite of the provision by clarifying that this election may be made by any settlor, trustee, or beneficiary of the trust.

Capital gains derived from an associated person and the ordering rules

The ordering rules are clarified to correct an unintended legislative change arising in the rewrite of the provision. The proposed amendment ensures that a capital gain derived from an associated person is treated as income derived by the trustee for the purpose of the ordering rules. This restores the intended timing effect for when such a capital gain is treated as distributed.

Minor beneficiary income

The proposed amendments correct an unintended legislative change arising in the rewrite of the minor beneficiary rules. The broad intent of these rules is to tax beneficiary income distributed to minors at the trustee rate of 33%. There is intended to be an exclusion from this broad intent if certain requirements (in sections HC 36 and HC 37 of the Income Tax Act 2007) about the trust are satisfied (for example, in some circumstances, minor beneficiary income derived that relates to a protected person under the Domestic Violence Act 1995).

However, the current law does not work as intended as it presently requires all listed circumstances to be satisfied before the exclusion applies. The proposed amendment clarifies that the exclusion applies if the requirements of either section HC 36 or HC 37 are satisfied.

No value in the beneficiary relationship for the purpose of section HC 14

There is an inconsistency between the rules applying to distributions, transmissions and gifts in subpart FC and the definition of distribution. The issue is that under subpart FC, a distribution of property may be treated as a purchase and disposal of that property at market value; whereas, in the definition of distribution, the beneficiary receiving property is treated as providing no value for a distribution by virtue of the beneficiary status.

The main purpose for the rules in subpart FC is to ensure that, for the trust making the distribution, the value of transferred revenue account property is correctly taken into account in calculating the trust's trustee income.

The amendment proposes that the rules in subpart FC do not apply for the purpose of applying the definition of distribution. This will ensure that a distribution will continue to be determined by whether a transfer of value has been made to a beneficiary.

TAX RULES FOR DEREGISTERED CHARITIES

(Clauses 174)

Summary of proposed amendment

Six remedial changes to the tax rules for deregistered charities are proposed in this Bill. They are intended to protect the integrity of the tax base by ensuring that if an entity has claimed tax exemptions as a charity and has accumulated assets, these assets should always be destined for a charitable purpose, even if the entity is deregistered by the New Zealand charity regulator, the Department of Internal Affairs – Charities Services, under the Charities Act 2005.

Key features and application dates

The proposed remedial amendments will better align the legislation with the policy intent of the tax rules for deregistered charities.

These proposed amendments will have retrospective effect from 14 April 2014 (when the tax rules for deregistered charities were first enacted):

- Addressing the tax treatment of land owned by deregistered marae charities.
- Preventing potential double-deduction for monetary gifts made within one year of deregistration.

These proposed amendments will apply to charities deregistered on or after 1 April 2019:

- Preventing potential over-taxation of deregistered charities in group structures in circumstances where multiple members in the group deregister together.
- Addressing the disposal of wholly-owned subsidiaries by a charitable group for market value.
- Clarifying the valuation of assets and liabilities at the date of deregistration.
- Introducing a *de minimis* threshold for charities with a low value of accumulated assets.

Background

Under the charity deregistration tax rules, the net assets of a deregistered charity must be transferred or disposed of for charitable purposes or in accordance with the charity's rules contained on the Department of Internal Affairs (DIA) Charities Services register, within 12 months; otherwise it will be subject to income tax on the value of its net assets. The calculation of net assets excludes assets received from the Crown in relation to a Treaty of Waitangi settlement claim or in accordance with the Maori Fisheries Act 2004, and any non-cash assets which were gifted to the organisation when it was exempt from income tax.

Detailed analysis

Deregistered charities in group structures

Large charities will often operate as part of a group, with charitable entities holding equity investments in other registered charities. If a parent entity and its subsidiaries are deregistered by DIA Charities Services, then the deregistration rules apply to each of those entities and each entity must pay tax based on the value of its net assets. The value of the underlying assets could therefore be taxed more than once.

This is an over-reach of the policy intent of the deregistration tax rules, and it is appropriate to allow the deregistered charitable parent entity to make an adjustment in its net asset calculation.

Amendments are proposed to ensure that if a parent entity and one or more members of a charitable group deregister at the same time, the value of the parent's shares in the subsidiary is ignored for the purposes of calculating the parent's income under the deregistration tax rules.

Disposal of assets by a charitable group for market value

If a charity acquires one hundred percent ownership of an investment company, it will typically register that company as a charity in its own right. When it later sells its shares, then that subsidiary may be required to deregister and therefore be taxed on the value of its net assets.

However, if the subsidiary is sold at arm's length for market value, no value leaves the charitable group and it is an overreach to impose the deregistration tax on the subsidiary.

It is not appropriate to apply the deregistration tax in these circumstances, because the charitable group has simply replaced a certain amount of value in shares with the same amount in cash. In addition, the deregistration tax liability is likely to be reflected in the sale price of the shares, which would mean that the charitable group bears the economic burden of the tax liability.

An amendment is proposed to ensure that if a charity sells an interest in a subsidiary at arm's length for market value, the deregistration tax does not apply to that subsidiary if it is deregistered as a result of the sale.

Carve-out for marae assets

Generally, a deregistered charity can reduce the amount of tax payable under the deregistration rules by disposing of or transferring their assets within one year of the day they were deregistered. However, "reservation" land, upon which marae are built, cannot be disposed of or transferred to pay the resulting tax bill because of restrictions on alienation of reservation land under the Te Ture Whenua Māori Act 1993. This means that marae that are registered as charities are unable to reduce their deregistration tax liabilities, unlike other deregistered charities.

Amendments are proposed to ensure that for marae built on reservation land established under the Te Ture Whenua Māori Act 1993, the value of the land and improvements on

the land will be excluded from the net asset calculation. This would ensure that they are no longer taxed on the value of assets which they are legally unable to dispose of or transfer.

Valuation of assets and liabilities

The legislation currently refers to a deregistered charity being taxed on its "net assets". However, there is no indication in the Income Tax Act 2007 as to what valuation method should be used to measure the entity's net assets. Providing a valuation method in the legislation will help provide more certainty for taxpayers.

Using the historical cost of the asset does not provide the desired deterrent effect against deregistration, as sometimes what is today a very valuable asset could be recorded at a much lower historical cost value. This is inconsistent with the policy intent of the deregistration tax rules, which is to provide an incentive for charitable assets to remain in the charitable sector.

It is proposed that the legislation specify that assets and liabilities should be valued at their market value. Market value refers in general terms to the price an asset would be sold for in an arm's length transaction. This is usually determined from market-based evidence by appraisal. Under the accounting standards for charities, the market value for an asset can also be established by reference to other items with similar characteristics, in similar circumstances and location – for example, by accepting the council ratings valuation as a market valuation for land.

Prescribed valuation methods for certain assets (premises, plant, equipment, and trading stock) are already contained in the deregistration rules. It is proposed that the market value requirement applies only to those assets which do not already have a prescribed valuation method.

Monetary gifts made within one year of deregistration

Under current law, a deregistered charity that is a company or Māori authority may make a monetary donation to another charity within 12 months of deregistration and this donation will both reduce its deregistration tax liability and be eligible for a gift deduction under the charitable giving rules.

Example 17

A deregistered charity holds $1 million worth of funds in its bank account at the date of deregistration. It donates half of that amount to another charity within 12 months of deregistration.

This has the effect of excluding $500,000 from tax under the deregistration tax rules. However, as the deregistered charity is now subject to normal income tax rules, it can also receive a $500,000 income tax deduction for the gift.

The one donation of $500,000 is therefore eligible for two tax concessions, despite not adding any new funds to the charitable sector.

This double benefit is not consistent with the policy intent, as the assets are effectively already in the charitable sector.

An amendment to the charitable giving rules is proposed to clarify that assets transferred to another charity in accordance with the deregistration rules do not also qualify for a gift deduction.

De minimis threshold for small deregistered charities

Small deregistered charities with limited resources may find it difficult to value assets for the purposes of the deregistration tax. It is inefficient for Inland Revenue to dedicate compliance resources to these small charities as the potential tax liability would be very low.

A "*de minimis*" threshold of $5,000 in net assets is proposed to exclude small charities from the deregistration tax rules.

A $5,000 net asset threshold would remove about half of all deregistered charities from the deregistration rules. It is also consistent with the settlement *de minimis* threshold used in relation to minor beneficiaries under the trust rules.

NOT-FOR-PROFITS REMEDIALS

(Clauses 5(52), 5(58), 42(16)–(18), 125, 134, 157, 176 and 213(32))

Summary of proposed amendments

A number of remedial changes to the tax rules for not-for-profit entities are proposed in this Bill. They are intended to improve the integrity and coherency of the tax system, as it applies to these entities.

Application date

The application dates for these proposed amendments are set out under their respective sections below.

Key features

Amendments to the Income Tax Act 2007 and the Tax Administration Act 1994 are proposed to ensure that:

- the charitable business income tax exemption applies only to charities registered under the Charities Act 2005;
- the deemed disposal provision for depreciation recovery income applies when a taxable entity becomes a registered charity;
- the disclosure requirements which apply to foreign trusts also apply to foreign trusts that are registered charities;
- organisations seeking donee status for donation tax credit, gift deduction or fringe benefit tax exemption purposes must be approved by the Commissioner of Inland Revenue;
- organisations with charitable purposes must be registered charities in order to obtain donee status; and
- relevant penalty, interest and avoidance provisions apply to donation tax credits.

Detailed analysis

Application of the charitable business income exemption

Registration under the Charities Act 2005 carries with it a number of reporting obligations, which improves transparency and promotes public trust and confidence in the charitable sector.

Entities are generally required to be registered as a charity in order to access the charitable tax exemption for non-business income.

However, an entity is not always required to be registered as a charity in order to access the charitable exemptions for business income under section CW 42 of the Income Tax Act 2007. Business income is exempt if it is derived by a registered charity, or by a separate business "carried on for, or for the benefit of" a registered charity. This ability to claim a charitable income tax exemption without being subject to the public reporting requirements of registered charities is contrary to the policy intent.

A small but increasing number of businesses are seeking to take advantage of the business income exemption without being registered charities themselves. This risks undermining public trust and confidence in the charitable sector. It also increases the extent to which Inland Revenue is involved in charity oversight and regulation. This does not align with the government policy that regulation of the charitable sector should sit primarily with the Department of Internal Affairs – Charities Services.

An amendment is proposed to section CW 42 to ensure that the business income exemption applies only to organisations that are registered under the Charities Act 2005.

The proposed amendment will come into force on the date of enactment.

Application of the deemed disposal provision for depreciation recovery income

Under the depreciation rules, a change in the use of an asset is treated as if that asset was disposed of for the market value of the asset. One of the events which could trigger this deemed disposal occurs when a business changes its constitution or rules in order to meet the legal requirements for an exemption from income tax (for example, if a registered charity buys one hundred percent of the shares in a business, and that business registers as a charity under the Charities Act 2005).

Once there has been a deemed disposal, any excess depreciation deductions are clawed back as depreciation recovery income arising in the following income year. However, if the change is from a taxable use to being used for exempt purposes (for example, for charitable purposes), then it is not possible to claw back the excess depreciation deductions because by the following income year the entity will be exempt from income tax.

An income tax exemption should not extend to depreciation recovery income, which is attributable to income years before the entity became exempt. Such an outcome is contrary to policy intent. Amendments are proposed to ensure that depreciation recovery income arises immediately before the entity is treated as being exempt from income tax, to ensure that excessive depreciation deductions are clawed back.

The proposed amendment will apply from the date this Bill was introduced.

Disclosure requirements for charities that are foreign trusts

If a New Zealand registered charity is also a "foreign trust" (a tax term, being a trust established in New Zealand but where no settlor is resident in New Zealand at any time), then it is not subject to the foreign trust disclosure requirements in the Tax Administration Act 1994, including the new foreign trust disclosure requirements implemented by the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017. The historic reason for this exclusion has been that such foreign

trusts are already subject to public disclosure and regulation requirements under the Charities Act 2005, so no further disclosure requirements were considered necessary.

However, the new foreign trust disclosure requirements now require some information that is not collected under the Charities Act 2005. The additional information involves identifying particulars and contact details for settlors, trustees and beneficiaries.

Amendments are proposed to the definition of "resident foreign trustee" in the Tax Administration Act 1994 to ensure that registered charities are not exempted from the foreign trust disclosure requirements. Foreign trusts that are also registered charities will be required to make annual disclosures to Inland Revenue like any other foreign trust.

The proposed amendment will come into force on the date of enactment.

Donee status – approved donee list

At present it is possible for an organisation to self-assess whether it satisfies the criteria in section LD 3(2) for donee status. Such an organisation can issue donation receipts to donors that qualify for a donation tax credit or gift deductions without being on Inland Revenue's list of donee organisations. To ensure public transparency and to strengthen the integrity of the tax system, it is proposed that organisations that want to qualify for donee status must be approved by the Commissioner of Inland Revenue under section LD 3(2)(a).

No changes are proposed for organisations registered under the Charities Act 2005 that are currently on the Inland Revenue's list of donee organisations. Similarly, organisations with benevolent, cultural or philanthropic (but not charitable) purposes that are currently on the Inland Revenue's list of donee organisations, will continue to have donee status.

A requirement for the Commissioner's approval for donee status is also proposed for funds, public funds, and public institutions, under sections LD 3(2)(b), (c), and (d), for consistency.

The proposed amendment will apply from 1 April 2019.

Donee status – application to organisations with charitable purposes

At present, organisations with charitable purposes can obtain donee status without being registered under the Charities Act 2005.

The proposed amendment will require all entities with charitable purposes to be registered under the Charities Act 2005 in order to qualify for donee status. This will ensure that all charitable organisations that can issue donation receipts that qualify for a donation tax credit or gift deductions are subject to the same reporting and regulatory requirements.

Entities with charitable purposes that are not registered under the Charities Act 2005 but are on Inland Revenue's approved donee list will be required to register under the Charities Act 2005 by 1 April 2020 if they wish to retain their donee status.

As noted above, this change will have no impact on organisations on the Inland Revenue's approved donee list that have only benevolent, cultural or philanthropic (but not charitable) purposes.

The proposed amendment will apply from 1 April 2020.

Application of penalties, interest and avoidance provisions

Under the current law, use-of-money interest and some penalties cannot be applied when donation tax credit claims are overstated. Avoidance provisions also do not apply to overpaid donation tax credits. This is contrary to policy intent.

Amendments are proposed to the definition of "tax" in the Tax Administration Act 1994, as well as inserting a new anti-avoidance provision (section GB 53) in the Income Tax Act 2007, to ensure that relevant penalty, interest and avoidance provisions apply in relation to donation tax credits that are overpaid.

The proposed application date is 1 April 2019.

Rewrite remedials

LAND SALES – ASSOCIATED PERSONS

(Clause 108)

Summary of proposed amendment

This amendment clarifies the two associated person rules that apply to disposals of land to ensure that:

- under an anti-avoidance rule applying to a disposal of "tainted land", the income derived on disposal is not income under any of the main land sales rules (sections CB 6 to CB 14); and
- a relief provision for associated persons applies only if the test of association applies in relation to a single transaction and not multiple transactions.

Application date

The proposed amendment will apply from the beginning of the 2008–09 income year. A savings provision is proposed to protect tax positions taken on the basis of the existing law prior to introduction of the Bill.

Key features

An amendment is proposed to section CB 15 to clarify that its two subsections apply in different circumstances for a disposal of land and are not interdependent. The different circumstances are:

- a disposal of land that was acquired at an earlier time from an associated person of the vendor who would have been taxed on the disposal had the associated person retained the land and made the disposal themselves;
- a disposal of land that would be taxed under one of the land sales rules if the land is sold within 10 years of acquisition (or, in the case of the land sales rule applying to builders, sold within 10 years of commencing making improvements to the land).

The amendment proposed to the anti-avoidance rule for land sales (section CB 15(1)) will clarify that the income derived on disposal is income of the vendor under the anti-avoidance rule, rather than under any of the main land sales rules. This will ensure that the anti-avoidance rule does not apply where there is a series of transactions between associated persons, and also clarifies that the vendor cannot use any of exclusions from the main land sale rules.

The amendment proposed for the associated persons relief rule (section CB 15(2)) will clarify that the vendor is not taxed on the disposal of land if there is a combined period of actual ownership exceeding 10 years between:

- the vendor; and
- in certain circumstances, an associated person from whom they acquired the land.

Detailed analysis

Section CB 15 contains both an anti-avoidance rule and a relief rule relating to a disposal of land, which the vendor of the land has acquired from an associated person. Under some recent interpretations of this provision, a disposal of land could be taxed incorrectly.

Independent operation of the two rules

One interpretation is that the relief rule applies only if the anti-avoidance rule applies. That is not how the provision is intended to operate. The proposed amendment clarifies that the two rules operate independently of each other.

Anti-avoidance rule

The anti-avoidance rule is intended to apply to a vendor who disposes of land to a third party if:

- the vendor had acquired the land from an associated person; and
- the associated person would have been taxed on the disposal of land to the third party, had they kept the land and disposed of it themselves to the third party.

One interpretation of the anti-avoidance rule argues that the associated person's requirements in the anti-avoidance rule can apply to a series of transactions between associated persons. This interpretation:

- arises from the anti-avoidance rule stating that the vendor is taxable under one of the main land sales rules; and
- results in over-taxation of disposals of land.

The proposed amendment clarifies the rule's intent by providing that the vendor is taxed under the anti-avoidance rule, rather than under the main land sales rules the associated person would have been taxed under. The income is derived in the year it is incurred unless a specific timing rule applies to the sale of the land.

A second interpretation is that the vendor of the land is entitled to the benefit of the exclusions from the land sales rules because they are taxed under one of the main land sales rules rather than under the anti-avoidance rule.

An example of a disposal of land to which this interpretation might result in unintended consequences is for land that:

- was acquired by a property developer for the development business;
- was later transferred by the developer to his or her spouse;
- the spouse builds a home on the land and lives in it; and

- later, the spouse on-sells the land to a third party and leases back the home.

As the property was acquired for the purpose of the property development business, it is intended that the disposal of that land to a third party is always subject to tax (revenue account property). The anti-avoidance rule is intended to tax a disposal of land that is revenue account property that has been transferred to an associated person before disposal to a third party.

However, under this interpretation, because the anti-avoidance rule makes the disposal of land taxable under one of the main land sales rule, the vendor is entitled to the exclusions from the land sales rules (for example, the residential home exclusion). This outcome is not intended and the proposed amendment will ensure that this interpretation is not available.

Associated persons' relief rule

The associated persons' relief rule is intended to apply to a person who disposes of land if the disposal of land would be taxable because it was disposed of within 10 years of the person acquiring the land. Typically, the associated persons' relief rule is relevant to a vendor who disposes of land within 10 years of acquiring it from an associated person and any of the following apply:

- The associated person is a builder, or a land dealer or a land developer.
- The value of the land has increased during vendor's actual period of ownership because of land zoning changes.
- Within the vendor's actual period of ownership, a scheme of development or subdivision has been carried out on that land.

In counting the 10-year period for the purpose of the associated persons' relief rule, the proposed amendment will permit the vendor of land to combine their actual period of ownership of the land with the actual period of ownership of the associated person from whom they acquired the land. The intent is that the disposal would not be taxed if this combined period of ownership was 10 years or more.

One interpretation is that the associated person's relief rule can be applied to a series of sequential transfers of land between associated persons (a circle of association). This interpretation results in the 10-year period being determined from the first date the land was acquired within that circle of association. This interpretation is inconsistent with the policy intent and can result in under-taxation.

The proposed amendment clarifies that the relief rule applies only to a combined ownership period of the vendor and the associated person from whom the vendor acquired the land.

CALCULATION OF AVERAGE TAX RATE FOR AN EXTRA PAY

(Clause 199)

Summary of proposed amendment

The proposed amendment corrects an unintended legislative change in section RD 17 that potentially results in too much PAYE being withheld from an extra pay.

Application date

The proposed amendment will apply from the beginning of the 2008–09 income year.

Key features

The calculation of PAYE to be withheld from an extra pay (for example, a performance bonus) is determined by a calculation of an average rate of tax on an annualised amount of PAYE income payments based on:

- the amount of the extra pay; and
- all regular wages and salaries paid in the four weeks prior to the date of the extra pay.

This annualised calculation is not intended to take into account any other amounts of extra pay that may have been made in that four week period.

The rewrite of this provision into the Income Tax Act 2007 inadvertently includes all previous amounts of extra pay within that four week period when calculating the annualised amount. This inadvertent drafting change could result in too much PAYE being withheld.

The proposed amendment restores the intended effect and confirms current practice.

PRE-CONSOLIDATION IMPUTATION CREDITS

(Clause 186)

Summary of proposed amendment

The proposed amendment provides a savings provision for tax positions relating to:

- the transfer of a pre-consolidation imputation credit from an individual company's imputation credit account (ICA) to the ICA of a consolidated imputation group; and
- the law as it was prior to amendments made to section OP 22 (use of pre-consolidation imputation credits) of the Income Tax Act 2007 by the Taxation (Annual Rates for 2017–18, Employment and Investment Income and Remedial Matters) Act 2018 (the EII Act).

Application date

The amendment proposes a savings provision for tax positions taken for the transfer of pre-consolidation imputation credits for tax years beginning before 29 March 2018 (the date of enactment of the EII Act).

Key features

The proposed savings provision relates to amendments made to section OP 22 by the EII Act (retrospective to the beginning of the 2008–09 income year) that:

- confirm the Commissioner's application of section OP 22;
- correct a minor unintended legislative change arising in the rewrite of the provision; and
- ensure the law works as intended.

The proposed savings provision applies if a pre-consolidation imputation credit is transferred to a group ICA prior to 29 March 2018 in excess of the amount that is allowed under the amended section OP 22. The amount of the transferred pre-consolidation credit must meet all of the following requirements:

- the group ICA has a debit entry in a tax year;
- the amount of the pre-consolidation imputation credits transferred to the group ICA is limited to the amount of that debit entry to the group ICA; and
- shareholding continuity is satisfied for the pre-consolidation imputation credits transferred up to the time of the transfer.

If the amount transferred exceeds the limit on the amount being transferred, the excess amount is treated as not being transferred to the group ICA (that is, the debit and credit entries would need to be retrospectively adjusted to achieve the correct outcome).

A transitional rule is proposed which will provide:

- retrospective debit and credit adjustments are to be aggregated and combined with the closing balance of the group ICA at 31 March 2018;
- further income tax that becomes payable as a result of these retrospective adjustments will have a due date 60 days after the enactment of the bill; and
- imputation penalty tax will not be imposed on this amount of further income tax.

If payment of the further income tax is not made by the due date, normal late payment rules will apply.

Detailed analysis

Amendments to section OP 22 in the EII Act:

- corrects an unintended legislative change in the rewrite of the section;
- ensures the law works as intended; and
- applies retrospectively to the beginning of the 2008–09 income year.

The amendments to section OP 22 in the EII Act confirmed that pre-consolidation imputation credits may only be transferred to a group ICA if the group ICA does not have sufficient imputation credits to offset an imputation debit to the group ICA and shareholding continuity was satisfied for the transferred credits (example 18).

This outcome is consistent with the policy for the use of pre-consolidation imputation credits set out in Tax Information Bulletin Vol 16, No. 1 February 2004, pages 56–57.

> *"As with the original consolidation provisions, the existing pre-consolidation balances of the members' balance of the members individual ICAs are not transferred to the imputation group's consolidated imputation credit account but remain separate until such time as the ICA of the consolidated imputation group has a debit to its ICA which it cannot offset by an existing credit in the group ICA."*
>
> *"… subject to shareholder continuity being maintained, a credit may be transferred from a member's individual imputation credit account to the … group ICA, to the extent of the ICA's debit balance."*

Prior to the EII Act amendments to section OP 22, some taxpayers argued, based on comments made in a 1992 business discussion document about the use of pre-consolidation imputation credits, that:

- pre-consolidation credits could be transferred to the group ICA if a debit entry had been made to the group ICA during a tax year, even if the group ICA had imputation credits made in the same tax year prior to that debit. The amount of the transfer would be limited to the debit entry to the group ICA (see example 19); and
- in some cases, the argument was that the amount of the transfer of pre-consolidation credits was not limited to the amount of the debit to the group ICA (see example 20).

Example 19: Tax position advocated by taxpayers to transfer pre-consolidation imputation credits to the extent to which a debit is made to the group ICA

Date	Group ICA	Member Company Company B
7 September 2014 (credit carried forward to 1 April 2015 and 1 April 2016 under section OA 7(1))		70,000
7 April 2015 (credit carried forward to 1 April 2016 under section OA 7(1))	10,000	
7 September 2016 (dividend paid by Company A)	(50,000)	
7 September 2016 (transfer from Company B)	50,000	(50,000)
31 March 2017 (calculated balance)	10,000	20,000

Savings provision proposed

The savings provision proposed is to protect tax positions taken by taxpayers that are consistent with example 19. For tax positions that reflect the outcome in example 20, past debits and credits will be adjusted to reflect the approach taken in example 19.

The retrospective adjustments to debits and credits are to be aggregated and treated as being combined with the ICA balance at 31 March 2018. If an amount of further income tax becomes payable because of these retrospective adjustments:

- the due date for payment of the further income tax is 60 days after enactment of the Bill; and
- imputation penalty tax is not imposed on this increased amount of further income tax.

DEFINITIONS OF SETTLOR AND SETTLEMENT

(Clause 161(1), (2) and (5))

Summary of proposed amendment

The proposed amendments:

- correct an unintended legislative change arising in the rewrite of the trust rules relating to services provided to the trust for less than market value; and
- clarifies that incidental services provided by a trustee (such as bookkeeping and trustee services) for less than market value are not a transfer of value, which aligns the general meaning of settlement with current practice.

Application date

The proposed amendment for the unintended legislative change will apply from the beginning of the 2008–09 income year.

The amendment to the meaning of settlement and transfer of value for incidental services provided for less than market value is proposed to apply from the date of enactment.

Key features

Rewrite amendment

The rewrite of the trust rules rationalised a number of provisions relating to definitions of “settlor” and “settlement”, into the definition of “transfer of value”. A transfer of value, in relation to a settlement on a trust, is defined generally as a transfer of money (or money’s worth) to or for the benefit of a trust, without adequate consideration being given in return from the trust.

In addition, other transactions are specifically included in the definition of settlor and settlement as they do not represent a transfer of value under ordinary principles. For example, a person who provides an “on demand” loan to a trust is treated as a settlor if the right to demand payment is either deferred, or not exercised.

However, under ordinary principles, a transfer of value-for-money’s worth normally requires the amount transferred to the trust to be convertible into money. For example, the gifting of property to a trust is a transfer of value to the trust because, under ordinary principles, the property is readily convertible into money.

However, the provision of services to, or for the benefit of, a trust for less than market value is not an amount that is readily convertible into money. Therefore services provided at less than market value do not come within the definition of transfer of value and would not be a settlement under the Income Tax Act 2007.

In contrast, the value of these services for less than market value was specifically treated as a settlement in the Income Tax Act 2004. The proposed amendment restores the position of the Income Tax Act 2004 into the rewritten provisions in the Income Tax Act 2007.

Incidental services provided to a trust

The minor beneficiary rules, which apply to tax trustees at 33% on income distributed to minor beneficiaries, recognise that incidental services such as bookkeeping and trustee services provided to the trust should not be counted as settlements. The purpose of that exclusion is to simplify compliance.

However, as a result of the proposed rewrite amendment, such incidental services will be counted as settlements under the more general meaning of settlement. On analysis this results in different rules relating to a settlement on a trust applying depending on whether the trust has minor beneficiaries. Aligning the two rules is more consistent with current practice.

The proposed amendment ensures that the incidental services provided to trusts (such as bookkeeping and trustee services) will not be treated as a transfer of value on a prospective basis.

MAINTENANCE AMENDMENTS

(Clauses as per the table)

Summary of proposed amendments

The following proposed amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

Application dates

Commencement dates for each proposed amendment are stated in the table.

Minor maintenance items

The following amendments relate to minor maintenance items to correct:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the inconsistent use of terminology and definitions.

Maintenance amendments: schedule of clause numbers and changes to text

Clause	Section	Enactment	Amendment	Commencement date
107	CB 11(2)	Income Tax Act 2007	Improve drafting consistency	1 April 2008
116	CD 3	Income Tax Act 2007	Correction to cross-reference	1 July 2009
117	CD 5(2)(a)	Income Tax Act 2007	Correction to cross reference	1 April 2008
118	CD 6(4)	Income Tax Act 2007	Correction to cross-reference	1 April 2008
122	CW 9(2)(a)(vi)	Income Tax Act 2007	Repeal redundant provision	Enactment date
123	CW 19	Income Tax Act 2007	Improve drafting consistency	30 March 2017
133	DV 19(2)	Income Tax Act 2007	Correction to grammar	1 April 2008
150	EW 46C	Income Tax Act 2007	Improve drafting consistency	2008–09 income year

Clause	Section	Enactment	Amendment	Commencement date
165	HE 3(1)(a)	Income Tax Act 2007	Correction to grammar	Enactment date
166	HM 2(3)	Income Tax Act 2007	Correction to cross-reference	Enactment date
193(2)	RD 2	Income Tax Act 2007	Correction to cross-reference	1 April 2019
200(1)	RD 22(1)	Income Tax Act 2007	Correction to cross-reference	1 April 2019
204	RF 2B	Income Tax Act 2007	Omit redundant terms	Enactment date
205	RF 2C	Income Tax Act 2007	Omit redundant term	Enactment date
213(11)	YA 1 "employer monthly schedule"	Income Tax Act 2007	Correction of terminology	Enactment date
213(12)	YA 1 "financial institution"	Income Tax Act 2007	Correction of terminology	Enactment date
213(15)	YA 1 "large budget film grant"	Income Tax Act 2007	Improve drafting for clarity	Enactment date
213(18)	YA 1 "multi-rate PIE"	Income Tax Act 2007	Correction to grammar	Enactment date
213(21)	YA 1 "overtime"	Income Tax Act 2007	Correction to cross-reference	Enactment date
5(41)	3 "person incorrectly assumed to be a provisional taxpayer"	Tax Administration Act 1994	Omit redundant terms	1 October 2007
24	23C(1)	Tax Administration Act 1994	Correction to cross-references	1 April 2019
25	23D(4)	Tax Administration Act 1994	Correction to cross-reference	1 April 2019
32	31C(5)	Tax Administration Act 1994	Correction to cross-reference	Enactment date
38	36BD(5)	Tax Administration Act 1994	Correction of terminology	1 April 2008
45	47(2)	Tax Administration Act 1994	Omit redundant cross-reference	Enactment date
100	Schedule 4, "earner levy"	Tax Administration Act 2004	Correction of terminology	1 April 2019
241	163(1)(b)	Child Support Act 1991	Correction to cross-reference	1 April 2019
249	Schedule 2	Student Loan Scheme Act 2011	Correction to cross-reference	9 December 2009