Taxation (KiwiSaver, Student Loans and Remedial Matters) Bill

Officials’ report to the Finance and Expenditure Committee on submissions on the Bill

October 2019

Prepared by Policy and Strategy, Inland Revenue, and the Ministry of Business, Innovation and Employment

First published in October 2019 by Policy and Strategy, Inland Revenue, PO Box 2198, Wellington 6140.

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ISBN 978-1-98-857307-6

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# Overview

## Overview

The main focus of this Bill is to continue the Government’s programme of simplifying and modernising tax administration. The provisions in this Bill are improvements aimed especially at KiwiSaver and Student Loans, whose administration is due to transition to Inland Revenue’s new technology platform in April 2020. The third main feature of the Bill is aimed at extending the refundability of research and development tax credits.

There were 13 submissions which were generally supportive of the KiwiSaver proposals. Some were concerned at potential compliance costs borne by employers with regard to the proposal to allow a person to change their KiwiSaver contribution rate through their employer or provider or Inland Revenue.

The Bill allows the Commissioner in all cases to notify a portfolio investment entity (such as a KiwiSaver scheme) if their customer was discovered to be on an incorrect prescribed investor rate. While largely supportive of the proposal, submitters discussed a range of concerns. These are addressed in this report.

In relation to this matter, officials have suggested a further measure for inclusion in the Bill, which would allow Inland Revenue to refund overpaid portfolio investment entity (PIE) tax. The measure included in the Bill will correct the rate, but current legislation does not allow Inland Revenue to refund overpaid PIE tax. Officials therefore recommend an amendment to allow an end of year square-up to allow a refund to be paid.

A further matter was introduced to this Bill by Supplementary Order Paper. The measure aims to allow a KiwiSaver member to be able to withdraw funds in the case of a life-shortening congenital disease. Submitters offered a range of adjustments to improve the proposal.

There were five submissions on the student loans proposals.

Submitters were largely positive of the proposal to alert an employer when an employee paying off a student loan is close to eliminating their debt. This would allow the employer to ensure that no over-deduction would occur. One submitter felt that the proposal would impose undue compliance costs on employers.

The Bill contains a proposal to reduce the number of cases that Inland Revenue will go back and reassess a borrower’s loan balance prior to 1 April 2013. This was not supported by a submitter who felt that it rewarded non-compliant borrowers.

Ten submissions were received on the R&D proposals in the Bill. Nearly all submitters supported broader refundability and the proposed remedials. Five submitters submitted that the exempt entity exclusion goes too far and would exclude businesses who only receive small amounts of exempt income from claiming the R&D tax credit.

A number of submissions were also received on the wider R&D funding landscape or commented on matters outside the scope of R&D provisions in the Bill.

Officials have suggested a range of further matters and these are discussed in this report. Some of these relate to Inland Revenue’s business transformation programme and aim to ensure that service provision is not adversely affected by the transition to the new technology. All matters suggested by officials aim to ensure that the legislation is consistent with the policy intent.

# KiwiSaver

## General submissions

### Issue: Support for the proposed amendments to KiwiSaver

#### Submission

(Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, Financial Services Council, PwC)

Three submitters were supportive of the proposed amendments. (*Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, Financial Services Council*)

Two submitters supported the proposal to allow Inland Revenue to on-pay employer contributions to KiwiSaver scheme providers based on employment income information. (*PwC, KPMG*)

One of the above submitters noted how the proposal operates in practice will be key. (*KPMG*)

#### Recommendation

That the support be noted.

### Issue: Greater consultation expected

#### Submission

(Corporate Taxpayers Group)

The submitter felt there had been insufficient industry consultation.

#### Comment

The proposed changes are part of Inland Revenue’s Business Transformation programme which will see the various tax types and functions administered through the tax system transferred to the department’s new technology platform. KiwiSaver will transition in April 2020 and this has meant that time available for consultation was constrained. It is desirable to implement legislative amendments aiming to enhance the central of administration of KiwiSaver at the same time.

Officials also note there is on-going engagement with KiwiSaver scheme providers about the changes (the main industry affected), including during the policy development phase.

#### Recommendation

That the submission be noted.

### Issue: Recovering unpaid employer contributions from scheme providers

(Clause 21)

#### Submission

(Corporate Taxpayers Group, Financial Services Council)

The submitters queried who would be liable if the employer did not subsequently pay the employer contribution amount to Inland Revenue and if there needed to be a mechanism in place for Inland Revenue to recover unpaid contributions from a KiwiSaver scheme provider.

#### Comment

Officials consider that such a mechanism is unnecessary. Where an employer has not paid an employer contribution amount by its due date, proposed amendments to section 78 of the KiwiSaver Act 2006 specify that the unpaid contribution would be paid from a Crown Bank Account (effectively creating a debt from the employer to Inland Revenue). Therefore, the employer contribution amount would not need to be recovered from the KiwiSaver scheme provider. This approach ensures employees are not disadvantaged by their employer’s non-payment and is consistent with the approach Inland Revenue currently adopts in relation to KiwiSaver employee contributions.

#### Recommendation

That the submission be declined.

### Issue: Aligning the provisional and holding periods with the opt-out period

(Clauses 6, 7, 8, 9)

#### Submission

(Financial Services Council)

The submitter supports the proposal to reduce the KiwiSaver provisional period and holding period from three months to two months. However, the submitter sought clarification as to whether the intent is also to change the KiwiSaver opt-out period, noting it would be good to synchronise the provisional period with the opt-out period.

#### Comment

Officials intent is not to align the provisional period and holding period with the KiwiSaver opt-out period. The proposal in the Bill would reduce the holding period from 92 days to 62 days, while the opt-out period would remain from day 13 until the end of day 55 after a person has been automatically enrolled in KiwiSaver.

Maintaining a holding period that is slightly longer than the opt-out period reduces the risk of contributions being transferred to KiwiSaver scheme providers, ahead of an opt-out request being processed. This should prevent an increase in contributions that need to be recovered by Inland Revenue from scheme providers because of opt-outs.

#### Recommendation

That the submission be declined.

### Issue: More education about KiwiSaver residence requirements

(Clauses 10, 11, 12)

#### Submission

(Financial Services Council)

The submitter supported removing the three-month grace period for people who were invalidly enrolled in KiwiSaver to meet the KiwiSaver residence requirement. However, to reduce the number of people invalidly enrolled, the submitter recommends Inland Revenue consider providing more education about the KiwiSaver residence requirements.

#### Comment

Removing the three-month residence grace period, would mean Inland Revenue would be able to contact an employer who has invalidly enrolled a person as soon as the invalid enrolment has been identified (to let them know that the KiwiSaver account has been closed). This would mean Inland Revenue would be able to help these employers understand the KiwiSaver residence requirements sooner, therefore, potentially preventing subsequent invalid enrolments. Officials also note that Inland Revenue already has information on its KiwiSaver website and in its KiwiSaver guide for employers, explaining the KiwiSaver residence requirements.

#### Recommendation

That the submission be declined.

### Issue: Calculating interest on contributions not received

(Clause 23)

#### Submission

(Financial Services Council)

The Bill proposes that interest paid on contributions while they are held by Inland Revenue would start accruing from the date of the member’s payday. The submitter sought clarification about how interest would be calculated and paid on contributions Inland Revenue had not yet received.

#### Comment

For the purpose of calculating interest payments, KiwiSaver contributions would be treated as received by Inland Revenue on the date of the member’s payday, as reported by the employer.

#### Recommendation

That the submission be noted.

## Changing contribution rates through a scheme provider or Inland Revenue

(Clause 14)

### Issue: Support for the proposal

#### Submission

(ANZ, Chartered Accountants Australia and New Zealand, Financial Services Council, PwC)

Submitters supported the proposal that would allow KiwiSaver members to change their contribution rate by giving notice to their scheme provider or Inland Revenue.

One submitter noted the change would positively impact s retirement outcomes and ensure KiwiSaver scheme providers have the ability to effectively engage with their members on this matter. (*Financial Services Council*)

Another submitter supported the proposal on the basis it would improve the member experience by making it easier for members to review and change their contribution rate. Consequently, this submitter strongly opposed the possibility of the proposal being removed from the Bill. (*ANZ*)

#### Recommendation

That the support be noted.

### Issue: Proposal creates compliance costs

#### Submission

(Corporate Taxpayers Group, Deloitte, EY, Martin Etherington)

The change will increase compliance costs for employers. (*Corporate Taxpayers Group, Deloitte, EY*)

One of these submitters also noted that the proposed notification process (where an employer actions a contribution rate change request once notified by the employer) would likely not be as efficient as a contribution rate change request made directly to an employer. However, this submitter felt it was desirable to have flexibility in the legislation and overall viewed the amendment as favourable, to the extent there was evidence indicating it was something employees would find useful. (*EY*)

One submitter was of the view the proposal should be removed from the Bill on the basis it would add complexity to the KiwiSaver scheme rules and introduce additional administrative costs for KiwiSaver scheme providers and Inland Revenue. (*Martin Etherington*)

#### Comment

Officials recommend that the application date for this proposal should be deferred until 1 April 2022 or an earlier date set by Order in Council.

The proposed change has received public support and would be worth implementing. However, deferring the application date would enable officials to undertake further consultation with stakeholders to explore the root of concerns raised in more detail and to investigate an operational approach that would minimise the compliance cost of this change for employers.

Allowing for the new application date for this proposal to be set by Order in Council at a date earlier than 1 April 2022 would mean there could be flexibility around when the proposal was introduced, to ensure the change could be implemented at a time that was workable for affected parties.

#### Recommendation

That, subject to officials’ comments, the submission be accepted.

### Issue: Proposal should not be deferred

#### Submission

(ANZ, Financial Services Council)

The submitters were of the view it would not be cost effective to defer the change past its current application date of 1 April 2020 (as this would require employers and payroll providers to make further KiwiSaver compliance changes at a later stage).

#### Comment

Based on concerns outlined above by other submitters, officials are recommending that the application date of the proposal be deferred until 1 April 2022 or an earlier date to be set by Order in Council. As employers and payroll providers update payroll specifications each tax year, making the change for a post 1 April 2020 tax year is unlikely to increase the implementation cost for employers and payroll providers.

#### Recommendation

That the submission be declined.

### Issue: The first pay period that the contribution rate change applies to

#### Submission

(Deloitte, EY)

Where a KiwiSaver member changes their contribution rate through their KiwiSaver scheme provider or Inland Revenue, the member’s employer would be required to apply the new contribution rate to the next “payment of salary or wages that is calculated” after being notified by Inland Revenue about the contribution rate change. Submitters raise concerns that it may not always be workable for an employer to comply with this requirement (for example, if a notification is received by an employer after details for their next pay run have already been finalised).

Employers should instead be required to respond to the rate change request as soon as practicable after receiving the notification from Inland Revenue, or the legislation should prescribe that if a rate change request is received within three working days of a pay run it does not need to be applied until the following pay run.

#### Comment

Under the existing legislation employers must already apply a new contribution rate to the next payment of salary or wages that is calculated after receiving notice from their employee of this request. This same timeframe applies for stopping KiwiSaver deductions where an employer receives notice from Inland Revenue that one of their employees has opted to go on a savings suspension. These rules have been in place since KiwiSaver was introduced in 2007 and officials are not aware of employers having difficulty complying with them in the past.

Moreover, once pay run details are finalised, an employer would have already calculated a payment of salary or wages. Therefore, in the situation the submitter has concerns about, the existing wording of the amendment would already allow employers to first apply the new contribution rate to the subsequent pay run.

#### Recommendation

That the submission be declined.

### Issue: Contribution rate information should be sent to scheme provider

#### Submission

(ANZ, EY)

Members’ contribution rates should be reported to KiwiSaver scheme providers. (*ANZ*)

Where a contribution rate change application is made to Inland Revenue under proposed new section 64(2D) of the KiwiSaver Act 2006, Inland Revenue should be required to notify the member’s scheme provider of the contribution rate. (*EY*)

#### Comment

Officials note that currently employers are not required to report information to Inland Revenue about the KiwiSaver contribution rates selected by their employees. As Inland Revenue does not hold this information, it is not possible for Inland Revenue to pass this information on to KiwiSaver scheme providers. Requiring employers to report their employees’ contribution rates to Inland Revenue would have compliance costs for employers and consultation would need to be undertaken to ascertain the scale of these compliance costs.

Officials also consider that if facilities were introduced to report contribution rates to Inland Revenue it would be more helpful if scheme providers received this information about all their members, not just members who had made a contribution rate request through a scheme provider.

With officials recommending deferring members being able to change their contribution rate through a scheme provider or Inland Revenue, this would allow time for further consideration to be given to sharing contribution rate information with KiwiSaver scheme providers, ahead of this proposal being introduced.

#### Recommendation

That the submission be declined.

### Issue: Certainty about when contribution rate change processed

#### Submission

(Financial Services Council)

The legislation should either specify a timeframe within which Inland Revenue must give notice to the employer of the employee’s request to change contribution rates or Inland Revenue should be required to confirm to the member and the member’s scheme provider, it has given notice to the member’s employer of the contribution rate change.

#### Comment

Inland Revenue would provide notice to an employer of a contribution rate change as soon as possible after receiving the contribution rate change request from a KiwiSaver scheme provider or member. Officials are recommending that the application date for this proposal be deferred to give further consideration to the operational design of the proposal. As operational design considerations could have implications for the delivery of information to Inland Revenue, officials are of the view a timeframe for providing notice to an employer should not be set.

Officials consider there to be limited benefit in advising a scheme provider when notice has been provided to an employer of a contribution rate change in isolation. Rather, as noted in relation to the above submission, information about all members’ contribution rates is likely to be more useful to scheme providers.

#### Recommendation

That the submission be declined.

### Issue: Timeliness of providing information to employers

#### Submission

(PwC)

It would be important to ensure information was provided to employers in a timely manner to ensure the preferred employee contributions are being deducted from an employee’s salary or wages at their preferred rate.

#### Comment

As noted, it is intended that Inland Revenue provide notice to an employer of a contribution rate change as soon as practicable after receiving the contribution rate change request from a KiwiSaver scheme provider or member.

#### Recommendation

That the submission be noted.

### Issue: Scheme providers should share contribution rate information with employers

#### Submission

(EY)

The submitter recommended that proposed new section 64(2C) of the KiwiSaver Act 2006 be amended so that KiwiSaver scheme providers would be required to notify a member’s employer (in addition to notifying Inland Revenue) where the member has made a contribution rate change request to their scheme provider.

#### Comment

The existing proposal would only require KiwiSaver scheme providers and employers to communicate with one other party (that is, Inland Revenue). Therefore, this submission would add significant complexity to the proposal, as KiwiSaver scheme providers would be required to communicate with all the employers of members who requested a contribution rate change. Moreover, as there are no existing channels for KiwiSaver scheme providers and employers to communicate, officials consider this recommendation would introduce additional administrative costs for both KiwiSaver scheme providers and employers.

The recommendation could also create issues where a member has not provided accurate employer details to their scheme provider when requesting a contribution rate change. This could result in KiwiSaver scheme providers being unable to satisfy their obligation to notify an employer of the contribution rate change. In contrast, Inland Revenue is better placed to determine whether a member’s employer details are accurate, as these details can be verified against information Inland Revenue already holds.

#### Recommendation

That the submission be declined.

### Issue: Guidance about implementing the proposal

#### Submission

(ANZ)

The submitter sought further guidance about how the proposal would work in practice. In particular, how contribution rate changes would be communicated between KiwiSaver scheme providers, Inland Revenue, and employers.

#### Comment

Inland Revenue officials will continue to work with stakeholders to establish a more detailed operational process for this change. Deferring the application date would provide further time to work through the operational details with stakeholders before the change must be implemented.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

## Collecting KiwiSaver income and ESCT rate information

(Clauses 13, 25, 132)

### Issue: Support for the proposal

#### Submission

(PwC, Financial Services Council)

Submitters supported employers being required to provide KiwiSaver income and employer superannuation contribution tax (ESCT) rate information to Inland Revenue.

#### Recommendation

That the support be noted.

### Issue: Compliance costs on employers

#### Submission

(Corporate Taxpayers Group, Deloitte, Martin Etherington)

One submitter raised concerns about the compliance costs for employers associated with the proposal. (*Corporate Taxpayers Group*)

Collecting ESCT rate information will impose unnecessary compliance costs on employers, as Inland Revenue should already be able to calculate an employee’s ESCT rate based on employment income information already collected from employers. (*Deloitte, Martin Etherington*)

#### Comments

##### ESCT rate information

While collecting ESCT rates would make it easier for Inland Revenue to detect potential miscalculations of ESCT deductions by employers (for example, where an employer has selected the correct ESCT rate but miscalculated the deduction); officials agree that the compliance costs on employers of this change would outweigh these benefits. Therefore, officials recommend that the requirement for employers to report ESCT rate information to Inland Revenue for new employees and existing employees where the information has changed, should be removed from the Bill.

##### KiwiSaver income information

The Bill currently proposes that employers be required to provide information to Inland Revenue about the income an employee’s KiwiSaver contributions are calculated from (as there are some amounts treated as income for PAYE that are excluded from the KiwiSaver definition of “salary and wages” for new employees and existing employees where this information has changes since it was last reported). To address concerns raised about compliance costs on employers, officials recommend changing the proposal so that employers would only be required to report this information to Inland Revenue about new employees. As a result, reporting this information could be incorporated into new employee on-boarding reporting processes.

As any differences between income for PAYE purposes and for KiwiSaver purposes generally does not change during the course of an employment relationship, collecting this information in relation to new employees only is likely to be sufficient for Inland Revenue to more effectively detect miscalculations of KiwiSaver contributions.

#### Recommendation

That, subject to officials’ comments, the submission be accepted.

### Issue: Reporting ESCT rate information on a payday basis

#### Submission

(EY)

Employers should be given the option of reporting ESCT rate information to Inland Revenue every payday, rather than only for new employees and also when this information has changed since it was last reported as proposed in the Bill. This would make it easier for the change to be programmed into automated PAYE information reporting systems.

#### Comment

This is no longer a consideration as officials are recommending that the proposal to require employers to report ESCT rate information to Inland Revenue be removed from the Bill.

#### Recommendation

That the submission be declined.

### Issue: Include the value of accommodation with the definition of “salary and wages” for KiwiSaver

#### Submission

(Martin Etherington)

The objective of Inland Revenue being able to identify earnings an employee is receiving that are not subject to the KiwiSaver definition of salary and wages is supported. However, this could be achieved by aligning the definition of “salary and wages” in the KiwiSaver Act 2006, with the definition of income used in the Accident Compensation Act 2001 for the ACC earners’ levy. This alignment could be achieved by including the value of accommodation within the definition of “salary and wages” in the KiwiSaver Act 2006.

#### Comment

Officials note that the definition of salary and wages used in the KiwiSaver Act 2006 is based on the definition of salary and wages used in the Income Tax Act 2007. However, there are some differences in recognition of the fact that including certain payments may impact the affordability of KiwiSaver.

The value of accommodation was not included in the definition of salary and wages in the KiwiSaver Act 2006 as doing so could have a significant impact on the affordability of KiwiSaver for both employees and employers. Generally, if an employee is required to have contributions deducted from a payment, an employer will also be required to take this payment into account when calculating compulsory employer contributions.

Officials also note that including the value of accommodation within the definition of “salary and wages” in the KiwiSaver Act 2006, would not align it with the definition of income used for the ACC earners’ levy. For example, weekly paid parental leave payments are included within the definition of “salary and wages” for the purpose of KiwiSaver employee contributions but are not included within the definition of income for the purposes of the ACC earners’ levy. Therefore, further alignment of these definitions could have adverse impacts on KiwiSaver members’ retirement savings.

#### Recommendation

That the submission be declined.

### Issue: General comments on greater information gathering capabilities

#### Submission

(Corporate Taxpayers Group)

If Inland Revenue were to obtain greater quantities of information as a result of proposed amendments to the KiwiSaver Act 2006, it needs to ensure that there is a good reason to do so and that the information was being used for a particular purpose.

#### Comment

As outlined above officials are recommending revisions to the KiwiSaver information collecting amendments included in the Bill, so that information will only be collected when there is a clear reason to do so. Information would only be collected where it is necessary for Inland Revenue to be able to ensure that KiwiSaver members are receiving their correct contribution entitlements.

#### Recommendation

That the submission be noted.

## Reducing the KiwiSaver transfer period

(Clauses 8 and 9)

### Issue: Support for the proposal

#### Submission

(Chartered Accountants Australia and New Zealand, Financial Services Council)

One submitter supported aligning the transfer times for default and non-default KiwiSaver scheme providers, noting that such transfers usually happen quickly. (*Financial Services Council*)

#### Recommendation

That the submitters’ support be noted.

### Issue: Exception to 10-day transfer rule sought

#### Submission

(Kensington Swan)

The submitter sought the introduction of an exception to the proposed 10 working days transfer rule, so that members were able to contract out of this transfer period if they wish to. The rationale for this was that it may be difficult for KiwiSaver providers offering “self-select” schemes (which enable investors to design their own KiwiSaver investment portfolio) or schemes investing in alternative asset classes (such as venture capital or private equity) to realise alternative assets for fair value or have access to sufficient liquid investments within the 10 day timeframe.

#### Comment

Officials consider that overall the risk described by the submitter is minimal. It is noted that as per their instruments of appointment, default KiwiSaver scheme providers already transfer default members within 10 days without issue. Many of these providers are already applying a 10 day transfer time to the transfer of all funds.

In addition, the legislation would also permit schemes to exceed the 10 working day transfer rule, so long as it was agreed to between the old and new KiwiSaver schemes. Officials consider that this provision provides sufficient protection for scheme providers.

#### Recommendation

That that submission be declined.

## Other KiwiSaver matters

### Issue: Insufficient information provided to employers around KiwiSaver opt-outs

#### Submission

(PwC)

When employees opt-out of KiwiSaver, employers are given insufficient information from Inland Revenue about amounts refunded. In the future Inland Revenue should provide clarity to an employer as soon as refunded amounts are processed.

Currently Inland Revenue may refund contributions to the employer for members who have opted-out of KiwiSaver, without including details of which employees the refunded amount relates to. This can cause issues for the employer when the refunded amounts formed part of a total renumeration package and therefore need to be returned to the employee.

#### Comments

The KiwiSaver Act 2006 does not prescribe what form information to employers about refunded contributions must take, therefore, a legislative remedy is not required. Inland Revenue is looking at ways to enhance the central administration of KiwiSaver. This includes ways to more effectively communicate with employers in relation to KiwiSaver refunds.

#### Recommendation

That the submission be noted.

### Issue: Entitlement to Government contribution ceasing at 65

#### Submission

(Neville Wynn)

Over 65 year olds should continue to be entitled to the annual KiwiSaver government contribution.

#### Comments

The upper age limit for compulsory employer contributions is linked with the age a KiwiSaver member qualifies for New Zealand superannuation, as well as the age they are able to withdraw their savings (that is, 65 years old).

Unlike other KiwiSaver members, over 65 year olds are able to withdraw their funds. Officials therefore note that extending entitlement to the annual government contribution to over 65 year olds, would create a risk of over 65 year olds inappropriately circulating money in and out of their KiwiSaver account to receive the government contribution (that is, immediately withdrawing the annual government contribution and then re-investing this same amount with their KiwiSaver scheme provider, so that it would count towards their entitlement to their next government contribution). This outcome would not be consistent with the purpose of this incentive, which is to encourage long-term retirement savings.

#### Recommendation

That the submission be declined.

### Issue: Entitlement to compulsory employer contributions for under 18 year olds

#### Submission

(Ayush Vyas)

Under 18 year olds should be entitled to compulsory employer contributions.

#### Comments

Setting a minimum age of entitlement to compulsory employer contributions at 18 years old avoids an incentive being created for those aged 16 or 17 to leave educational training and enter the workforce in order to obtain the benefit of compulsory employer contributions. By encouraging young people to stay in educational facilities for longer, the current setting helps to ensure the greater earning power of those young people (through higher education) and hence improve their ability to save in the future.

Setting the minimum age of entitlement to compulsory employer contributions and the annual government contribution at 18 is also consistent with the KiwiSaver automatic enrolment rules. Aligning these rules helps to ensure the scheme remains simple for employers to administer.

Any changes to this setting would raise issues that would require resourcing and prioritising as part of the Government’s tax policy work programme.

#### Recommendation

That the submission be declined.

### Issue: Flexibility of employee contribution rates

#### Submission

(Martin Etherington)

Employees should be able to have KiwiSaver contributions deducted from their salary or wages at any rate up to a maximum of 10% (this would include rates that are not whole numbers). This would allow voluntary contributions (which are currently paid directly to scheme providers) to be reported and paid in the same manner as other KiwiSaver contributions deducted (that is, through Inland Revenue).

#### Comments

There is a trade-off between providing flexibility for members and ensuring KiwiSaver remains simple, with low administrative and compliance costs for employers. Allowing members to contribute at any rate above 3% would increase compliance costs for employers (especially for smaller employers not using payroll software).

Officials also note that voluntary contributions are often in the form of one-off lump sum payments. As they are not necessarily regular payments nor will they always be made out of an employee’s salary or wages, it would be undesirable to require that these contributions are subject to the same reporting and payment process as the percentage based contributions deducted from members’ salary or wages.

Officials believe the additional 6% and 10% rates introduced in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 adds sufficient flexibility for members, without over complicating the KiwiSaver employee contribution rules.

#### Recommendation

That the submission be declined.

### Issue: “Lock-in” of QROPS funds in KiwiSaver schemes

#### Submission

(PwC)

An amendment should be made to the KiwiSaver Act 2006 to introduce a new permitted withdrawal ground that allows UK retirement savings currently held in a KiwiSaver scheme to be transferred to a qualifying recognised overseas pension scheme (QROPS). This would address the issue of UK migrants who transferred their retirement savings to a KiwiSaver scheme before it lost its QROPS status effectively being “locked-in” to their current KiwiSaver scheme provider.

#### Background

Under UK law, migrants can transfer their UK retirement savings out of the UK to a QROPS. If these UK retirement savings are not transferred to a QROPS (or are withdrawn) then a migrant can be subject to a UK pension tax of 55% of the total savings transferred.

Previously, KiwiSaver schemes were QROPS. However, the QROPS criteria were tightened in April 2015 to ensure savings could not be withdrawn until retirement age. Because of the KiwiSaver first home withdrawal facility, this led to KiwiSaver schemes no longer qualifying as QROPS.

This has resulted in UK migrants who transferred their retirement savings to a KiwiSaver scheme before it lost its QROPS status effectively being “locked-in” to their current KiwiSaver scheme provider. This is because:

* another KiwiSaver scheme will not accept an inward transfer of a KiwiSaver account that includes UK retirement savings; and/or
* transferring to another KiwiSaver scheme would trigger the 55% UK tax liability.

As the KiwiSaver Act 2006 only allows for KiwiSaver accounts to be transferred to other KiwiSaver scheme providers, it is currently not possible for an affected member to transfer their UK retirement savings to a non-KiwiSaver New Zealand QROPS.

#### Comments

Officials are aware of the matter raised in this submission, however, note that it requires prioritising and resourcing as part of the Government’s tax policy work programme.

#### Recommendation

That the submission be declined.

### Issue: ESCT rate for employee with secondary tax code should be the same as base tax rate

#### Submission

(Martin Etherington)

An employer determines the ESCT rate for an employee based on the employee’s earnings from that employer only, without regard to earnings the employee may have elsewhere or the tax code the employee has declared. The submitter proposes the ESCT rate for employees using a secondary (or other fixed rate) tax code should be the same as the base tax rate for that tax code.

#### Comments

Using a secondary tax code can result in some individuals overpaying tax during the year. As the employee’s secondary income will be subject to a flat rate of tax at their marginal tax rate, tax is overpaid when this secondary income takes a person’s total income over a tax threshold. In this situation the individual will be entitled to a refund of the overpaid tax at the end of the tax year.

In contrast, ESCT is treated as a final tax, which means overpaid ESCT cannot be refunded. Therefore, if the same rate of tax was applied to employer superannuation contributions paid by a second employer as was applied to other earning received from that employer, this would create situations where tax would be overpaid without an entitlement to a refund.

#### Recommendation

That the submission be declined.

### Issue: Reporting employer’s name and address to Inland Revenue

#### Submission

(Matter raised by officials)

Under proposed new section 64(2C) of the KiwiSaver Act 2006 when giving notice to Inland Revenue that a member has made a contribution rate change request, a KiwiSaver scheme provider is required to provide Inland Revenue with the name and address of the employers the member wants the new contribution rate to be applied by. Similarly, under proposed new section 64(2B), a member requesting a contribution rate change through Inland Revenue is required to provide Inland Revenue with the names and addresses of the employers they want the new contribution rate to apply to.

Similar requirements to provide employer name and address details to Inland Revenue also exist in section 38(2) of the KiwiSaver Act 2006 (a KiwiSaver scheme provider is required to report these details to Inland Revenue where a person has enrolled directly with a scheme provider) and section 103 (a member is required to report these details to Inland Revenue when applying to go on a savings suspension).

Issues arise where employer name and address details reported by a scheme provider or member are not accurate. This can occur when a member’s place of work has a different name to the entity they are employed by. For example, a member works at Local Corner Store but are legally employed and paid by Food Conglomerate Limited. As Food Conglomerate Limited will need to administer any changes to the employee’s contribution rate or a savings suspension request, it should be their details that are reported to Inland Revenue. However, often the member will provide Local Corner Store’s details. This can delay the member’s request being actioned.

#### Comment

Officials recommend that the requirement in proposed new sections 64(2B) and 64(2C), and existing section 38(2) of the KiwiSaver Act 2006, for KiwiSaver scheme providers and members to report an employer’s name and address to Inland Revenue be removed. Instead, Inland Revenue would notify each active employer it has on record for the employee where one of the employees has enrolled in KiwiSaver or of an employee’s new contribution rate if they have requested a contribution rate change through their scheme provider or Inland Revenue.

Officials recommend the requirement in section 103(2)(b) of the KiwiSaver Act 2006 for members to provide employer name and address details should be on an “as required” basis only (that is, when the information has been requested by Inland Revenue). Members who are applying for a savings suspension via their myIR account would indicate which employers they wish the savings suspension to apply to. Inland Revenue would then notify these employers that a savings suspension had been granted and as per existing practice Inland Revenue would also send notice of the savings suspension to the member, which they could show to subsequent employers of their choice. For a member applying for a savings suspension via other channels, to avoid the issue of employer details being misreported, no employer details would be requested. Instead, Inland Revenue would send the member a letter advising that a savings suspension had been granted, which the member could show to employers of their choice. This would ensure the employee could action the savings suspension with relevant employers as soon as possible.

The amendments related to the employer information reporting requirements for KiwiSaver provider opt-ins and savings suspensions are required before Inland Revenue transfers the administration of KiwiSaver into its new IT system from 1 April 2020. The removal of the employer name and address reporting requirements for contribution rate changes would apply from 1 April 2022 or an earlier date set by Order in Council (this being the date that officials are recommending in this report that members be able to change their contribution rate through their KiwiSaver scheme provider or Inland Revenue).

#### Recommendation

That the submission be accepted.

### Issue: Aligning employee address requirements in the KiwiSaver Act 2006 with the Tax Administration Act 1994

#### Submission

(Matter raised by officials)

Table 2 of schedule 4 of the Tax Administration Act 1994, inserted by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018, intends to bring together the requirements from the IR330 (Tax code declaration) and KS2 (KiwiSaver deduction form) in a way which supports consolidated “fully electronic onboarding” of new employees (although, paper forms for these requirements will continue to exist). As there is currently significant overlap between these reporting requirements, consolidation would mean employers would no longer be required to provide Inland Revenue with the same information about a new employee twice.

Under Schedule 4 of the Tax Administration Act 1994, an employer must provide a new employee’s contact address to Inland Revenue “as required” (that is, when this information has been requested by Inland Revenue). However, under the KiwiSaver 2006 an employer will always be required to provide an employee’s contact address to Inland Revenue for KiwiSaver new enrolments.

This would mean in situations where Inland Revenue did not require a new employee’s contact address under the Tax Administration Act 1994, the employer would still be required to provide this information if the relevant employee had also been enrolled in KiwiSaver. Such an outcome would be inconsistent with the intent to consolidate new employee reporting requirements.

#### Comment

To align with the language in the Tax Administration Act 1994, officials recommend that the KiwiSaver Act 2006 be amended to clarify that an employer is only required to provide the contact address of an employee who has been enrolled in KiwiSaver as required.

As new employee reporting requirements are expected to be consolidated by April 2020 (that is, when the administration of KiwiSaver is transferred to Inland Revenue’s new IT system), it is desirable to address this discrepancy now. Therefore, it is recommended amendments apply from 1 April 2020.

#### Recommendation

That the submission be accepted.

## New early KiwiSaver withdrawal category for people with life-shortening congenital conditions

### Issue: Support for the proposals

#### Submission

(ANZ, BNZ, Financial Services Council of New Zealand, KPMG, Sarah Peters)

Submitters support the proposals that people with a life-shortening congenital condition should be able to access their KiwiSaver funds early.

One submitter supported early withdrawal of KiwiSaver funds for people whose lives are shortened for any reason. (*Sarah Peters*)

#### Comment

Officials welcome the support expressed by submitters for the proposals.

#### Recommendation

That the submissions be noted.

### Issue: Definition of life-shortening congenital condition taken to be a life expectancy below the New Zealand superannuation qualification age

(Clauses 38(2) of Supplementary Order Paper 293)

#### Submission

(Financial Services Council)

The submitter states that the definition of life-shortening as being below the New Zealand qualification age is narrower than their understanding of the original policy intention.

#### Comment

Officials consider that defining a life-shortening congenital condition as one that shortens a person’s life below the New Zealand qualification age is appropriate. Once a person reaches the age of 65 their KiwiSaver account is unlocked and they are able to access their retirement savings.

To take the definition of life-shortening congenital condition beyond the age of 65 starts to advance the definition into age ranges and timeframes that a person with a normal life-expectancy could reasonably expect to reach in retirement. This withdrawal category has been specifically designed for people who will not reach the age at which their KiwiSaver account would be “unlocked” under existing KiwiSaver settings (65 years old).

#### Recommendation

That the submission be noted.

### Issue: KiwiSaver providers may have a grace period for updating disclosure information

(Clause 37C of Supplementary Order Paper 293)

#### Submission

(Financial Services Council, BNZ)

The submitters support the proposal that KiwiSaver providers will have additional time to update the disclosure documentation they are required by law to provide to their KiwiSaver members about the new withdrawal category.

One has asked whether the additional time period to update information could also extend to information that they are not legally required to provide but is used to inform investors of the rules relating to their KiwiSaver scheme, for example, material on their website and customer brochures. (*BNZ*)

#### Comment

Officials welcome the support but consider that the additional time allowed to update disclosure documentation does not need to be extended to information that is not legally required to be provided.

#### Recommendation

That the submission about extending the grace period to information that is not legally required be declined.

### Issue: Application process

(Clauses 38(2) and (3) of Supplementary Order Paper 293)

#### Submission

(Financial Services Council, ANZ)

The submitters support the final decision for a member’s withdrawal under the new clause to sit with the supervisor of the KiwiSaver scheme.

One submitter suggests that it may be helpful from a process point of view if a registered medical practitioner were required to provide a statement as part of the standard process for applications for withdrawal in order to ensure consistency across providers.

The submitter also expressed their support for the proposal that those relying on the new withdrawal category should be able to select the age at which they retire. However, both the Financial Services Council and ANZ noted that allowing a member to choose the date at which they retire (as distinct from the date at which the application for withdrawal is made) could be confusing and difficult to operationalise. (*Financial Services Council*)

#### Comment

Officials consider it would be appropriate for supervisors and managers of KiwiSaver schemes to be able to rely on the judgment of medical professionals in order to determine whether a person meets the requirements for withdrawal under the new category. It would be appropriate for a statement from a registered medical practitioner to be part of the standard process for application as this would allow the supervisor or manager to easily assess whether the person meets the criteria for withdrawal.

Officials agree that the potential separation between application for withdrawal and the date the withdrawal takes place could create some operational challenges.

#### Recommendations

That the submission be accepted, and amendments made to the information requirements for the application to include a certificate from a registered medical practitioner.

That the submission about the application process triggering the withdrawal of KiwiSaver funds be accepted.

### Issue: Operational matters requiring clarification

(Clause 38(2 of Supplementary Order Paper 293))

#### Submission

(Financial Services Council, ANZ)

The interaction between the new withdrawal category and the existing five year lock-in period would prevent those people subject to the five year lock-in from withdrawing their KiwiSaver funds even if they qualify for a withdrawal under the new category. Both submitters have suggested amendments to ensure withdrawal can take place even for those who are subject to the five year lock-in period.

One submitter asked whether a person can reactivate their KiwiSaver account at a later date if they have made a withdrawal under the new category. The “reactivation” would give the person the ability to return to a “locked-in” status and again become eligible for compulsory employer and government contributions (for example if their health improves). (*Financial Services Council*)

#### Comment

A five year lock in period applies to KiwiSaver contributions for people who joined before 1 July 2019. A person that joins before this date is a grandparented member and can withdraw their savings on the later date of New Zealand Superannuation qualification age or the five year grandparenting period. This lock-in period impacts people that joined not long before they turn 65.

In regard to whether a person can “reactivate” their account following a withdrawal under the new category, the purpose of the withdrawal category is to facilitate an early retirement period. Allowing a person the ability to reactivate and “lock-in” their contributions again would be counter to the purpose of facilitating an early retirement by making KiwiSaver funds available.

#### Recommendations

That the submission about the five year lock-in period be accepted, and amendments made to ensure that a person subject to a five year lock-in period can still withdraw under the new early withdrawal category.

That the submission about whether a person can reactivate their account be noted.

### Issue: Clarification of ability to work following withdrawal under the new category

(Clauses 38(2) and (3) of Supplementary Order Paper 293)

#### Submission

(Financial Services Council, ANZ)

The combination of the clauses relating to a member’s ability to continue in paid employment despite making a withdrawal is inconsistent, with 12B(5) stating a withdrawal does not prevent a person from continuing in paid employment and 13(1C)(a) requiring a statutory declaration stating that the person does not intend to continue in full-time paid employment, or to accept it in the future.

No statutory declaration should be required so that the withdrawal is aligned with a withdrawal that is made at age 65.

#### Comment

The statutory declaration referred to in clause 13(1C)(a) sets out that the person seeking a congenital condition withdrawal needs to declare that that is the purpose of the withdrawal.

Notwithstanding the requirement in clause 13(1C)(a), if a person chooses to continue in some form of paid employment, clause 12B(5) makes it clear that any contributions made after a congenital condition withdrawal has been made will not receive Crown or compulsory employer contributions for any future contributions to their KiwiSaver account.

Officials consider that the statutory declaration is still required in order to make it clear that the purpose of the withdrawal is for retirement from full-time paid employment. It is also reasonable that a person may want to continue in some form of paid employment as this is consistent with a positive retirement.

#### Recommendation

That the submission be declined.

### Issue: Drafting matters

#### Definitions of life-shortening congenital condition

(Clause 38(2) of Supplementary Order Paper 293)

#### Submission

(Financial Services Council, ANZ)

There are some inconsistencies with the drafting of the definitions of life-shortening congenital condition.

#### Comment

Officials agree that the definition of life-shortening congenital condition should be clarified in the drafting to remove inconsistencies.

#### Recommendation

That the submission be accepted, and the drafting revised.

### Issue: Impact of withdrawal on social assistance payments

#### Submission

(Financial Services Council)

Clarify how a withdrawal under the new category would affect a person’s entitlement to social assistance.

#### Comment

Under current settings, KiwiSaver funds are no longer locked-in and able to be withdrawn are treated as an available asset for the purpose of social assistance and income earned from that asset is treated as income. This means that unlocking a person’s KiwiSaver account under the proposed early withdrawal category will most likely reduce or stop a person’s social assistance payments.

Work is underway to examine the interaction between early withdrawal of KiwiSaver and entitlement to social assistance and recommendations. Amendments would need to be made to the Social Security Regulation 2018 to change the impact that a withdrawal under the proposed new category would have on a person’s entitlement to social assistance.

#### Recommendation

That the submission be noted.

# Student loans

## Matters raised by submitters

### Issue: Limiting the ability to reopen repayment obligations prior to 1 April 2013

(Clause 57)

#### Submission

(Chartered Accountants Australia and New Zealand)

The submitter does not support the proposed changes and considers that despite the complexity introduced by significant numbers of changes since 1992, there is no principled reason to enact this change.

#### Comment

In general, officials note that by the time the changes take effect, 1 April 2013 will be seven years in the past. This is more than the median repayment time for New Zealand-based borrowers. Given this, there are unlikely to be many borrowers affected by this change. If a borrower is adversely affected by this change, the proposed legislation enables the Commissioner to reinstate the borrower back to the position they would have been in prior to this change.

Retaining the rules going back to 1992 imposes compliance costs for borrowers who have their repayment obligations changed before 2013, as the majority of the changes to rules prior to 2013 do not feature in the current scheme. The low likely impact on borrowers significantly outweighs the cost imposed by building and testing systems to manage the old and complex rules that are unlikely to affect many borrowers.

#### Recommendation

That the submission be declined.

### Issue: Allowing Inland Revenue to notify employers when an employee’s loan balance is close to zero

(Clause 45)

#### Submission

(Martin Etherington, Corporate Taxpayers Group, EY)

Two submitters expressed support for the proposal to allow Inland Revenue to notify employers of a borrower’s remaining loan balance. Both also noted that it would be important that when Inland Revenue notifies an employer, that this is done allowing enough time for the employer to make the necessary adjustments. (*Martin Etherington, Corporate Taxpayers Group*)

Implementing the change within payroll software should not be difficult. “Close” could be defined as where the loan is likely to be paid off within the next month. (*Martin Etherington*)

The proposal would impose significant compliance costs on employers for little benefit. The proposal should be made optional for employers. Alternatively, Inland Revenue could provide a faster refund process for overpaid loan deductions in the interim period between annual returns. (*EY*)

#### Comment

Officials welcome the support for the proposal and agree that providing sufficient notice to employers is important. Officials would prefer that the timeframe is not defined in legislation to allow greater flexibility to cater for different borrower situations. Generally, Inland Revenue is looking to issue letters to employers and borrowers when the borrower’s loan is expected to be repaid in the next three months.

Officials consider that the compliance costs imposed by this change should not be significant, and that as a result, this change is appropriate. Qualitative research undertaken by Inland Revenue with groups of employers concluded that employers supported the proposal. Officials consider that making compliance with these requirements voluntary is not appropriate.

Inland Revenue agrees that the refund process should be as efficient as possible and is making significant efficiency changes as part of its transformation process. It still considers that it is preferable for no over deductions to occur for student loan borrowers. Independent testing on Inland Revenue’s behalf has shown a positive response from employers and customers to this change.

#### Recommendation

That the submission to make the proposal optional for employers be declined and the other submissions be noted.

### Issue: Loan put on hold for those with life-shortening congenital conditions

(Clause 42)

#### Submission

(Sarah Peters)

That those with life-shortening congenital conditions should have their loan put on hold to prevent further debt.

#### Comment

Officials consider that the current loan scheme strikes the correct balance between providing relief to those with life-shortening congenital conditions and ensuring equity among borrowers. Where the borrower is based in New Zealand, loan repayments are income contingent with repayments only required where the borrower’s income is above the repayment threshold of $19,760 and no loan interest is imposed. If the borrower’s income is above the repayment threshold and loan repayments are required, the borrower may be able to qualify for hardship relief if the repayments are causing difficulties for the borrower. The Bill would extend this treatment to overseas-based borrowers with serious illnesses or disabilities.

Officials therefore recommend that the submission be declined.

#### Recommendation

That the submission be declined.

## Matters raised by officials

### Issue: Repeal the requirement for loan repayments to be deducted from schedular, election-day, and casual agricultural income

#### Submission

(Matter raised by officials)

The changes requiring student loan repayments be deducted from schedular, election-day, and casual agricultural income should be repealed. This is because consultation with employers has identified significant compliance costs for them to implement the changes.

#### Comment

From 1 April 2020, changes included in the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 require student loan repayments to be deducted from schedular, election-day, and casual agricultural income each payday. These changes apply from 1 April 2020.

These changes would be beneficial to borrowers in reducing the compliance costs of making loan repayments during the year. However, consultation undertaken by Inland Revenue with employers has identified significant costs for implementing these proposals. Therefore, officials recommend that this legislative requirement be repealed.

#### Recommendation

That the submission be accepted.

### Issue: Underestimation penalty

#### Submission

(Matter raised by officials)

That the student loan underestimation penalty be replaced with a shortfall penalty to align it with the penalty imposed for underestimation of provisional tax for tax purposes.

#### Comment

Borrowers who earn income other than salary and wages and whose end-of-year repayment obligation on this income is more than $1,000, are required to make interim repayments in the following year. A borrower can base these interim repayments on either the previous year’s assessed amount plus an uplift percentage or an estimate of the expected end-of-year repayment obligation.

To ensure borrowers who choose the estimate option make an accurate estimate of their interim repayment obligations, a penalty is imposed on those who significantly underestimate their interim repayments.

To provide consistency of penalties between underestimations of loan repayments and the underestimations of provisional tax, it is proposed that the current underestimation penalty be replaced with a tax shortfall penalty.

The Government tried to make this legislative change in 2011, but it had to be reversed because of Inland Revenue’s system limitations at the time. With Inland Revenue’s Business Transformation changes, this system limitation has been removed.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Repayment obligations limited to loan balance

#### Submission

(Matter raised by officials)

Remove the requirement for pay-period repayment obligations to be limited to the loan balance. Instead, enable repayment obligations to continue until the consolidated loan balance (including unpaid amounts and interest) is repaid.

#### Comment

The Student Loan Scheme Act 2011 limits a borrower’s repayment obligation to their loan balance, rather than their consolidated loan balance. The consolidated loan balance includes amounts in default, whereas the loan balance excludes these amounts. These terms are defined in the Act. Occasionally, borrowers working in New Zealand may have no remaining loan balance, but because of amounts being in default, may have a consolidated loan balance remaining. In these cases, the current provisions prevent salary and wage deductions from being made to repay these outstanding amounts.

Officials recommend an amendment to allow salary and wage deductions to continue until the consolidated loan balance is fully repaid.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Lowering the adjusted net income threshold from $1,500 to $500

#### Submission

(Matter raised by officials)

That the $1,500 adjusted net income threshold, below which a borrower is not required to make repayments on their adjusted net income, be reduced to $500.

#### Comment

The Act contains a concessionary $1,500 threshold. If a borrower has less than $1,500 of non-salary and wage income, they are not required to make any student loan repayments on this income. This threshold reflects the compliance costs associated with the requirements to file a return and/or notify Inland Revenue of any adjustments to income for student loan purposes.

From the 2018−19 tax year, most salary and wage earners will have their tax automatically assessed. Therefore, as the compliance costs associated with complying with the filing requirements have been reduced, officials recommend lowering the threshold to $500 of income, which would require $60 of repayments. This is very close to the $50 threshold for income tax owed from an automated assessment, where amounts owed of less than $50 are written off.

This would mean that a larger number of borrowers would be required to make repayments and if payments are made, would reduce the term of the loan. Where the borrower does not pay, provisions in the student loan scheme currently allow unpaid amounts of less than $334 to be capitalised back onto the loan balance. No borrowers will be subject to penalties as a result of this change if they do not make repayments when required to do so.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Date repayment deductions are deemed to be made

#### Submission

(Matter raised by officials)

The date that student loan repayment deductions are deemed to be made should be changed from the 15th of the month to the employee’s payday.

#### Comment

Currently deductions are deemed to be made on one fixed date, the 15th of the month. This is because until 1 April 2019 Inland Revenue did not receive pay day information for all employees, and determining employees’ pay days would impose compliance costs on employers. The introduction of payday filing now enables Inland Revenue to deem deductions to be made on the employee’s payday. This should not have adverse implications for borrowers.

Officials recommend that an amendment be made to deem student loan repayment deductions be made on the employee’s payday.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Aligning the write-off rules

#### Submission

(Matter raised by officials)

Amend the Student Loan Scheme Act 2011 to enable the Commissioner to write off amounts of $20 or less.

#### Comment

Currently, the Tax Administration Act 1994 allows the Commissioner to refrain from collecting tax of amounts not more than $20. In the Student Loan Scheme Act 2011 the Commissioner may write off amounts less than $20. Officials recommend aligning these by changing the wording in the Student Loan Scheme Act 2011 to align with the Tax Administration Act 1994. This would provide consistency of treatment between small amounts of income tax and student loan obligation. This should not have a significant impact as it will adjust the threshold for a small balance write-off by one cent.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Interest for New Zealand-based borrowers

#### Submission

(Matter raised by officials)

Remove the requirement to impose interest and then write it off for New Zealand-based borrowers, for reassessments prior to 1 April 2020.

#### Comment

Systems limitations have meant that New Zealand-based borrowers had interest applied to their loans and the interest was immediately written off. This has caused confusion and concern. Inland Revenue’s business transformation programme means that those systems limitations no longer exist. However, when changes are made to borrower’s loan balance after 1 April 2020 that apply to periods before 1 April 2020, the legislation technically requires interest to be imposed and written off for New Zealand-based borrowers. From a systems perspective and to improve clarity for borrowers, it is simpler to confirm that this treatment should also apply to any recalculations or reassessments on a New Zealand-based borrower’s loan before 1 April 2020. Officials propose including a savings provision to confirm this treatment.

No borrower’s repayment obligations will be affected by this change.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the recommendation be accepted.

### Issue: Payment ordering rules

#### Submission

(Matter raised by officials)

Payments should be generally allocated against the oldest unpaid period, and within each period against interest first, then the principal.

#### Comment

Currently, the Student Loan Scheme Act 2011 requires that payments be offset first against interest on the loan, then against the principal. Inland Revenue’s new system has been configured so that payments are generally allocated against the oldest unpaid assessment, and then against interest before principal within each period. This treatment is generally advantageous to borrowers as it will minimise any interest they are charged.

Officials recommend that the legislation be amended to reflect the period-based allocation of payments within the new system.

This change is required before Inland Revenue moves administration of student loans repayment rules to its new computer system from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Early assessment of student loan adjusted net income

#### Submission

(Matter raised by officials)

Where a borrower files a valid return before the end of the tax year, a borrower’s end of year repayment obligation should be finalised before the end of the tax year.

#### Comment

Currently, the Student Loan Scheme Act 2011 requires that a borrower’s end-of-year repayment obligation on their adjusted net income cannot exceed their loan balance on the last day of the tax year. In some cases, a borrower may file a return before the end of the tax year (for example, if they go overseas) and this requirement would delay Inland Revenue being able to complete this assessment. Where a return is filed earlier than the last day of the tax year, officials propose that the assessment could be completed, and the borrower’s repayment obligation should not exceed their loan balance on that day.

This change is required to enable Inland Revenue to configure the student loan rules in its new computer systems and processes which apply from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: Notification of income by overseas-based borrowers applying to be treated as New Zealand-based

#### Submission

(Matter raised by officials)

An amendment is required to clarify that borrowers are able to notify the Commissioner of their adjusted net income at the time they apply for treatment as being physically in New Zealand or a later date.

#### Comment

Borrowers can apply to be treated as being physically in New Zealand if the principal reason for not being in New Zealand is included within a list of categories in the Student Loan Scheme Act 2011, for example, as part of their New Zealand employment the borrower is posted overseas. If granted, borrowers’ repayment obligations are income contingent and the loan is interest free for the relevant period. Borrowers can apply for this treatment before, during or after being absent from New Zealand.

As a condition of some of the listed reasons, borrowers must notify the Commissioner of their adjusted net income. However currently, it is unclear whether those borrowers who apply for this treatment after their absence must make a separate extension of time application, or whether they may notify the Commissioner of their income information at the time of application.

Officials recommend that the Act be amended to make it clear that a borrower can notify the Commissioner of their adjusted net income at the time they apply or at a later date if the Commissioner agrees. This change would apply from 1 April 2020.

#### Recommendation

That the submission be accepted.

Research and development

## General support

### Issue: Support for the R&D tax credit regime

#### Submission

(Corporate Taxpayers Group, Deloitte, Pharmaceutical Solutions,[[1]](#footnote-2) EY, New Zealand Technology Industry Association)

Submitters support the R&D tax credit regime.

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Effect on innovation and investment

#### Submission

*(Corporate Taxpayers Group, Deloitte, EY, New Zealand Technology Industry Association)*

The R&D tax credit will lead to more investment in the New Zealand technology sector and aligns New Zealand with other leading technology nations. (*New Zealand Technology Industry Association*)

A well designed and administered R&D tax credit regime, in combination with other measures, has the potential to achieve the Government’s goal of incentivizing R&D in New Zealand to drive innovation, productivity, and economic growth. (*EY*)

A successful R&D tax credit regime will benefit all New Zealanders, by helping to increase productivity, enhance skills and knowledge, and potentially attract new activity to New Zealand. (*Corporate Taxpayers Group, Deloitte*)

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Long-term sustainability is important

#### Submission

(EY)

The R&D tax credit regime needs to be sustainable from a fiscal and cost management perspective, which includes compliance costs on claimants and administrative costs for Government.

The submitter supports measures that aim to maintain the regime’s sustainability over time. We support the broad direction of the tax reforms in the Bill because simplifications in administration are positive for the tax system as a whole.

#### Comment

Officials welcome the support and agree that sustainability is important. The R&D tax credit rules already contain a number of integrity measures. The proposed refundability cap is also aimed at ensuring the sustainability of the regime.

The systems and processes for claiming the credit have been designed so that wherever possible compliance and administrative costs are minimized while still ensuring the continued integrity and sustainability of the regime.

#### Recommendation

That the submission be noted.

### Issue: Support for stakeholder engagement on proposals before Bill introduced

#### Submission

(Corporate Taxpayers Group, Deloitte)

Submitters appreciated the consultation undertaken prior to the introduction of the Bill, as it means that we have already had the chance to provide feedback on the R&D proposals in the Bill. It has been a constructive process and we have found it particularly useful to understand officials’ specific concerns behind the proposals. This understanding has helped us address these concerns directly and to work with officials to find solutions.

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

## Refundability

(Clause 101 (proposed new sections LA 5(4B), (5B) and (5C)))

### Issue: Support for broader refundability

#### Submission

(EY, Corporate Taxpayers Group, Deloitte, NZRise, Chartered Accountants Australia and New Zealand, New Zealand Technology Industry Association, PwC, KPMG, Pharmaceutical Solutions)

Support broader refundability because it is a necessary incentive for firms in loss, or with insufficient tax to pay, to participate in the regime and increase their R&D activity. It will also help the Government reach its goal of increasing New Zealand R&D expenditure to two percent of GDP over the next ten years.

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Support for refundability cap

#### Submission

(EY, KPMG)

Support having the cap. (*EY, KPMG*)

While some businesses may not be able to receive refunds of all their R&D tax credits because of the cap, the cap is nevertheless a reasonable approach to ensure the integrity of the regime is maintained. (*EY*)

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Changing the name of the cap

#### Submission

(Matter raised by officials)

The name of the cap should change from “payroll-tax based cap” to “refundability cap”. The references to “payroll” in the components of the formula for the cap should, where appropriate, just refer to “tax” (and not refer to payroll).

#### Comment

Officials recommend the name of the cap be changed from “payroll-tax based cap” to “refundability cap” because the current name may cause confusion. Changing the name to “refundability cap” better reflects that the cap applies to R&D tax credit refunds and is made up of the total PAYE, ESCT and FBT paid by a claimant[[2]](#footnote-3) in a given income year.

The same changes should be made to the components of the formula, so that instead of referring to “payroll” they just refer to “tax”. That is, the relevant components of the formula should be “own tax”, “other wholly-owned tax”, and “other controller tax”.

#### Recommendation

That the submission be accepted.

### Issue: Contractors and sweat equity

#### Submission

(Chartered Accountants Australia and New Zealand, PwC)

A payroll tax-based cap is not appropriate, because start-up businesses often use sweat equity or contractors (and do not opt into voluntary withholding) instead of hiring employees. These businesses may not pay payroll taxes. (*Chartered Accountants Australia and New Zealand, PwC*)

A cap is unnecessary because:

* the credit is largely only available for work performed in New Zealand. (*Chartered Accountants Australia and New Zealand*)
* there are sufficient integrity measures in place to prevent fraud, such as in-year approval. (*PwC*)

If the Government is not willing to remove the cap, then a solution would be to extend it to include the tax effect of contractor payments not already subject to schedular tax. (*Chartered Accountants Australia and New Zealand*)

#### Comment

The Bill seeks to broaden access to refundable research and development (R&D) tax credits so that more businesses with insufficient tax liability are able to access support for their R&D expenditure sooner. Without refundable R&D tax credits, firms in a tax loss position or with insufficient income tax liability would be unable to benefit from R&D tax credits for some time, which would reduce the incentive for these firms to perform additional R&D.

The provisions introduced by the Taxation (Research and Development Tax Credits) Act 2019 earlier this year currently allow some businesses to have their R&D tax credits refunded. The rules that currently apply to refundable tax credits, including the corporate eligibility and wage intensity tests, significantly constrain the number of firms that can access this part of the scheme. The value of the tax credits that can be refunded is also capped at $255,000, although any unused credits can be carried forward.

The objective of the R&D tax credit is to support as much genuine R&D as possible while maintaining the integrity of the tax system. This objective has informed the design of the broader refundability rules proposed in the Bill.

The Bill proposes to replace the current refundability rules with a single measure which would cap the maximum amount of R&D tax credits paid out to the total amount of PAYE, fringe benefit tax (FBT), and employer superannuation contribution tax (ESCT) paid in the same income year by the claimant business. PAYE includes schedular payments deducted from contractors’ pay. The cap would apply at the group level. That is, the cap can include amounts of PAYE, FBT, and ESCT paid by firms the claimant is controlled by, and firms in the same wholly-owned corporate group as the claimant (subject to a double dipping rule, which prevents the same amount of tax counting towards more than one claimant’s cap). The cap would not apply to credits claimed by levy bodies, or that relate to eligible R&D expenditure on approved research providers.

The proposal would take effect for the R&D tax credit regime from the 2020−21 income year (“year 2”).

Officials consider a refundability cap necessary to ensure the continued integrity and sustainability of the R&D tax credit regime. It is widely recognised that paying refunds through the tax system increases the risks of fraud. This has been the experience of overseas jurisdictions that offer refundable tax credits, as well as other parts of the New Zealand tax system (such as GST refunds). To counter this risk, all countries that offer refundable tax credits have put in place additional integrity measures. It is common to limit the amount of refund with reference to tax paid by a claimant business.

For example, the UK initially had a payroll-type cap on refundability but removed it. After this they experienced large amounts of R&D tax credit fraud. The UK is now looking to reinstate their cap − earlier this year HM Treasury and HM Revenue & Customs released a consultation document *Preventing abuse of the R&D tax relief for SMEs*.[[3]](#footnote-4)

New Zealand officials discussed our proposal to broaden refundability from year two of the regime with UK officials. UK officials recommended that we introduce the proposed style of refundability cap because it is an effective and efficient deterrent of fraud, and because it is more difficult to introduce a cap once a regime has had uncapped refundability.

Officials considered and discarded other options to manage the increased risks of fraud associated with refundable tax credits including:

* allowing chartered accountants or lawyers to certify that a claimant has a tangible economic presence in New Zealand instead of imposing a refundability cap; and
* a minimum threshold below which claims would be automatically approved.

It was considered that these options could increase complexity and compliance costs as well as administrative costs. In addition, they did not fully address risks associated with refundability. The proposal to limit refunds by the amount of labour-related taxes paid by a business provides a measure of tangible economic presence. This ensures that refunds are only paid to businesses undertaking genuine R&D in New Zealand. The proposed cap is easy for businesses to calculate, thereby providing them with certainty about their claim. It is also simple for Inland Revenue to administer, thereby reducing administrative costs so that effort can be focussed on assessing claims.

Officials acknowledge the cap may mean some R&D performers do not fully benefit from the tax credit. Modelling of the potential impact among current Callaghan Innovation Project Grant recipients indicates the number of affected firms will be small. Chartered Accountants Australia and New Zealand has suggested the cap include the tax effect of contractor payments. This would impose an additional administrative and compliance burden for both Inland Revenue and businesses. The burden associated with calculating the tax effect of payments to potentially multiple contractors per claim, and cross-checking this against the amount claimed by each business, is significantly greater than that imposed by the cap as currently proposed.

With respect to the point about sweat equity, officials note that this is not eligible for the R&D tax credit because the credit is based on actual expenditure incurred. For the same reason, that it would be difficult to verify, officials do not support its inclusion in the cap. Therefore, it would not be appropriate to include it in the calculation.

The R&D tax credit will provide substantial support for businesses’ R&D, but it is not the only measure available to support businesses to increase their investment in R&D. Businesses that may not be eligible for the credit because they spend less than $50,000 a year on R&D (so do not satisfy the minimum threshold), or who are in a tax loss position but have no employees (and therefore cannot access refundable tax credits) may be eligible for R&D grants provided by Callaghan Innovation. This includes the following grants:

* Getting Started Grant: provides a grant for forty percent of eligible expenditure up to $5,000.
* Project Grant: provides a grant for forty percent of eligible expenditure up to $800,000, and then twenty percent after that.

The Callaghan Innovation grants not only offer higher rates of co-funding than the tax credit, but also provide businesses with wrap around support. This includes access to advisory services and Callaghan Innovation’s research and technical experts. MBIE has commenced a review of the wider funding landscape to ensure that these other forms of support complement the R&D tax credit.

Officials will also ensure the refundability cap is reviewed as part of the five-yearly evaluation of the R&D tax credit regime.

#### Recommendation

That the submission be declined.

### Issue: Cashing out non-refundable year one credits in year two

#### Submission

(Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand)

The refundability of non-refundable credits carried forward from year one of the regime to year two needs to be clarified. (*Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand*)

If the proposed new refundability cap (based on payroll taxes) applies to credits carried forward from year one to year two, then year one payroll taxes should be included when calculating the cap on refunding credits carried forward from year one. (*Corporate Taxpayers Group, Deloitte*)

#### Comment

If a claimant in loss (or with insufficient income tax payable to use up its R&D tax credits) cannot refund all of its R&D tax credits in year one, then the claimant can carry forward its non-refundable credits to year two of the R&D tax credit regime. The policy intent is for these year one credits to then be refundable in year two, provided the total number of credits in year two (including any year two credits) does not exceed the total PAYE, ESCT and FBT paid for year two.

Officials agree, however, that allowing PAYE, ESCT, and FBT paid in year one[[4]](#footnote-5) to be taken into account in year two when determining the refundability of year one credits brought forward to year two is sensible. Allowing year one taxes paid to be taken into account in year two would allow claimants to benefit from the scheme more in the first two years of the regime. It is in line with the regime’s goal of incentivizing R&D activity. Officials recommend that this rule apply for year two only. That is, in year three, only year three PAYE, ESCT, and FBT paid will be included in the year three refundability cap, even if non-refundable credits are brought forward from prior years.

Officials recommend that guidance is published on how the proposed new rules would apply to credits brought forward from year one.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

## Wider R&D support mechanisms

### Issue: Wider R&D funding landscape

#### Submission

(EY, Corporate Taxpayers Group, Deloitte, NZRise, Pharmaceutical Solutions, New Zealand Technology Industry Association, PwC)

The R&D Tax Incentive must be considered in combination with a wider package of initiatives to drive innovation in New Zealand. Together, these measures have the potential to help drive innovation, productivity, and economic growth. (*EY, Corporate Taxpayers Group, Deloitte*)

The definition of R&D in the R&D tax credit rules excludes virtually all commercial software development. Growth Grants are ceasing soon, so will no longer be available to support software R&D. (*NZRise, New Zealand Technology Industry Association*)

Other initiatives in the package could better target areas of the economy that do not necessarily fit easily into the R&D tax credit regime, including:

* Software development. (*Corporate Taxpayers Group, Deloitte, New Zealand Technology Industry Association*)
* The digital economy. (*Corporate Taxpayers Group, Deloitte*)
* Start-ups and small-medium sized businesses. (*New Zealand Technology Industry Association*)
* Charities. (*PwC*)
* Clinical trials undertaken by global businesses in New Zealand. (*Pharmaceutical Solutions*)

The Government should continue to engage with the industry and undertake a broad education campaign to ensure businesses are aware of the range of options available beyond tax credits. The Bill presents the Government with an opportunity to:

* make it easier to identify the various grants and other support mechanisms (like the tax credit) that are available to encourage and support firms making investments in R&D;
* grow innovative new businesses; and
* clearly demonstrate to innovative firms how each piece of Government support for R&D is interlinked (in a manner similar to Hong Kong). *(New Zealand Technology Industry Association)*

#### Comment

MBIE has commenced a review of the wider funding landscape, to ensure that other forms of support such as Callaghan Innovation grants complement the R&D Tax Incentive.[[5]](#footnote-6)

Officials recognise that education is critical to increasing business awareness, especially amongst small-medium sized enterprises. Callaghan Innovation has received additional funding to deliver an education and engagement programme to raise awareness of the tax credit and support high quality applications. Callaghan Innovation is New Zealand’s innovation agency, and one of its core functions is to educate businesses about the benefits that R&D creates for businesses. Callaghan Innovation also supports businesses who wish to increase their investment in R&D.

Officials note that online guidance is available, which addresses the eligibility of software development. The guidance provides examples of software development expenditure that may be eligible for the credit.[[6]](#footnote-7)

#### Recommendation

That the submission be noted.

### Issue: Tax barriers to innovative activity

#### Submission

(Corporate Taxpayers Group, Deloitte)

There are existing barriers to innovation in the tax system. These issues include the deductibility of feasibility and black hole expenditure, and the tax loss carry-forward rules. Addressing these issues would help encourage innovative activity in New Zealand.

#### Comment

Officials recognise that these issues may present barriers to innovative activity, and that addressing them would help encourage innovative activity in New Zealand. These issues are on the Government’s tax policy work programme.

#### Recommendation

That the submission be noted.

## Tax-exempt entity exclusion

(Clauses 106 and 107 (proposed new sections LY 3(2)(f) and LY 8(2B))

### Issue: Entities that derive small amounts of exempt income should be eligible

#### Submission

(EY, Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand, KPMG)

The proposed exclusion may apply more broadly than intended because it extends to all entities that receive any exempt income (other than from dividends). As currently drafted, the exclusion prevents some businesses from claiming the credit, even though they only receive small amounts of exempt income and otherwise sit within the tax system. This is inconsistent with the policy intent. (*EY, Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand, KPMG*)

There are various provisions under which otherwise taxpaying entities or individuals may receive exempt income. Receiving income that is exempt under such provisions should not make a potential claimant ineligible. These sections include:

* CW 1: Forestry companies established by the Crown, Māori owners, and holding companies acquiring land with standing timber from founders. (*Corporate Taxpayers Group, Deloitte*)
* CW 1B: Treaty of Waitangi claim settlements – rights to take timber. (*Corporate Taxpayers Group, Deloitte*)
* CW 2: Forestry encouragement agreements. (*Corporate Taxpayers Group, Deloitte*)
* CW 3: Forestry companies and Māori investment companies. (*Corporate Taxpayers Group, Deloitte*)
* CW 26: Jurors’ and witnesses’ fees. (*KPMG*)
* CW 27: Certain income derived by transitional residents. (*KPMG*)
* CW 28: Pensions. (*KPMG*)
* CW 34: Compensation payments. (*KPMG*)
* CW 53: Distributions from complying trusts. (*Corporate Taxpayers Group, Deloitte, KPMG*)
* CW 55: Māori authority distributions. (*KPMG*)
* CW 55BAB: Rebates of fees paid by FIFs. (*Corporate Taxpayers Group, Deloitte*)
* CW 55B: Amounts of exempt income from partners. (*Corporate Taxpayers Group, Deloitte, KPMG*)
* CW 58: Disposal of companies’ own shares. (*Corporate Taxpayers Group, Deloitte, KPMG*)
* CW 59C: Life reinsurance outside New Zealand. (*Corporate Taxpayers Group, Deloitte*)

There needs to be flexibility for the Commissioner to disregard the tax-exempt entity exclusion where the exclusion would prevent businesses that are not the target of this reform from claiming the credit. (*EY*)

A more targeted approach should be taken to appropriately exclude specific entities. (*Corporate Taxpayers Group, Deloitte, KPMG*)

Prefer a more targeted approach to excluding exempt income entities. An alternative rule is excluding “a person whose main source of income is exempt income”. (*KPMG*)

#### Comment

Officials agree that the legislation as currently drafted has some overreach, so does not satisfy the policy intent. The policy intent is for businesses that receive exempt income (such as lines company dividends) but otherwise pay tax to be eligible for the credit.

Officials recommend the legislation is amended so that the exempt entity exclusion is more targeted, rather than being a blanket exclusion that prevents any recipients of exempt income from receiving the credit. Officials prefer this targeted approach which provides more certainty to business and reduces both compliance and administrative costs.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Rationale for tax-exempt entity exclusion acknowledged

#### Submission

(EY)

The submitter acknowledges the rationale for making tax -xempt entities (such as charities) ineligible for refundability and from the R&D tax credit as a whole.

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Eligibility of charities

#### Submission

(Deloitte, KPMG)

Some organisations, such as social enterprises, have eligible R&D activities but are tax exempt. It would be useful to review the tax exempt exclusion to ensure these organisations are not disadvantaged from participating in R&D. (*Deloitte*)

Charities should be eligible for the R&D tax credit and refundability. The fact that they are not “income” taxpayers does not alter the logic for their entitlement to the credit. The R&D tax credit is delivered through the tax system because it is agnostic to activities and businesses. Any changes to the eligibility of charities should be subject to the full Generic Tax Policy Process and public consultation, with changes applicable only from the 2021−22 income year onwards. Bypassing this wider consultation raises serious questions about the process followed for such a fundamental change to the scope of the R&D tax credit regime. (*KPMG*)

#### Comment

Throughout the policy development process of the R&D tax credit officials have signalled that it was uncertain whether charities and other social enterprises would be eligible for the R&D tax credit.

The Taxation (Research and Development Tax Credits) Act 2019 introduced provisions that allow charities to claim the R&D tax credit in year one of the regime, but does not provide charities with any way to cash-out their credits. This makes the credits effectively unusable for charities because they do not pay income tax (and non-refundable credits can only be used to offset a claimant’s income tax payable, with any remaining credits able to be carried forward to the next income year only if shareholder continuity requirements are satisfied). This means that while charities can claim the credit in year one, they cannot benefit from the credit unless changes are made to the refundability rules for charities.

Officials engaged with charities and other tax-exempt entities at various workshops early this year, where the current eligibility of these entities for the credit was expressly discussed. Officials made it clear to participants that the eligibility of charities for the credit from year two of the regime was under consideration, and that it was possible they would not continue to be eligible for the regime (and that they may never be able to cash out any credits claimed in year one).

Charities do not pay income tax and receive additional Governmental support in the form of GST concessions, an exemption from FBT, and the donor tax credit regime. Tax-exempt entities such as charities sit outside the tax system, so it is not appropriate for them to also benefit from incentives provided from within the tax system. This approach was reflected in the initial uncertainty of charities’ eligibility, which has been communicated by officials to tax-exempt entities.

The proposed new tax-exempt entity exclusion does not extend to associates or entities controlled by a tax-exempt entity. This means that from year two of the regime, tax exempt enterprises will be able to continue accessing the credit through their wholly or partially-owned subsidiaries, provided they do not register these subsidiaries as charities.

#### Recommendation

That the submission be declined.

### Issue: Credits carried forward by excluded entities and definition of levy body researcher

#### Submission

(Chartered Accountants Australia and New Zealand)

Support the amendment to section LY 8, which ensures that tax-exempt entities ineligible from year two will not be able to carry forward their year one R&D tax credits. Also support the proposed definition of levy body researcher in section YA 1.

#### Comment

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Eligibility of Māori enterprises

#### Submission

(Deloitte)

The tax-exempt entity exclusion highlights the challenges faced by some Māori enterprises that may have eligible R&D activities but be tax exempt. It would be useful to review the credit to ensure Māori enterprises are not disadvantaged from participating in R&D because of a lack of legal recognition of organisations using business models to address social and environmental issues.

#### Comment

Officials understand that there is some concern that Māori enterprises may be ineligible for the credit because they are charitable or may have charitable entities within their group structure.

Officials have already reviewed the proposed tax-exempt entity exclusion to ensure it does not prevent Māori enterprises from accessing the credit. This review included discussions regarding the proposed exclusion with both internal and external experts on Māori enterprises, charities, and subpart CW of the Income Tax Act 2007.

Under section CW 42 of the Income Tax Act 2007, income derived by a tax charity is tax exempt. “Tax charity” is defined to include registered charities and unregistered charities that carry on business for (or for the benefit of) a registered charity.

From 1 April 2020, a new tax provision is coming into force which means an entity will only be able to use the section CW 42 tax exemption if the entity is a registered charity. This is the case even where the entity is wholly owned by a registered charity. This means that entities owned by charitable, tax-exempt Māori enterprises will soon have the flexibility to choose whether the CW 42 tax exemption will apply to them.

The proposed new tax-exempt entity exclusion does not extend to associates or entities controlled by a tax-exempt entity. This means that from year two of the regime, tax exempt enterprises will be able to continue accessing the credit through their wholly- or partially-owned subsidiaries, provided they do not register these subsidiaries as charities.[[7]](#footnote-8)

#### Recommendation

That the submission be noted.

## Administration

Clauses 105, 122, 123, 128, 145 (sections LY 1, 46, 108, 113E, and 138E)

### Issue: Timeframe for completing disputes process

#### Submission

(EY, Chartered Accountants Australia and New Zealand)

Support the amendment about the timeframe for completing the disputes process.

#### Comment

The proposed amendments to sections 108(1E) and 113E of the Tax Administration Act 1994 will allow the Commissioner to adjust a person’s R&D tax credit claim upwards if the person has initiated the disputes process through issuing a notice of proposed adjustment (NOPA) before the earlier of:

* four months of filing their income tax return; or
* a year after their income tax return due date.

The legislation currently requires a person to **complete** the disputes process within a year of their income tax return due date. The policy intent is for the person to **initiate** the process within the earlier of their income tax return due date or four months of filing the return, but not for the person to have to complete the disputes process within this timeframe. Therefore, the proposed amendments would ensure the legislation satisfies the policy intent.

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Challenging the Commissioner’s decisions

#### Submission

(EY, Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand)

Support the amendment about challenging the Commissioner’s decisions. (*EY, Chartered Accountants Australia and New Zealand*)

There should be transparency as to why an application might be declined in respect of applications to exceed the $120 million cap. Officials should work closely with an organisation to determine whether the Commissioner might apply her discretion. (*Corporate Taxpayers Group, Deloitte*)

#### Comment

The Bill proposes an amendment to prevent a person from challenging the Commissioner’s decisions regarding the pilot approval scheme and exceeding the $120 million eligible expenditure cap. The amendment brings these parts of the R&D tax credit regime into line with other Commissioner decisions regarding R&D, such as whether an entity can be an approved research provider, the in-year approval of activities that will apply from year two, and whether an entity can be an R&D certifier. This amendment does not prevent a person from applying for judicial review of the Commissioner’s decision.

Officials welcome the support for this amendment and agree that there should be transparency regarding why an application to exceed the $120 million cap might be declined. Officials recommend that guidance be published on the process involved in applying the exceed the $120 million cap, so that potential applicants understand what is required and can prepare their applications accordingly. As with other parts of the R&D tax credit regime that involve the Commissioner exercising discretion, officials will contact each applicant before their application is declined. They will also provide applicants with the opportunity to supply additional information in support of their applications, before they are declined, if appropriate.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Allocating credits to joint venture members

#### Submission

(EY, Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand,

We support the amendment regarding allocating credits to joint venture members. (*EY, Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand*)

The amendment ensures the rules are in line with how joint ventures operate in practice. (*Corporate Taxpayers Group, Deloitte*)

#### Comment

The Bill proposes an amendment to correct the allocation of R&D tax credits claimed for R&D activities performed by joint ventures, so that these credits are allocated in accordance with members’ interests in the joint venture (rather than members’ interests in the income of the joint venture, which is impractical for joint ventures that do not derive income).

Officials welcome the support.

#### Recommendation

That the submission be noted.

### Issue: Cost of claiming credits

#### Submission

(New Zealand Technology Association, Red Crater Software)

Concerned that the R&D tax credit claims process may have excessive compliance costs for businesses. (*New Zealand Technology Association, Red Crater Software*)

The administrative and compliance costs of the R&D tax credit currently outweigh its value. Instead of the current R&D tax credit claims process, it would be faster and easier if a representative worked through only the most necessary information required one-on-one with us, either in person or on the phone. (*Red Crater Software*)

Since in-year payments are not available under the R&D tax credit but are available under the existing Callaghan Innovation grants regimes, businesses are more likely to perceive that the credit has high compliance costs. (*New Zealand Technology Association*)

#### Comment

Officials recognise that there will be compliance costs associated with claiming the R&D tax credit, but compliance costs need to be balanced against the need for integrity and sustainability. The credit has been designed with various integrity measures to help ensure the credit’s sustainability. Some of these measures mean claimants will be required to provide the Government with information as part of the claims process.

The intent is that claimants should only be required to provide information they would generate as part of their usual business processes wherever possible. This may involve claimants assembling the information required to make an R&D tax credit claim but should not require the creation of new information just to satisfy the requirements of the R&D tax credit regime.

#### Recommendation

That the submission be noted, subject to officials’ comments.

## Entity eligibility criteria

(Clause 106 (section LY 3))

### Issue: Tertiary education organisation exclusion

#### Submission

(Matter raised by officials)

The legislation should be amended so that it is clear that foreign tertiary education organisations are ineligible for the credit, regardless of whether they are registered in New Zealand.

#### Comment

The legislation as currently enacted should exclude foreign tertiary education organisations but officials agree that it should be amended so that it is clear they are ineligible. This exclusion should include the organisations themselves, entities they are directly or indirectly controlled by, and entities they are associated with. This amendment would apply from year one of the regime (so from the 2019−20 income year), so that it can be incorporated into the processing and administration of year one claims.

#### Recommendation

That the submission be accepted.

### Issue: Fixed establishment and in-business requirement

#### Submission

(Pharmaceutical Solutions)

The general entity eligibility criteria for the credit are too narrow, so make it harder to qualify for the credit when compared with the Australian R&D tax credit regime. The Australian regime only requires foreign claimants to have at least one resident director and allows a business to be eligible even if it only has a virtual presence. This is an easy requirement to meet.

On the other hand, the New Zealand regime requires foreign claimants to have a fixed establishment and operate a substantial business in New Zealand. This currently does not occur with clinical trials, which means that many foreign companies that run clinical trials in New Zealand will not be able to access the credit.

The credit should be available to foreign businesses with no fixed establishment or substantial business in New Zealand, because the R&D these businesses do in New Zealand through clinical trials provides the same benefits and spill-over effects to New Zealand. Clinical trials are considered the backbone of R&D in the life sciences industry.

#### Comment

Officials have met with and discussed New Zealand’s R&D tax credit regime with officials from other jurisdictions as part of the policy development process. The New Zealand regime has been designed with integrity and sustainability in mind, taking into account issues that have arisen in other jurisdictions.

Officials consider the fixed establishment and in-business requirements necessary to help ensure the continued integrity and sustainability of the regime. Removing these requirements would potentially enable claimants with little presence in, or connection with, New Zealand to claim the credit.

Claimants with no fixed establishment in New Zealand are unlikely to pay income tax in New Zealand, so would need to receive refundable credits to derive any benefit from the R&D tax credit regime. Refunding credits to such claimants is particularly risky because the claimants’ lack of New Zealand presence would make it difficult to ensure any overpaid refundable credits are paid back to the Commissioner (for example, if a fraudulent or excessive claim is made that is later reassessed downwards).

Officials note that there are benefits to clinical trials being undertaken in New Zealand but consider that support might be better targeted through other mechanisms such as grants.

#### Recommendation

That the submission be declined.

### Issue: Excluding Growth Grant recipients

#### Submission

(Corporate Taxpayers Group, Deloitte)

The inclusion of an association test means that shareholders in a company that receives a Growth Grant are ineligible for the R&D tax credit regime for the remaining duration of the Growth Grant scheme. There are enough measures within the R&D tax credit rules already to prevent double dipping – this additional exclusion is unnecessary.

The exclusion creates a significant area of ineligibility that was not previously included when the Taxation (Research and Development Tax Credits) Act 2019 was first introduced, nor was it submitted on or covered in the officials’ report on that legislation.

We prefer removing the association rule to a grandfathering approach (which officials have previously indicated to the Corporate Taxpayers Group is their preference, should a change be made), because a grandfathering rule would be unnecessarily complex.

It does not make sense for eligible R&D undertaken by an entity to become ineligible when it later makes a separate investment into an entity which receives a Growth Grant. This change prevents access to capital needed by innovative firms, because it discourages recipients of R&D tax credits from investing in Growth Grant recipients as doing so means they can no longer access R&D tax credits. This may limit the extent to which companies are prepared to invest in Growth Grant recipients and the growth of Growth Grant recipients.

An announcement or other action should be taken to provide comfort to affected taxpayers that this rule will be amended, before the Select Committee reports back on the Bill. This will enable affected businesses to know whether they will be eligible for the regime, and if so, whether they should be keeping records of their R&D to meet the requirements.

It is not practical for these businesses to have to wait until Select Committee reports back to find out whether they will be eligible because:

* the regime already applies for affected businesses in the Corporate Taxpayers Group;
* a significant amount of work is required to bring businesses up to speed with the R&D tax credit rules; and
* the credit has contemporaneous documentation requirements.

#### Comment

A person cannot currently claim the credit if they:

(i) receive a Callaghan Innovation Growth Grant;

(ii) are directly or indirectly controlled by a Growth Grant recipient; or

(iii) are associated with a Growth Grant recipient.

The Taxation (Research and Development Tax Credits) Bill as introduced only contained the rule in (i) above, with rules (ii) and (ii) introduced at Select Committee.

These two additional limbs were introduced to prevent Growth Grant recipients from artificially structuring so that they could claim both the credit and the Growth Grant at the same time. The policy intent is that a person can only claim either the credit or the Growth Grant, because the credit is intended to replace the Growth Grant regime.

Officials acknowledge that adding limbs (ii) and (iii) to the Growth Grants exclusion at the Select Committee stage may have had effects beyond what was intended by the Government. Some businesses may have entered into arrangements in reliance on the Growth Grants exclusion in the Taxation (Research and Development Tax Credits) Bill as introduced, prior to the Select Committee report back on 3 April 2019.

While officials recognise that a grandfathering approach involves more complexity than removing the association rule altogether, officials consider the association rule necessary to prevent businesses deliberately structuring themselves so that they can claim both the credit and the Growth Grant. Therefore, officials recommend:

* that the rule in the Taxation (Research and Development Tax Credits) Bill as introduced (just limb (i) above) apply before the date the Select Committee reported back, so that businesses who entered into arrangements in reliance on the rule in the Taxation (Research and Development Tax Credits) Bill as introduced can still access the credit; and
* that the rule that is currently in place (which includes all three limbs above) apply from the date Select Committee reported back, to ensure businesses cannot structure themselves to get around the Growth Grant exclusion (and claim both the credit and the Growth Grant).

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Callaghan Innovation ineligible for the R&D tax credit

#### Submission

(Matter raised by officials)

Callaghan Innovation should not be eligible for the R&D tax credit. Nor should entities directly or indirectly controlled by Callaghan Innovation, or associated with Callaghan Innovation be eligible.

#### Comment

Callaghan Innovation is a Government agency and is helping Inland Revenue administer the R&D tax credit regime. For the avoidance of doubt, officials recommend a new provision that ensures Callaghan Innovation, entities it controls, and any of its associates cannot claim the R&D tax credit. This amendment would apply from year one of the R&D tax credit regime (the 2019−20 income year), so that it can be incorporated into the processing and administration of year one claims.

#### Recommendation

That the submission be accepted.

## In-year approval

(Clause 127 (schedule 21, sections 68CB, 68CC, and 124ZI))

### Issue: R&D certifier approvals and applications

#### Submission

(EY, Chartered Accountants Australia and New Zealand, PwC)

Support the amendments about R&D certifier approvals and applications. (*EY, Chartered Accountants Australia and New Zealand, PwC*)

There should be a clear process or framework for those businesses potentially affected by the revocation of their R&D certifier, noting that those businesses would have been responsible and compliant. Therefore, they should not be adversely impacted. *(Pw*C)

#### Comment

Officials welcome the support. Officials agree that there should be a clear process or framework for businesses potentially affected by an R&D certifier’s status being revoked. Officials recommend that guidance be published on this issue.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: General approval binds the Commissioner

#### Submission

(Matter raised by officials)

General approval should be binding on the Commissioner.

#### Comment

Binding approval will provide businesses with the certainty that their activities are eligible earlier in the claims process. However, general approval is not currently legally binding on the Commissioner. Therefore, it is possible for the Commissioner to change her view as to whether an activity is a core or supporting activity, even if it has been approved as part of the general approval process. This is contrary to the policy intent, which is for general approval to be binding on the Commissioner.

Officials recommend the legislation be amended so that general approval is binding on the Commissioner. This amendment would apply from year one of the R&D tax credit regime (the 2019−20 income year) for the general approval pilot, and from year two of the R&D tax credit regime for general approval once it is rolled out for all customers (from the 2020−21 income year), so that it can be incorporated into the processing of relevant year one claims and the administration of the tax credit from year two.

#### Recommendation

That the submission be accepted.

### Issue: Clarifying the scope of general approval in relation to supporting activities

#### Submission

(Matter raised by officials)

Schedule 21, part B does not currently specify that supporting activities are ineligible if they have not been approved. It should be amended to clarify this.

#### Comment

Various amendments were made to the Taxation (Research and Development Tax Credits) Bill in response to submissions made to the Select Committee earlier this year. This included an amendment to the scope of general approval. In the Taxation (Research and Development Tax Credits) Bill as introduced, general approval only applied to core activities.

At the Select Committee stage, the proposed legislation was amended following submissions requesting general approval be extended to cover supporting activities as well. This was to provide businesses with added certainty that their R&D would be eligible for the credit. A clause equivalent to schedule 21, part A, clause 24 should have been added into schedule 21, part B at the time these other changes were made.

Officials recommend that a clause be added into schedule 21, part B to clarify that supporting activities are ineligible if they have not been approved. This amendment would apply from year two of the R&D tax credit regime (the 2020−21 income year), so that it can be incorporated into the administration of the tax credit once in-year approval is rolled out in year two.

#### Recommendation

That the submission be accepted.

### Issue: Criteria and methodologies approval mandatory for significant performers

#### Submission

(Matter raised by officials)

Criteria and methodologies approval (CAM) should be mandatory for businesses that choose to opt out of the general approval regime.

#### Comment

From year two of the R&D tax credit regime, all businesses will be required to obtain general approval or, if they qualify, opt into the significant performer regime. A business can be eligible for the significant performer regime if it reasonably expects to have more than $2 million of eligible R&D expenditure for the relevant income year. The significant performer regime is intended to provide large R&D performers with an alternative to the general approval regime, because the compliance and administrative costs associated with obtaining general approval for large amounts of R&D activities may outweigh the benefit of the R&D tax credit for these businesses.

It is recognized, however, that businesses who spend significant amounts on R&D will still want certainty regarding their R&D tax credit claims. This led to the creation of the CAM regime, which is optional for businesses in the significant performer regime. Businesses in the significant performer regime can apply for CAM if they want to obtain approval from Inland Revenue that their R&D systems and processes are appropriate for determining the eligibility of R&D activities and expenditure.

Without general approval or CAM, businesses in the significant performer regime have no way of knowing for certain whether their activities or expenditure are eligible until they file their income tax and R&D supplementary returns.

At recent meetings with the Research and Development Advisory Group (RDAG)[[8]](#footnote-9) and other key external stakeholders, officials were advised that CAM should be mandatory for significant performers. This was for these reasons:

* Businesses who opt out of general approval (which is mandatory for businesses that are not in the significant performer regime) but do not have CAM will have no certainty that their R&D will be eligible for the incentive.[[9]](#footnote-10) This is because they will not have general approval and will not have CAM. It is expected that most businesses in the significant performer regime who are legitimately performing R&D will want CAM because of this.
* Some stakeholders had always thought CAM would be mandatory and were surprised to discover it was optional.
* Businesses in the significant performer regime are required to obtain R&D certificates from R&D certifiers that they have complied with the R&D tax credit rules. Providing an R&D certificate to a business with no CAM involves significantly more work for a certifier, because the certifier would have to:

1. Identify the systems and processes the business has in place;
2. determine whether these systems and processes would enable compliance with the R&D tax credit rules; and
3. test samples of the business’s claim to determine whether they satisfy the R&D tax credit rules.

On the other hand, if a business has CAM, (i) and (ii) above will have been completed by the R&D core team working with the business as part of the CAM process. Only (iii) would need to be completed by a certifier, who would also be tasked with checking whether the business has complied with their CAM.[[10]](#footnote-11) Therefore, the cost obtaining an R&D certificate is expected to be comparatively greater for non-CAM significant performers.

* R&D advisors have indicated that they are comfortable certifying whether businesses have complied with the requirements of their CAM, but that they may not be willing to certify much beyond this because of the risk associated with erroneously providing an R&D certificate to a business who has not complied with the rules.[[11]](#footnote-12) This means it may be difficult to find certifiers willing to provide R&D certificates to non-CAM businesses in the significant performer regime.
* Businesses in the significant performer regime who do not have CAM will not have early engagement with officials, which means that more scrutiny will have to be applied later in the claims process. This is not ideal for businesses, because if they have reduced their provisional tax payments expecting to receive a certain amount of R&D tax credits for a given year, the reassessment of their R&D tax credit claim could lead to the imposition of penalties and interest.

Officials agree with the points raised by stakeholders. Officials recommend that CAM is amended so that it is mandatory for businesses that opt into the significant performer regime. Officials also recommend that additional guidance is published on CAM and the R&D certifier process. This amendment would apply from year two of the R&D tax credit regime (the 2020−21 income year), so that it can be incorporated into the administration of the tax credit once in-year approval is rolled out in year two of the regime.

#### Recommendation

That the submission be accepted.

## Other R&D submissions

***(Clause 113(5) (schedule 21B, sections LY 2, YA 1 and 124ZH))***

### Issue: Eligibility of software

#### Submission

(NZRise, New Zealand Technology Industry Association)

The definition of R&D may exclude a lot of software R&D. It does not incorporate a novelty or innovation test, which currently enables some software R&D to be eligible for the Callaghan Innovation Growth Grant. (*NZRise, New Zealand Technology Industry Association*)

Further consideration should be given to the definition of eligible R&D for software R&D. As it stands, Australia may offer a more favourable environment for software R&D, so this creates the risk of exporting companies shifting their R&D from New Zealand to Australia. (*NZRise*)

New Zealand’s definition expressly excludes elements of the Frascati definition, such as experimental development and activities. Most other jurisdictions use the Frascati definition of R&D. (*New Zealand Technology Industry Association*)

#### Comment

In developing the tax credit and associated policies, such as the transitional arrangements for Callaghan Innovation Growth Grant recipients, the Government has wanted to minimise any disruption to R&D performers. In switching from one scheme to another, however, it is not possible to guarantee that all firms will get the same support as they did with the Growth Grant. There are inherent differences between a tax credit and a grant.

Some firms may be entitled to less money under the R&D tax credit, while other firms may be entitled to more than they would have received under the Growth Grant. Overall, the Government considers that the settings within the tax credit will mean that a greater amount of support to a larger number of R&D performers will be provided.

Officials consider that the current definition adequately incentivises software development. Widening the definition, such as by introducing a novelty test, would create an easier test and may let in activities of the kind that the Government does not wish to incentivise. Officials have already made changes to the definition from what was originally proposed in the discussion document by dropping the requirement that the R&D is conducted using a scientific method, in order to better accommodate software development. By introducing a novelty test, a claimant could qualify where they have created something “new”, without it necessarily incorporating the degree of difficulty and risk required by the uncertainty concept (that is, being “hard”).

New Zealand’s R&D activity definition is based on the Frascati definition of R&D. The Frascati manual provides that for an activity to be an R&D activity, it has to be novel, creative, uncertain, systematic, and transferrable/reproducible. All five of these criteria have to be satisfied.[[12]](#footnote-13) Similar to Frascati, New Zealand’s core activity definition requires the use of a systematic approach, an intention to create new knowledge or things, and the resolution of uncertainty.

The New Zealand definition is comparable with definitions used by other jurisdictions including Australia and Canada. Other jurisdictions with a similar R&D activity definition to the one proposed in New Zealand support a considerable amount of software related R&D. Officials expect this outcome in New Zealand, but the credit will not support all software development activities.[[13]](#footnote-14)

#### Recommendation

That the submission be declined.

### Issue: Approved research providers

#### Submission

*(Matter raised by officials)*

To be eligible to become an approved research provider, an entity must be capable of performing core R&D activities.

#### Comment

Under the legislation as currently enacted, an entity can technically apply to become an approved research provider for the R&D tax credit regime if it performs core **or** supporting activities in New Zealand. Officials are concerned that this is too easy a threshold to meet, as a supporting activity just has to be inextricably linked to a core activity without necessarily involving any scientific or technological uncertainty in its own right.

There are benefits associated with being an approved research provider. There is a special rule for expenditure on approved research providers in relation to the proposed new refundability cap. Businesses can also claim expenditure on an approved research provider despite being under the $50,000 minimum threshold. These benefits may make the approved research provider regime an attractive way of getting around the cap or the minimum threshold.

Officials therefore recommend that to be eligible to become an approved research provider an entity must at a minimum be able to perform core activities on behalf of R&D tax credit claimants. This amendment would apply from year one of the R&D tax credit regime (the 2019−20 income year), so that it can incorporated into the processing and administration of year one claims.

#### Recommendation

That the submission be accepted.

### Issue: Internal software development expenditure

#### Submission

(EY, Chartered Accountants Australia and New Zealand, Deloitte)

Support the amendment to the definition of internal software development. (*EY, Chartered Accountants Australia and New Zealand*)

It would be useful to update the R&D tax credit guidance to include some examples of affected expenditure for clarity. (*Deloitte*)

#### Comment

The Bill proposes an amendment to clarify the definition of internal software development expenditure, to make it clear what expenditure is subject to the $25 million internal software development expenditure cap.

Officials welcome the support for this amendment. Officials also recommend updating the guidance to include examples of affected expenditure for clarity.

#### Recommendation

That the submission be accepted.

### Issue: Eligibility of expenditure on creating depreciable tangible property

#### Submission

(Corporate Taxpayers Group, Deloitte)

R&D expenditure that contributes towards the cost of depreciable tangible property should be eligible for the R&D tax credit because it is true R&D expenditure. The R&D regime is intended to incentivise R&D expenditure in New Zealand, but many organisations are finding this exclusion a significant barrier to their entry into the regime. We want to continue working with officials to develop an appropriate rule.

#### Comment

R&D expenditure that contributes towards the cost of creating depreciable tangible property is currently ineligible for the R&D tax credit. The rationale for this exclusion is the fiscal risk associated with R&D claimed in relation to creating large assets such as bridges and dams. Despite the exclusion, the cost of creating prototypes can be eligible, as can the depreciation associated with using an asset in subsequent eligible R&D.

Officials look forward to continuing to work with the Corporate Taxpayers Group, Deloitte and other stakeholders on this issue.

#### Recommendation

That the submission be noted.

# Other policy and remedial changes

## Refunding overpaid PIE tax

(Clause 99)

### Issue: No symmetry between overpayment and underpayment of PIE tax

#### Submission

(David McLay)

The proposed changes enhance the over taxation of investors in PIEs by not proposing symmetrical tax treatment for overpayments and underpayments that arise from the use of an incorrect prescribed investor rate (PIR). Current law enables Inland Revenue to impose additional tax on investors who specify a rate that is too low, but do not allow for any refund for investors who provide a PIR that is too high.

The submitter proposes a mechanism should be introduced to provide a form of refund for an over-taxed PIE investor and suggests a refundable tax credit for the individual investor to achieve this.

#### Comment

The PIE income attributed to an investor in a multi-rate PIE is generally excluded income to the investor. This means that the PIE income is not taken into account when calculating the investor’s income tax liability. Overpaid PIE tax cannot be refunded.

However, where tax on PIE income has been underpaid because the investor has notified a rate that is lower than their actual PIR, the PIE income ceases to be excluded income. It is required to be included in the investor’s assessable income and taxed at the investor’s marginal tax rate. A tax credit is given for the PIE tax that has already been paid.

Officials agree that a mechanism to provide a form of refund for an over-taxed PIE investor and create symmetry between over and underpayment of tax on PIE income is desirable. However, officials recommend a different mechanism to achieve this than the one suggested by the submitter. This is because mirroring the current legislative treatment of underpayment would in some cases result in inequitable outcomes for the taxpayer.

To achieve refundability of overpaid tax on PIE income and symmetry between over and underpayments, officials recommend that a year-end square-up process for all individual investors in multi-rate PIEs is introduced, regardless of whether tax on PIE income has been correctly, over- or under-withheld during the tax year.

This square-up would apply the correct PIR to the PIE income to determine the PIE tax payable. The PIE tax that had been deducted during the tax year would be a tax credit against the PIE tax payable. Any refund due or tax payable would be added to the person’s end of year tax position and would either be refunded, payable or reduce the person’s tax payable. This would address any over- or underpayment of PIE tax during the tax year.

This recommended square up would mean a change compared to the current treatment for investors who have notified a PIR that is too low. Their PIE income would no longer be subject to their marginal tax rates, but instead to their correct PIR.

It is recommended that this change apply from the 2020−21 tax year.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

## Widening the Commissioner’s power to put people on the correct prescribed investor rate

(Clause 99)

### Issue: Support for the proposal

#### Submission

(AMP Capital, ANZ, Chartered Accountants Australia and New Zealand, EY, Financial Services Council)

The submitters supported Inland Revenue being able to correct an investor’s prescribed investor rate (PIR), by advising the investor’s portfolio investor entity (PIE) of the correct rate to apply.

A number of submitters caveated their support with specific concerns, which are set out below.

#### Comment

Officials welcome the support. The report notes the specific concerns raised by submitters as separate issues.

#### Recommendation

That the submitters’ support be noted.

### Issue: Further widening the Commissioner’s powers to put people on correct prescribed investor rate

#### Submission

(Matter raised by officials)

Officials recommend further widening Inland Revenue’s ability under section HM 60 of the Income Tax Act 2007 so that it can proactively provide PIEs with their investors’ PIRs when Inland Revenue holds sufficient information.

#### Comment

Under section HM 60 of the Income Tax Act 2007 Inland Revenue can provide the PIR it considers appropriate for an investor directly to a PIE if Inland Revenue thinks the rate the investor has notified is incorrect. The Bill as introduced widens this ability to include situations when a PIE investor has not notified a rate and has defaulted onto the top PIR of 28%. However, under the new section HM 60 for new members of PIEs, there would have to be at least one incidence of using a wrong PIR for the new investor, before Inland Revenue could determine that the rate used is incorrect and can notify the PIE of the correct PIR.

Officials therefore recommend further widening Inland Revenue’s ability to provide PIEs with their investors’ correct PIRs. This would enable Inland Revenue to pro-actively provide PIRs for all investors to the PIE providers where Inland Revenue holds sufficient information to determine the PIR applicable for the tax year.

Officials recommend that this change apply from 1 April 2020.

#### Recommendation

That the submission be accepted.

### Issue: 1 April 2020 application date should be deferred

#### Submission

(AMP Capital, Corporate Taxpayers Group)

Submitters sought a deferral of the 1 April 2020 application date of the change, noting that sufficient lead-in time is required for PIE providers to analyse Inland Revenue’s build specification, make IT and system changes and to educate frontline staff.

Submitters also noted that PIEs are busy with PIE end-of-year assessments during April of each year and therefore changing investors’ PIE tax rates at this time is not optimal.

#### Comment

Officials note that under section HM 60 of the Income Tax Act 2007 Inland Revenue has had the ability to advise PIEs where certain investors appear to be on an incorrect PIR, since the introduction of the PIE regime in 2007. Therefore, the proposed amendments would simply be widening the situations when Inland Revenue was permitted to communicate an investor’s PIR to a PIE. However, officials do recognise that the pre-existing power in section HM 60 of the Income Tax Act 2007 had not been widely used and, as a result, the amendment will require PIEs to make changes to their systems. Inland Revenue is currently engaging with PIE providers about the design of these changes.

There are currently a large number of PIE investors who are being taxed at an incorrect PIR. The proposed change would help to address this issue and therefore, benefit a significant number of PIE investors (including KiwiSaver members). Delaying this change would prolong the issue of investors being taxed at an incorrect PIR. Therefore, the earliest reasonably possible implementation date is needed.

Officials also note that although the change will apply from 1 April 2020, in practical terms, Inland Revenue is not likely to have sufficient information to determine correct PIRs for the tax year until at least June 2020. Advising PIEs of their investors’ correct PIRs will be actioned after that.

#### Recommendation

That the submission be declined

### Issue: Clarification about liability for under and over paid tax for investors on Commissioner advised rate

#### Submission

(AMP Capital, Corporate Taxpayers Group, Financial Services Council, EY)

Submitters sought clarity about who would be liable for under or over deducted PIE tax, where the Commissioner had inadvertently advised the PIE to apply an incorrect tax rate.

Two submitters noted a PIE investor’s experience is likely to be adversely impacted if the investor were to end up having income tax filing obligations, as a result of an incorrect rate advised by Inland Revenue. (*AMP Capital, Corporate Taxpayers Group*)

#### Comment

The proposed change to refund overpaid PIE tax, in this report would mean that all PIE income is subject to an end of year square-up. Where an investor’s PIE income was taxed at an incorrect rate based on information provided by the Commissioner, the over or under paid PIE tax would be squared up at the end of the tax year. If adopted, this proposal would address the concerns raised by submitters. For most investors the square-up would happen automatically and they would not be required to do anything. For investors who are required to file an income tax return for their other income, the PIE income information Inland Revenue holds would be pre-populated into their income tax profile to be available when they file their income tax return.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Increased engagement about operationalisation of proposal

#### Submission

(ANZ, Financial Services Council)

Noting that the change would have impacts for PIEs’ IT systems and collateral, submitters sought increased engagement from Inland Revenue around the design and operational process for sharing PIR information with PIEs.

#### Comment

Inland Revenue is currently engaging with PIE providers on the changes proposed. This engagement will continue with an increased focus on the operational design of the proposal and the practical application of the change.

#### Recommendation

That the submission be accepted.

### Issue: Notifying an investor of a change to the PIR

#### Submission

(Chartered Accountants Australia New Zealand, Financial Services Council)

Inland Revenue should notify a PIE investor where they are being placed on a different PIE tax rate. (*Chartered Accountants Australia New Zealand*)

Another submitter sought clarity about who would be responsible for notifying members that their PIE tax rate had been updated. (*Financial Services Council*)

#### Comment

During the current tax year Inland Revenue has been notifying investors directly where, based on information Inland Revenue holds, it appears they are being taxed at an incorrect PIR. When Inland Revenue begins notifying the PIE directly to change the investors’ PIR, Inland Revenue would also advise the investors that it has instructed their PIE to change their PIR.

#### Recommendation

That the submission be accepted.

### Issue: Ultimate responsibility for determining the PIR

#### Submission

(ANZ, Financial Services Council)

Where Inland Revenue had advised a PIE of a tax rate to apply, the investor would still be able to subsequently advise the PIE to apply a different tax rate to the one supplied by Inland Revenue. The submitters recommended that instead Inland Revenue should be responsible for mandating an investor’s PIE tax rate (that is, an investor should not have the ability to advise their PIE to disregard a tax rate supplied by Inland Revenue).

#### Comment

Although officials are proposing that Inland Revenue would provide investors’ PIRs to PIEs, the ultimate responsibility for determining whether their PIE income is being taxed at the correct rate should remain with the investor. There will also be some instances where an investor has information relevant to determining their correct PIR that has not yet been made available to Inland Revenue. Therefore, an investor should have the ability to update their PIR in accordance with this additional information.

#### Recommendation

That the submission be declined.

### Issue: Process required where Inland Revenue recommends the wrong rate

#### Submission

(Chartered Accountants Australia New Zealand, EY)

Inland Revenue should implement a process to allow an investor to notify Inland Revenue where the rate Inland Revenue advised the PIE to apply is incorrect, to avoid the same change being made each year. (*Chartered Accountants Australia New Zealand*)

Another submitter recommended that the PIE should be required to notify Inland Revenue if an investor had subsequently changed their PIR after a rate had been advised by the Inland Revenue. (EY)

#### Comment

Under current information provision requirements, the situation envisioned by the submitters is unlikely to arise. PIEs are already required to annually report notified investor rate information to Inland Revenue. Officials consider that this information is likely to be sufficient for Inland Revenue to identify where an investor has subsequently changed their PIE tax rate after Inland Revenue has advised the PIE of a rate to apply.

An investor in a PIE has one correct PIR for a tax year. This PIR is determined by the investor’s taxable income and their PIE income for the last two income years before the tax year in which the PIR is to be applied. The PIR can change from year to year, if the investor’s relevant income passes a threshold. If Inland Revenue has the investor’s relevant income information, it will be able to determine the applicable PIR for the investor for the tax year.

#### Recommendation

That the submission be declined.

### Issue: Require PIEs to report PIR information to Inland Revenue on a semi-regular basis

#### Submission

(EY)

PIEs (in particular KiwiSaver PIEs) should be required to report PIRs used by their members to Inland Revenue on a semi-regular basis (monthly or quarterly), to assist Inland Revenue in the earlier identification of incorrect PIR usage.

#### Comment

PIEs are currently required to report notified investor rates to Inland Revenue annually. As an investor’s PIR is set with reference to their two prior years’ income, this annual reporting requirement is likely to be sufficient for most existing PIE investors. Therefore, officials consider that the additional reporting burden this recommendation would create for PIEs would likely outweigh its benefits.

#### Recommendation

That the submission be declined.

### Issue: Technical drafting issues

#### Submission

(EY, Financial Services Council)

Submitters raised the following technical drafting issues:

(a) The reference to “investor does not have a notified rate” should be replaced with the “investor does not advise a multi-rate PIE of their notified investor rate”, on the basis the current drafting implies the investor has no notified investor rate, when rather they have failed to provide their rate to the PIE. (*EY*)

(b) Rather than referring to a notified investor rate being “inconsistent” with an investor’s PIR, the legislation should refer to the rate as being incorrect. (*EY*)

(c) The current drafting provides that the “Commissioner may notify a multi-rate PIE to apply a rate”. The submitter is of the view the revised drafting makes it less clear that the PIE is required to disregard any earlier rate advised by the investor and must apply the rate advised by the Commissioner. (*EY*)

(d) That the existing drafting only enables the Commissioner to correct a rate notified by the investor, it does not make it clear the Commissioner is able to correct a previous Commissioner-notified rate. (*EY, Financial Services Council*)

#### Comment

“Notified investor rate” is defined in section YA 1 of the Income Tax Act 2007 to mean a rate notified under section HM 60 or HM 58. Therefore, officials are of the view where an investor has not notified a rate to their PIE then they do not have a notified investor rate, meaning issue (a) does not need to be addressed. In relation to issue (b), by virtue of its definition, it is not possible for a “notified investor rate” to be incorrect even if the rate is different from the investors PIR. Therefore, the current language of “inconsistent” is more appropriate than “incorrect”.

Officials agree with the submitters on issue (c). On issue (d), the current drafting allows the Commissioner to correct any incorrect notified investor rate, which includes one that has been notified by the Commissioner. However, officials acknowledge that the use of “notified investor rate” as a nonce term in section HM 60(1) for rates notified by investors could cause confusion, and consider that the clarity of the legislation could be improved.

#### Recommendation

That the submissions covering issues (a) and (b) be declined.

That submissions (c) and (d) be accepted, subject to officials’ comments.

### Issue: Process for investor being listed in part A of schedule 29

#### Submission

(AMP Capital, Russell McVeagh)

To qualify as a PIE an entity must meet the eligibility criteria listed in section HM 7 of the Income Tax Act 2007 – this criterion includes requirements as to the minimum number of investors per investor class (section HM 14) and the maximum interest that can be held by a single investor (section HM 15).

However, there is an exception to the criteria in sections HM 14 and 15, for investors listed in part A of schedule 29 of the Income Tax Act 2007. For example, as PIEs themselves are listed in schedule 29, this means where a PIE invests in another PIE the above requirements do not need to be met.

Currently, an Act of Parliament is required to update schedule 29. The submitter proposes that investors should be able to be added to part A of schedule 29 by way of an Inland Revenue determination or an Order in Council.

#### Comment

Although officials note there are some examples where the Income Tax Act 2007 can be amended by Order in Council, to ensure maximum transparency in setting tax laws it is generally desirable for amendments to be made via primary legislation. Therefore, changing the method for updating schedule 29 would raise issues that would require prioritising and resourcing as part the Government’s tax policy work programme.

Moreover, as entities are generally included in Part A of schedule 29 by type (for example, the list currently includes all PIEs and life insurers) rather than by organisation, there is unlikely to be a need for the schedule to be frequently updated. Therefore, as omnibus tax bills are regularly progressed through Parliament, officials consider the current setting should not act as a significant impediment to part A of schedule 29 being updated in a timely manner.

#### Recommendation

That the submission be declined.

### Issue: Extension of new PIE transitional period

#### Submission

(AMP Capital, Russell McVeagh)

Generally, where a PIE fails to satisfy certain investment and investor requirements on the last day of a quarter and does not remedy the issue by the last day of the next quarter, it will lose its PIE status. However, section HM 25(3)(a) of the Income Tax Act 2007 provides that a newly established PIE has six months before failure to meet these requirements will result in the entity losing its PIE status. This is to recognise when a new PIE is established, the investor base may be more concentrated than it typically would be.

The submitter seeks for this six month transitional period to be extended to a year, on the basis the length of the transitional period does not reflect the practicalities of establishing a new PIE (with institutional investors typically only meeting quarterly or semi-annually).

#### Comment

This submission raises issues that would require prioritising and resourcing as part of the Government’s tax policy work programme. Engagement with the managed fund industry about new PIE investment practices would be required to determine whether there is an issue with the current six month transitional period.

#### Recommendation

That the submission be declined.

## Taxation of trusts

### Issue: Remedial amendments to trust rules supported

(Clauses 59, 89, 92(1) – (7), 93, 95, 97, 113(16) – (20))

#### Submissions

(Chartered Accountants Australia and New Zealand)

The proposed amendments to clauses 59, 89, 92(1) – (7), 93, 95, 97, and 113(16) – (20) are supported.

#### Recommendation

That the submission be noted.

### Issue: Residence of co-trustees as a single notional person

(Clause 87)

#### Submissions

(Chartered Accountants Australia and New Zealand, KPMG)

The proposed amendment should be included in subpart YD of the Income Tax Act 2007.

The proposed amendment is a departure from the common law position and should be consulted on. *(Chartered Accountants Australian and New Zealand)*

The relevant provision should be:

* reconsidered for whether it applies the correct test of residence;
* included in Subpart YD rather than in Subpart HC of the Income Tax Act 2007;
* the commencement date should be deferred; and
* the consequential impacts should be further considered. (*KPMG*)

#### Comment

##### Residence of the trustee

We agree with submitters that the trustee is not necessarily the only determining factor for taxation of trustee income of a trust.

However, residence is an important factor for the taxation of New Zealand-sourced income as well for compliance with assessment obligations because:

* the trustee of the trust is the person responsible for calculating and satisfying the income tax liability;
* residence of the trustee is relevant for the determining if certain tax credits can be used in satisfying the income tax liability of the trustee; and
* payers of passive income need to know the residence status of an investor to determine the correct tax rate (for example, is the passive income subject to resident withholding tax or non-resident withholding tax).

It is necessary for a trustee to determine their tax residence because, under the global/gross framework for calculating taxable income, New Zealand-sourced income is subject to New Zealand tax and a New Zealand resident is taxed on their world-wide income. The only exception in the trust rules for the global/gross framework is foreign-sourced income derived for an income year by a trustee of a trust that does not have a settlor resident in New Zealand at any time in that year. Residence is also relevant to determining the withholding tax payable on passive income and for the PIE rules.

The proposals for residence clarify the law to ensure it is consistent with how the Commissioner applies the current law.

Adopting a common law principle instead would put New Zealand out of step with most other jurisdictions including Australia. Officials consider it would also result in more uncertainty.

If a trust has a sole trustee, the residence of the trustee is based on the rules in subpart YD. If a trust has co-trustees, we consider it is appropriate to apply the residence rules on the basis that the trustees are a single notional person. We note that co-trustees have always been treated as if they were an individual deriving the trustee income.

We agree with submitters that the Commissioner applies the residence test for co-trustees in the same manner proposed in the amendment. The Commissioner has published her view in IS 16/03 and reaffirmed that administrative approach in IS 18/01.

We also note that an election can be made to pay New Zealand tax on world-wide trustee income, irrespective of the residence of the settlor or the trustee or any beneficiary of the trust.

Officials consider the comments made by the submitters in referring to the FATCA rules and common reporting standards are cross-border matters relating to those specific measures and do not affect how New Zealand approaches the taxation of trustee income generally.

##### Effect on withholding taxes

The proposed amendments clarify how trustees are to apply the withholding tax rules. The clarification is consistent with the conclusions drawn by the Rewrite Advisory Panel, which concluded that, a trust cannot meet the requirements to be a complying trust of trustee income derived by co-trustees is apportioned to give different (withholding) tax effects based on the personal residence of the co-trustees.

##### Location of the residence rule

Officials consider this submission has some merit. However, there are many examples in the Income Tax Act 2007 of definitions that are index entries in Part Y, and which point to the substantive definition within a complex set of rules (for example, many of the definitions within the depreciation rules).

Officials recommend that drafters consider either relocating the substantive definition or making an appropriate index entry in Part Y that refers to the substantive definition.

##### Deferral of effective date

To clarify, officials wish to point out that the proposed amendment does not apply from the date of enactment. Instead, clause 87 states that this proposed amendment applies to *income years beginning after* the date of enactment.

Our view is that this should result in the proposed amendment applying, in most cases, from the beginning of the 2020−21 income year. Officials consider this is enough time for trustees to advise payers of interest and dividends of the correct withholding tax rate or tax rate (for PIE investments).

##### Consequential impacts

The proposed amendments do not deem a trust to be a resident or a non-resident. They apply only to the trustee. It is the trustee (including co-trustees treated as a notional single person) who is responsible for compliance with income tax obligations for trustee income.

Officials consider the proposed amendments:

* improve the clarity of how the tax residence rules apply to co-trustees of a trust;
* are consistent with how the Commissioner has applied the residence rules to trustees since 2016; and
* do not affect the taxation of distributions from a trust.

Taxation of distributions from a trust remain unchanged as the proposals do not impinge on the factors that determine the nature of a distribution. The four main factors that determine the nature of a distribution are:

* the classification of the trust as either a complying trust, a foreign trust or a non-complying trust in relation to the amount being distributed;
* the tax residence of the beneficiary;
* the source of the distribution from the trust fund; and
* the ordering rules which stipulate the order in which distributions from either a foreign trust or a non-complying trust are to be made.

#### Recommendations

That the submission that requests a reconsideration of the policy for tax residence of co-trustees be declined.

That the submissions that the tax residence rule be included in Part Y be accepted, subject to officials’ comments.

That the submissions on the proposed amendments affecting the tax residence of the trust be declined.

That the submissions on the effect on withholding taxes be declined.

That the submissions on the deferral of the effective date (application date) be declined.

That the submissions on consequential impacts be accepted, subject to officials’ comments.

### Issue: Corpus

(Clause 88)

#### Submissions

(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Law Society, nsaTax)

The proposed amendment should consider the situation of debt forgiveness. (*Chartered Accountants Australia and New Zealand*)

The definition of corpus be reconsidered. (*KPMG*)

The wording of the proposed amendment to section HC 4(1) may create uncertainty as to whether certain amounts are included in the corpus of the trust.

Confirmation should be given that debt forgiveness would give rise to corpus under the proposed amendment to section HC 4(1). (*New Zealand Law Society*)

The proposed amendment should include, within the definition of property, money that is loaned to the trustee where the loan is subsequently forgiven by the lender. (*nsaTax*)

#### Comment

Corpus is an amount that is analogous to the capital of the trust and so is intended to consist of property settled on the trust. That capital is applied by the trustee as required in the trust deed to generate income and gains for the purposes of the trust. Under the trust rules, corpus may be distributed tax free.

The proposed amendment that an amount included in corpus should be capable of distribution is consistent with the Commissioner’s application of the law. KPMG suggests the proposed amendment is unnecessary. We have consulted with submitters on this point and we now consider that under the general law, an amount can only be distributed if it is capable of being distributed. Therefore, we agree that it is unnecessary for the definition of corpus to state that the amount must be capable of being distributed.

In our consideration of the submissions, we noted that a forgiveness of a loan owed by a trustee of a trust is within the technical meaning of “disposition of property”, a defined term for the purpose of the trust rules. As both a settlement and a distribution are defined by reference to the concept of a transfer of value in the Income Tax Act 2007, we reviewed the technical components of the definitions of “settlor” and “distribution” in Income Tax Act 2004. The components of these definitions in the Income Tax Act 2004 were rationalised into a single concept of “transfer of value” in the Income Tax Act 2007 during the rewrite of the trust rules.

In the Income Tax Act 2004, a settlement and a distribution include a forgiveness of a loan, because they are included in the definition of “disposition of property” in the Income Tax Act 2004. The rationalisation of these various rules during the rewrite may have obscured this policy.

Therefore, we agree that the legislation should be clarified to ensure that a forgiveness of a loan is treated as a disposition of property for both a settlement on a trust and a distribution from the trust.

#### Recommendation

That the submissions be accepted, subject to officials’ comments.

### Issue: Drafting relating to trustee income

(Clause 89)

**Submission**

(New Zealand Law Society)

The drafting of clause 89 could be improved by reflecting the exclusion of beneficiary income from trustee income.

#### Comment

The proposed amendment is a response to a submission made during the administrative review of trust taxation. The submission identified that certain settlements on a trust would be taxed to the trustee as trustee income, and could not be taxed to the beneficiary, even if the amount of that settlement had been on-distributed to a beneficiary.

We consider the proposed amendment is clear that such an on-distribution would not be taxed to the trustee as trustee income.

#### Recommendation

That the submission be declined.

### Issue: Source of capital gain

(Clause 91)

#### Submission

(KPMG, Chartered Accountants Australia and New Zealand)

The efficacy of the rule should be confirmed, and consideration given to whether an equivalent rule is required for capital losses. (*KPMG*)

That the rule should specify how section YD 4 should apply to capital losses. (*Chartered Accountants Australia and New Zealand*)

#### Comment

Officials consider it is appropriate for the source rules applying for income to be also used to determine the source of a capital gain.

A distribution of a capital gain from a trust may be untaxed (distribution from either a complying trust and foreign trust) or taxed (distribution from a non-complying trust). The submissions are primarily concerned with a capital gain included in a taxable distribution made from a non-complying trust to a non-resident beneficiary. This is because if such a taxable distribution is made to a non-resident beneficiary, the beneficiary is taxed only to the extent that distribution is sourced from New Zealand.

As the ordering rules require capital losses to be netted off from capital gains, we agree with the submitter that the source of a capital loss should also be determined on a similar basis as proposed for capital gains. We consider that the proposed amendment should be adjusted to reflect this effect.

#### Recommendation

That the submissions be accepted.

### Issue: Taxable distribution not subject to the ordering rule

(Clause 91(2))

#### Submission

(New Zealand Law Society)

Further consideration should be given to the current interpretation and the scope and application of subpart FC of the Income Tax Act and the wider ramifications of the interpretation underlying the proposed amendment to clause 91(2) of the application of other aspects of the trust rules.

#### Comment

The submitter raises two issues:

* valuing a distribution at market may result in circularity because there is not a transfer of value from the trustee to the beneficiary (a bitcoin example is used to illustrate the submitter’s point); and
* gifted property to a trust would not be a transfer of value to the trust.

We agree with the submitter that the purpose of subpart FC of the Income Tax Act 2007 is to tax holding gains on revenue account property when certain transactions occur (for example a distribution of property from a trust, or the making of a gift).

In relation to the issue raised about distribution of property, officials note that a recent amendment in section FC 2(4) of the 2007 Act ensures that the valuation of a distribution of property is only for the purpose of determining:

* whether the trustee is liable for tax on any holding gains or depreciation recovery on revenue account property being distributed; and
* the cost base of the distributed property for the beneficiary (if that property is revenue account property).

Under that amendment, the value of distributed property under subpart FC is not considered in determining whether a transfer of value has occurred from the trustee to the beneficiary. We agree this rule should be expanded to ensure that the valuation rules in subpart FC should not apply in determining whether a gift is a settlement on a trust.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Foreign-sourced income of a resident trustee − distributions

(Clause 93(1))

#### Submission

(KPMG)

The treatment of a distribution of beneficiary income should be confirmed in a *Tax Information Bulletin* item.

#### Comment

Officials agree with the submission.

#### Recommendation

That the submission be noted.

### Issue: Foreign-sourced income of a resident trustee

(Clause 93(1))

#### Submission

(New Zealand Law Society)

That the term “trustee income” should be used instead of references to income as for example in section HC 26(1) of the Income Tax Act 2007.

#### Comment

In section HC 26 of the Income Tax Act 2007, the term trustee income could be misinterpreted as the provision is about defining when an amount of foreign-sourced income is treated as exempt income for the purpose of calculating taxable income of a trustee. The rule is not about trustee income but about a subset of trustee income.

The purpose of section HC 26 is to override the general rule that taxes the world-wide trustee income of a resident trustee. This rule is concerned with:

* a subset of trustee income (foreign-sourced income derived by a trustee);
* defining the circumstances when that foreign-sourced income is not included in the calculation of the trustee’s taxable income.

Although the foreign-sourced income referred to is also included in trustee income, the concept of trustee income is more relevant for the application of the ordering rules, the nature of a distribution, and for the election to pay tax on world-wide trustee income.

#### Recommendation

That the submission be declined.

### Issue: Foreign-sourced income of resident trustees – a trust that has no settlor

(Clause 93(2))

#### Submission

(New Zealand Law Society)

That the relevant issue is whether any settlor of the trust died or ceased to exist when it was a New Zealand resident, and this can be addressed by amending section HC 25(2)(c).

That section HC 25(2)(c) be reviewed in light of the amendment proposed by clause 87 of the Bill (which clarifies the tax residence of co-trustees treated as a notional single person).

#### Comment

(Clause 93(2))

A submission received during the administrative review of the taxation of the trust rules noted that the current wording of section HC 26 implies it will apply only in situations where a trust has a settlor. The proposed amendment addresses this submission.

The proposed amendment seeks to clarify that the exemption for foreign-sourced income under section HC 26(1) can apply when the trust has no settlor provided that the last remaining settlor of the trust was a non-resident at the time of death or the time it ceased to exist.

We consider the proposed wording achieves this objective.

##### Suggested review of section HC 25(2)

The general rules for taxing income result in a New Zealand resident being taxed on their world-wide income unless a specific exemption applies.

The proposals in clause 87 result in co-trustees being treated as a New Zealand resident (as a notional single person) for the purpose of calculating the income tax liability on trustee income as follows:

* if the settlor of a trust is resident in New Zealand, the trustee of that trust will be taxed on their world-wide trustee income for an income year; and
* if the settlor of a trust is non-resident, foreign-sourced income derived by the trustee of that trust may be exempted under section HC 26.

If the proposals in clause 87 result in co-trustees being treated as a non-resident (as a notional single person), section HC 25 will apply to those trustees only if the trust has a resident settlor.

Officials consider these effects are consistent with the application of the law set out in IS 18/01.

We note that the New Zealand Law Society also suggests section HC 25(2)(c) should be modified to apply to corporate trustee that has ceased to exist. We agree with this submission.

#### Recommendation

That the submission relating to a trust that has no settlor be declined.

That the submission to include a reference to non-natural person trustees in section HC 25(2)(c) be accepted, subject to officials’ comments.

### Issue: Foreign-sourced minor beneficiary income drafting

(Clause 93(4))

#### Submission

(New Zealand Law Society)

That the proposed amendment in clause 93(4) is unnecessary.

#### Comment

The proposed amendment addresses a matter raised in submissions received during the administrative review of the taxation of trusts. The proposed amendment clarifies that minor beneficiary income that is foreign-sourced does not enjoy the benefit of the exemption for foreign-sourced income derived by a trustee of a trust having only a non-resident settlor. That exemption is intended to apply only to income retained by the trustee (that is, it does not apply to a distribution that is beneficiary income).

As a base protection measure, minor beneficiary income is intended to be attributed to the trustee and taxed at the trustee rate. This attribution of minor beneficiary income:

* is only for the purpose of ensuring New Zealand tax is paid on that income at the trustee rate; and
* ensures that minor beneficiary income is not taxed to the beneficiary.

The submitter’s concern likely relates to foreign-sourced income derived and retained by the trustee which is exempt income of the trustee under this rule. We agree with the submitter that a subsequent distribution of that income is likely to be a taxable distribution and would be taxed to the minor beneficiary under the normal source and residence principles. However, for the reasons stated above, we feel that the amendment is necessary.

#### Recommendation

That the submission be declined.

### Issue: Settlement by acts of associates

(Clause 94)

#### Submissions

(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Law Society, nsaTax, Russell McVeagh)

The proposed rule should apply only where the person has influence or control over the actions of an associate. (*Chartered Accountants Australia and New Zealand*)

The proposal does not clearly meet the objective and it may expand the definition of settlor significantly and inappropriately. (*KPMG*)

* Clause 94 should be amended so that the proposed amendment specifies which persons must be associated.
* Clause 94 should clearly set out which subsection of section HC 27 of the Income Tax Act 2007 is being referred to in the reference to “paragraphs (a) or (b)”. (*New Zealand Law Society*)

The interaction between the proposed amendment for section HC 27(4) and existing section HC 27(6) be clarified by making section HC 27(6) subject to section HC 27(4). (*nsaTax*)

Clause 94 should not proceed as the proposed replacement of section HC 27(4) of the Income Tax Act 2007 would result in a significantly broader definition of “settlor” for income tax purposes. (*Russell McVeagh*)

#### Comment

The Commissioner considers the current provision concerning the treatment of indirect settlements is very broad and overreaches. The objective for the proposed amendment is to limit when a person is treated as a settlor because they have a connection with an indirect transaction that results in a transfer of value to a trust.

The purpose of the proposed amendment (as introduced) was to restrict the current rule to transactions where:

* a person (person A) controls or influences the actions of another person (person B) for that transaction; and
* a result of that transaction is that a transfer of value is indirectly made to a trust.

An example of a transaction that is intended to be within the scope of the proposed amendment would be where Person A influences person B to make a gift of property to a company, which is owned 100% by a trust of which person A is a trustee and a beneficiary. The interpretation statement (IS 18/01) notes that the control or influence effect of such a transaction is more likely to occur if the two persons are associated with each other.

Officials agree that the wording of the proposed amendment should more clearly reflect the intent of the provision. We have also consulted on this issue with submitters and we agree the proposed amendment is not intended to apply to advice (which could be considered to be influence), for example professional or family advice offered on the establishment of a trust.

The reference to paragraphs (a) or (b) grammatically can only be the paragraphs listed in the proposed amendment. However, we note that the submission is likely suggesting that the issue relates more to the reference in the proposed amendment to subsection (2) of section HC 27. Changes made to the proposal relating to control or influence, will render references to paragraphs (a) or (b) unnecessary.

We agree that the relationship between subsection HC 27(6) and proposed subsection HC 27(4) be clarified.

#### Recommendations

That the submissions be accepted, subject to officials’ comments.

### Issue: Value of deferral and non-exercise

(Clause 96)

#### Submission

(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Law Society)

The rule should apply only where the interest rate is less than market.

The relevant rate should be reconsidered. (*KPMG*)

Further work is required to ensure the formula works in a guarantee situation and that officials provide detailed examples to illustrate the application of this provision where financial assistance is provided in the form of a guarantee. (*New Zealand Law Society*)

#### Comment

Officials agree that the prescribed rate of interest at present can be substantially in excess of market rates in some sectors or markets. We consider that the relevant rate should be, as submitted, the lower of the market rate (but cannot be less than zero) or the prescribed rate.

Officials consider that the proposed amendment should state that for a guarantee, the guarantee fee should be the basis for determining the amount that is calculated as the transfer of value for a guarantee. An example will be provided in the *Tax Information Bulletin* on the enactment.

#### Recommendation

That the submissions be accepted.

### Issue: Election to pay New Zealand tax on world-wide trustee income

(Clauses 90 and 97)

#### Submission

(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Law Society)

That a retrospective election should be allowed. (*Chartered Accountants Australia and New Zealand, KPMG*)

That an annual notification obligation on non-active trusts is unnecessary and imposes a compliance burden which diminishes the advantage that non-active trust status affords such trusts (clause 97(2)). (*New Zealand Law Society*)

#### Comment

The purposes of the election rule and taxable distribution rules are to encourage people to elect into the complying trust regime at an early stage rather than when a problem or adverse effect arises. We agree with the submission that the tax status of a trust may be fluid.

We also note that the ability to elect into the complying trust regime was enacted before the current penalties and interest regimes came into force. We considered the submissions of Chartered Accountants Australia and New Zealand about:

* the interest and penalties regime; and
* the fluid nature of family trusts.

We discussed this issue with the advisor to the Committee and consider that it would be appropriate to provide the ability to make a retrospective election subject to the following requirements:

* the trustee has always been compliant with their New Zealand income tax obligations on New Zealand sourced income;
* use-of-money interest is applied on any trustee income derived in prior years not previously taxed in New Zealand;
* the date of a change in status of the trust can be identified;
* the date from which the election applies must not include any period that is subject to the time bar for amending assessments;
* the election changes the status of the trust for future distributions from income derived after the effective date of the election; and
* tax payable on distributions made before the date the Commissioner is notified of the election is not affected.

##### Non-active trust

The submission is concerned with the situation of a non-active trust, which is a complying trust that derives no income. We agree with the submitter that it is unnecessary for the trustee of a non-active trust to give an annual notice of an election for the trust be a complying trust unless the trust begins to derive income. We consider that the proposed amendment for section HC 33(1B)(c)(i) should not apply to a non-active trust.

The proposed amendment applies to trustee of a complying trust if certain technical requirements relating to income derived by the trustee.

The amendment is intended to apply to:

* a trustee of a trust when a settlor of the trust migrates from New Zealand, which may result in a change to the way in which income of the trust may be taxed or exempted; or
* a foreign registered charitable trust. If the trustee of such a trust wishes to have complying trust status, the proposed amendment requires the complying trust status to be notified when the trustee files its annual foreign trust disclosure form.

#### Recommendation

That the submissions be accepted, subject to officials’ comments.

### Issue: Taxation of distributions from a trust that has elected to become a complying trust

(Clause 97(8))

#### Submission

(New Zealand Law Society)

That careful consideration should be given to whether it is appropriate that the ordering rules are applied in the way (provided in the proposed amendment) and whether doing so gives rise to the appropriate outcome in all circumstances.

That a detailed analysis of the fact scenarios should be carried out to ensure that the proposed amendments result in an appropriate outcome for a trust which “flips” in and out of being a complying trust under the proposed amendment and for a trust which has suffered losses in some periods over its lifetime.

#### Comment

The New Zealand Law Society’s submission on the application of the ordering rules is to the effect that the status of the trust at the date of the distribution should determine the taxation of the distribution because the trust fund is a single fund. We agree this is the policy for a trust that does not change its status during its lifetime.

However, this is not the policy for a distribution from a trust that has changed its status, as for example, if a settlor of that trust has migrated to New Zealand and has become a tax resident of New Zealand. The proposed amendment is based on the approach taken under current law for distributions from a trust that was a foreign trust and a settlor of that trust has migrated to New Zealand which taxes distributions based on when the income was derived by the trustee and not just by the date of the distribution.

For such a trust, an election may be made within one year of the time the settlor becomes a New Zealand tax resident for all purposes. If the election is made, the trust is treated as a complying trust from the date of the election (settlor migration rule), provided the trustee satisfies their income tax obligations for world-wide trustee income on an ongoing basis.

However, under the settlor migration rule, a distribution from the trust after the election is treated as follows:

* a distribution of an amount derived by the trustee before the date of the election is treated as a distribution from a foreign trust; and
* a distribution of an amount derived by the trustee after the date of the election is treated as a distribution from a complying trust.

If the election to be a complying trust is not made that one year period, a distribution from the trust after the election is treated as follows:

* a distribution of an amount derived by the trustee before the date of the election is treated as a distribution from a foreign trust; and
* distribution of an amount derived by the trustee after the date of the election is treated as a distribution from a non-complying trust; and
* in both cases there are may be some technical adjustments to the amount of the distribution to take account of New Zealand tax payable on income derived before the election date.

Officials consider that the proposed amendment for the taxation of distributions is consistent with the policy that already applies for a foreign trust that changes its status by electing into the complying trust rules. We also consider that it is appropriate for the ordering rules to be applied for all trusts to determine the timing of when the amount being distributed was derived by the trustee.

#### Recommendation

That the submissions be declined.

## Māori authority tax credits

(Clauses 104 and 108)

### Issue: Correction of unintended legislative change in the rewrite of the provision into the Income Tax Act 2007

#### Submission

(Chartered Accountants Australia and New Zealand)

That the proposed amendment is supported.

#### Recommendation

That the submission be noted.

## Removal of the requirement to estimate at final provisional tax instalment date

(Clause 110 and 125)

### Issue: General support for the measure

#### Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Tax Management New Zealand Limited, EY, KPMG, Deloitte)

General support for the removal of the requirement to estimate a taxpayer’s final instalment of provisional tax where they believe their residual income tax will be less than the final instalment amount.

#### Recommendation

That the submissions be noted.

### Issue: Relationship between sections RC 7 and proposed sections RC 10(5) and (6) should be clarified to avoid the confusion of terms

#### Submission

(EY)

The drafting as currently worded could pose potential confusion when taxpayers look to apply this section because of the use of terms such as “RIT estimate” with reference to the standard uplift method which could be confused with the estimation method in section RC 7. We recommend that the relationship be clarified.

#### Comment

Officials considered that using the term “RIT estimate” was sufficiently different from the use of the term “estimate” in section RC 7, however, on reflection we can see how that wording could create some confusion so drafting will be amended to “expected RIT”.

#### Recommendation

That the submission be accepted.

### Issue: A subsequent change is required to account for early balance date taxpayers

#### Submission

(Corporate Taxpayers Group, Deloitte)

While the removal of the requirement to estimate at the final instalment makes sense there would need to be a subsequent change to sections RC 5(2) and RC 5(3) to account for early balance dates as these sections do not allow taxpayers to use 110% for the final instalment.

#### Comment

Officials agree that sections RC 5(2) and RC 5(3) as currently written do not work well for early balance date taxpayers who are unable to use a standard uplift based on 110% of the year preceding the prior year at the final instalment date but yet, because of an extension of time to file their prior year tax return they are unable to use an uplift of 105%. This issue has existed for some time.

However, taxpayers who have early balance dates have a significant amount of time to file their tax returns (up to 18 months following their balance date) and, in addition, most taxpayers will generally prefer to base their final instalment under the standard method on their approximation of their RIT for the year as it is from this date that use of money interest will apply to any shortfall which is five weeks after their balance date.

To provide more certainty to taxpayers they can make use of other tools to minimise their exposure to use of money interest from this date including using a tax pooling intermediary.

Officials consider that to make a special rule around early balance date taxpayers would add significant complexity to the rules and raise integrity concerns.

#### Recommendation

That the submission be declined.

### Issue: The practical implications of the change to eliminate estimating the final instalment should be fully considered

#### Submission

(Chartered Accountants Australia and New Zealand)

Potentially there may be some practical issues around debt demands issued automatically by START if a taxpayer pays less than the amount calculated under the standard method. We understand no formal estimate will be required so it is not clear how START will know that a payment has been made under section RC 10(4) as opposed to a taxpayer short paying their provisional tax.

We recommend the practical implications be fully canvased and the necessary changes (if any) are made to START to prevent any unnecessary angst for taxpayers.

#### Comment

Officials have been actively engaged with our technical experts in designing this change. A taxpayer who does pay less than the instalment required under the standard uplift because they believe their residual income tax will be less than what they have already paid will not be able to be identified within START, however, the correct calculation of penalties and interest will occur when that taxpayer files their returns.

It may be that notices outlining that a payment has been short-paid may be issued to taxpayers who make a short payment and do not inform us that this has been done under proposed section RC 10(4), however, there is no practical way to identify those payments without increasing compliance costs.

#### Recommendation

That the submission be declined.

## Clarifying the “lesser of” calculation for standard uplift taxpayers

(Clause 109)

### Issue: General support for the amendment

#### Submission

(Chartered Accountants Australia and New Zealand, EY, KPMG, Tax Management New Zealand Limited, Corporate Taxpayers Group)

Support for the amendment to clarify the “lesser of” calculation for standard uplift taxpayers.

#### Recommendation

That the submissions be noted.

### Issue: The proposed amendment should be located in the Tax Administration Act 1994

#### Submission

(Chartered Accountants Australia and New Zealand)

The inclusion of the provision clarifying the application of the use-of-money interest (UOMI) rules in the Income Tax Act 2007 is contrary to the principles of the rewrite of the Act and this amendment should be included in the Tax Administration Act 1994.

#### Comment

Officials agree that this provision is better placed in the Tax Administration Act 1994 and recommend moving that section to section 120KBB of the Tax Administration Act 1994.

#### Recommendation

That the submission be accepted.

## Removing the ability for provisional taxpayers to allocate payments to particular instalments

(Clause 126)

### Issue: Disagree with the proposed amendment

#### Submission

(Chartered Accountants Australia and New Zealand, KPMG, Tax Management New Zealand Limited)

Removing the ability for taxpayers to choose the provisional tax instalment to which a particular payment is applied is unacceptable and unprincipled.

This amendment may unfairly penalise taxpayers by exposing them to additional late payment penalties even though payment has been made on time.

#### Comment

In practical terms the ability for taxpayers to allocate provisional tax payments to particular provisional tax instalments has never been available to taxpayers. Neither the heritage FIRST system nor the configuration of the new START platform have had the facility to apply payments to an instalment other than the oldest.

However, it is noted that prior to the removal of incremental penalties on income tax it was always more beneficial to allocate payments to the oldest debt to stop incremental penalties being charged. Once those penalties were removed it now gives non-compliant taxpayers the ability to reduce the impact of penalties by applying payments to later instalments.

Officials agree that this will be an adverse outcome to those taxpayers who do not pay their provisional tax instalments. Submitters made the point that this would be particularly harsh on taxpayers who inadvertently missed an instalment. However, with the ability to purchase funds from tax pooling intermediaries we consider that taxpayers in the situation where they have inadvertently missed a payment have the ability to correct that issue.

To allow those taxpayers who are non-compliant to reduce their exposure to late payment penalties by allocating payments to later instalments is not equitable to those taxpayers who make their payments on time.

#### Recommendation

That the submission be declined.

### Issue: The Government should add a review of the coherence of the interest and penalty rules

#### Submission

(EY)

While the example given as the justification for the amendment is one of deliberate non-compliance, and we agree in those circumstances that taxpayers should not be able to game the system for advantage in relation to late payment penalties, we are also concerned that the amendment will also apply to taxpayers who under pay because of oversight.

We recommend that the Government undertake a review of the coherence of the use of money interest and penalty regime as part of future business tax reforms in that context to ensure that taxpayers who inadvertently under pay, or late pay, provisional tax are not disproportionally penalised because of the way in which Inland Revenue’s systems allocate the payments.

#### Comment

For those taxpayers who inadvertently fail to pay instalments there are other options available to them to ensure that no penalties are incurred.

The coherence of the use of money interest and penalties regime is always considered when changes are made to the legislation. The practical impact of this change is insignificant as no one has ever allocated payments in such as manner as the legislation allows.

#### Recommendation

That the submission be noted.

## Clarifying the way in which provisional tax instalments are truncated to whole dollars

(Clause 110(1))

### Issue: General support for the amendment

#### Submission

(Tax Management New Zealand Limited, EY, Corporate Taxpayers Group)

Support for the amendment to clarify the way in which provisional tax is truncated to whole dollars.

#### Recommendation

That the submissions be noted.

### Issue: Legislation should be altered to deal with taxpayers who have short paid their instalments by small amounts

#### Submission

(Chartered Accountants Australia and New Zealand, EY, Deloitte )

The legislation should be altered to deal with taxpayers who have short-paid their instalments by less than $1 to ensure they can still use safe harbour concessions.

#### Comment

Officials have recommended that a tolerance be added to the legislation and system to ensure that taxpayers who do underpay their instalments by $20 or less will be deemed to have paid the instalment for the purposes of assessing concessionary rules such as the safe harbour.

This is included in the new matters raised at Select Committee section of this report.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Example in the commentary

#### Submission

(Chartered Accountants Australia and New Zealand)

The example in the commentary about truncation is incorrect.

#### Comment

The example in the commentary is correct according to the calculation in the legislation.

#### Recommendation

That the submission be noted.

### Issue: Inland Revenue should provide further guidance

#### Submission

(EY)

Inland Revenue should provide further guidance as to what is required at each instalment to provide greater certainty.

#### Comment

Inland Revenue’s technology platform provides taxpayers with clear direction on the amounts that are payable for provisional tax purposes at particular dates. This is via both notices and via taxpayers’ myIR accounts. Taxpayers should be aware from those sources how much they need to pay, by when, and if they have overdue amounts.

#### Recommendation

That the submission be noted.

### Issue: The proposed amendment is in the wrong section

#### Submission

(EY)

Support the codification of the current practice of truncation within the legislation.

However, considers this amendment should be made to section RC 9(2) rather than section RC 10(7). Section RC 10 details the method of calculation for instalments under standard and estimation methods whereas section RC 9(2) clarifies a general principle for the way in which payments are to be divided into instalments.

#### Comment

Truncation is important for assessing whether a taxpayer has made the correct payments to make use of concessions within the Tax Administration Act 1994 including the safe harbour rules in section 120KE and the interest concession rules in section 120KBB.

Section RC 10 of the Income Tax Act 2007 calculates the amount of each instalment required at each payment date and this is where truncation will apply. We consider that RC 10 is the preferred place to have a rule that applies to the calculation of the instalments.

However, after reviewing the way it is proposed that numbers will be truncated officials do recommend some adjustments to the wording in the legislation to reflect this and this is raised below.

#### Recommendation

That the submission be declined.

### Issue: The amendment should apply retrospectively to the 2017−18 income year

#### Submission

(Tax Management New Zealand Limited)

Support the codification of the current practice of truncation within the legislation but believe it should apply retrospectively to the 2017−18 income year, as this is when the safe harbour concession was changed.

#### Comment

The submitter is correct that the safe harbour concession was changed to require taxpayers to make their instalments from the 2017−18 income year, however, this rule was not applied in the heritage FIRST system for that year and therefore no one was impacted by this issue for that year.

We do, however, agree that for completeness the application date should be made retrospective although note that practically this will not change the outcome for any taxpayers.

#### Recommendation

That the submission be accepted.

### Issue: Additional truncation

#### Submission

(Matter raised by officials)

Truncation takes place at two points when determining the amount of provisional tax instalments. There is a truncation when the uplift is undertaken and also when the uplift amount is divided into thirds.

The truncation points are illustrated in figure 1.

**Figure 1: Provisional tax truncation points**



#### Comment

The proposed truncation amendment in clause 110(1) should be applied to sections RC 5(2) and RC 5(3) and RC 20 of the Income Tax Act 2007 in addition to RC 10.

In the truncation rule in clause 110(1) replace the word “amounts” with “instalments” – this is to ensure that there is no argument that residual income tax should be truncated.

All the above have application from the 2017−18 and later income years.

#### Recommendation

That the submission be accepted.

## Clarifying the application of late payment penalties applicable from the final provisional tax instalment date

(Clause 130)

### Issue: Concerned about unintended consequences for a taxpayer who has residual income tax of less than the amount due to settle the liability

#### Submission

(Tax Management New Zealand Limited)

The submitter had concerns as to how the rule will apply in practice and whether any late payment penalty will take into account any over payments on previous instalments. They consider the wording should be supported by examples.

#### Comment

Officials agree that these types of changes are best illustrated with examples and these will be provided with the accompanying *Tax Information Bulletin* that will be published once the Bill is enacted.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

## Non-standard provisional tax instalments

(Clause 129)

### Issue: Support for the amendment

#### Submission

(Tax Management New Zealand Limited)

General support for the amendment.

#### Recommendation

That the submission be noted.

### Issue: Application date of this clause should be amended

#### Submission

(Chartered Accountants Australia and New Zealand)

The application date should be amended to apply to the 2017–18 and later income years.

#### Comment

This issue has not arisen in practice as the Inland Revenue computer systems have been applying the rule as if the definition is correct. However, we agree the change should apply retrospectively to the 2017–18 income year, when section 120KBB applied from.

#### Recommendation

That the submission be accepted.

## The effect of regular amendments to provisional tax

### Issue: Constant changes provide a negative impact to the provisional tax rules

#### Submission

(EY)

Broadly support the amendments to clarify the provisional tax rules, but believe the Select Committee should be mindful of the wider impact that regular changes to this regime has and ensure that only those amendments that are sustainable and clearly needed are progressed.

#### Comment

We note the submitter’s concerns. However, the majority of the proposed amendments ensure that the legislation matches the administrative practice to provide certainty to taxpayers and these amendments have been necessitated where there are gaps in the legislation.

We agree that regular amendments do impact on taxpayer certainty and ensure that only those amendments that are clearly needed to improve certainty should be made. However, in the majority of cases the legislation is catching up to the administrative practice and should have no practical effect on taxpayers.

#### Recommendation

That the submission be noted.

## Tax administration matters

(Clause 134)

### Issue: Support for permitted disclosure relating to representatives

#### Submission

(Chartered Accountants Australia and New Zealand, Institute of Certified NZ Bookkeepers)

The submitters support the proposal to extend the ambit of an existing rule that allows Inland Revenue to disclose information to associations or groups that represent tax agents to also allow Inland Revenue to disclose information to associations or groups that represent “representatives” (including bookkeepers) in the same circumstances.

#### Recommendation

That the submission be noted.

(Clauses 2(19) and 119 – 121)

### Issue: Support for remedial amendments relating to the binding rulings regime

#### Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposals to:

* enable the Commissioner to withdraw short-process binding rulings; and
* specify the period that a person can continue to rely on a withdrawn private, short-process, or product ruling in relation to a matter that does not involve an arrangement.

#### Comment

The proposed amendments were identified following the enactment of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019, which extended the scope of matters for which the Commissioner could issue binding rulings and introduced a new type of binding ruling – short-process rulings.

The proposed amendment includes new section 91ESB of the Tax Administration Act 1994, which would enable the Commissioner to withdraw short-process rulings. This corrects an oversight following the drafting of the short-process rulings provisions, and mirrors existing provisions which allow the Commissioner to withdraw other binding rulings. Binding rulings are generally only withdrawn where there has been a change in the interpretation of the relevant taxation law, or where the ruling needs to be withdrawn and reissued with a variation.

The other proposed amendments (to sections 91EI and 91FJ of the Tax Administration Act 1994) provide that where a private, short-process, or product ruling has been withdrawn in relation to a matter that does not involve an “arrangement”, the person to whom the ruling applies can continue to rely on it for the period specified in the ruling. This is consistent with the rules that apply for private, short-process, and product rulings on matters involving arrangements where these rulings still have effect for the applicant (despite being withdrawn) where the applicant has already entered into the arrangement described in the ruling before it is withdrawn.

#### Recommendation

That the submission be noted.

### Issue: Clarifications to the legislative drafting for removing tax agents, representatives, and nominated persons

#### Submission

(Matter raised by officials)

Officials recommend remedial amendments to section 124G of the Tax Administration Act 1994 which contains the discretion for the Commissioner to remove a person from the list of tax agents, disallow a person’s status as a representative, and disallow a person as a nominated person.

The proposed amendments would ensure the rules operate as intended. Specifically, the amendments would ensure that there is no ambiguity about the effective date a person is removed from the list of tax agents or disallowed as a representative or nominated person.

It is intended that before a person is removed as a tax agent (or disallowed as a representative or a nominated person) the Commissioner will be required to consider arguments against the proposed removal (or disallowance) unless the Commissioner considers it necessary in the circumstances to remove the person immediately to protect the integrity of the tax system. For example, this could be the case where the Commissioner becomes aware of a person acting fraudulently and it is necessary to revoke their access from Inland Revenue’s computer systems. In such circumstances it would be inappropriate for the Commissioner to continue to allow the person to act on behalf of others.

Officials also recommend a proposed amendment to section 124G(6)(a) of the Tax Administration Act 1994 to make it clear that the Commissioner is not required to divulge information that could, for example, be withheld under section 6 of the Official Information Act 1982. The proposed amendment is consistent with the same rules requirements on the Commissioner when she refuses to list a person as a tax agent (see section 124G(5)(a) of the Tax Administration Act 1994).

Officials recommend the proposed amendments apply from the date of enactment.

#### Recommendation

That the submission be accepted.

### Issue: Clarification to the rules that allow for the self-correction of certain errors in subsequent returns

#### Submission

(Matter raised by officials)

Officials have identified several refinements which can be made to ensure that the rules that enable taxpayers to self-correct certain errors in returns for income tax, fringe benefit tax (FBT) and goods and services tax (GST) operate as intended. The refinements are to address interpretative and practical issues that have been raised with officials since the changes were made to the rules as part of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 earlier this year.

The refinements aim to:

* Confirm that the $10,000 limit in the materiality threshold test refers to the tax discrepancy caused by the error(s) and not the amount of the error(s).
* Ensure that there is no confusion between the application of the thresholds in section 113A (either a tax discrepancy of $1,000, or a tax discrepancy that does not exceed the greater of $10,000 and two percent of the taxpayer’s annual gross income or GST payable for the relevant period) and the self-correction rules for PAYE, RWT and NRWT which have their own rules.
* Clarify that multiple errors that do not exceed the new materiality threshold can be corrected, provided the total discrepancy caused by the errors do not exceed the relevant thresholds.

Officials recommend the proposed amendments apply from the date of enactment.

#### Recommendation

That the submission be accepted.

### Issue: Self-correction of certain errors in subsequent returns – guidance and changes to the test for GST errors

#### Submission

(Deloitte)

The meaning of “total discrepancy in the assessment” should be clarified.

The correct interpretation of section 113A(4) of the Tax Administration Act 1994 is that the two percent threshold is two percent of the output tax for the return period in which the error occurred, not the annual output tax.

To resolve the fact that exporters have a limited ability to use these rules in relation to their GST returns (because export sales do not generate output tax), measuring materiality for GST errors should involve a test that looks at a person’s “taxable supplies” instead.

#### Comment

The phrase “total discrepancy in the assessment” is intended to refer to the total amount of the tax discrepancy caused by the error, or errors, that were included in the original return. For example, if a return contained an error that resulted in an omission of output tax of $800 (a debit), and an error that resulted in an omission of input tax of $400 (a credit), the total discrepancy in the assessment caused by those errors is $400 (that is, $800 minus $400). Officials intend to include further examples in the *Tax Information Bulletin* that covers the changes made by the Bill.

Officials also agree that the two percent test in section 113A(4) for GST errors is intended to be two percent of “output tax” for the relevant return period, and not two percent of a taxpayer’s “annual output tax”. The expression “annual gross income” is defined for the purposes of the Tax Administration Act 1994 in section BC 2 of the Income Tax Act 2007. The use of the word “annual” in section 113A(4) is intended only to refer to “annual gross income” as in the defined term, and it is not intended to extend to “annual output tax”, which is not a concept that is used in either the Tax Administration Act 1994 or the Goods and Services Tax Act 1985.

Officials can see merit in changing the test from “2 percent of output tax” to “2 percent of taxable supplies” (or another alternative) for the purposes of GST to address the issue raised by the submitter. However, officials consider that before an amendment be made to change the test, further consultation should be undertaken on whether “2 percent of taxable supplies” is the most appropriate solution. Officials recommend that this consultation occur as part of a future taxation bill.

#### Recommendations

That the submissions about “total discrepancy in the assessment” and the correct interpretation of the two percent materiality test for GST be noted.

That the submission to change the materiality test for GST to address a possible issue for exporters be declined.

## Consideration for grant of an easement

(Clauses 61 and 62)

### Issue: Transitional rule

#### Submission

(EY)

A transitional rule should be introduced for taxpayers who have previously treated a one-off payment for a permanent easement as taxable, because of the uncertainty of treatment in the period between the release of the *Vector* decision and this amendment coming into force. These taxpayers should be able to claim refunds in respect of these amounts; it does not appear fair to penalise taxpayers who may have conservatively paid tax on such receipts in the interim period.

#### Comment

Taxpayers who have conservatively paid tax on one-off payments for the grant of a permanent easement after the *Vector* decision and before this amendment comes into force may be able to claim refunds in respect of these amounts. However, officials do not consider that a transitional rule is necessary to achieve this. Taxpayers can already apply to the Commissioner to have an assessment amended under section 113 of the Tax Administration Act 1994. It is also unlikely there are any taxpayers in this position, as section CC 1(2C) has always had the clear intent of excepting these payments from tax.

#### Recommendation

That the submission be declined.

### Issue: Payments for the grant of a land right

#### Submission

(Matter raised by officials)

An existing remedial amendment in the Bill moves section CC 1(2C) – a provision that excepts one-off payments for the grant of a permanent easement from income tax – from section CC 1 to section CC 1B of the Income Tax Act 2007.

Doubts have arisen as to whether section CC 1B taxes consideration for the grant of an easement (or other land right). A clarifying amendment should therefore be made to ensure that, consistent with the policy intent, such payments are taxable.

#### Comment

It is intended that payments for the grant of an easement or other land right are taxable.

Originally, it was thought that payments for the grant of a land right were taxable under section CC 1. However, the Court of Appeal in *CIR v Vector Limited* [2016] NZCA 396 found that the words “other revenues” in section CC 1 do not capture traditionally capital amounts such as one-off payments for the grant of an easement, and none of the other “amounts” listed in section CC 1(2) captures such payments. This meant that the exception for permanent easements in section CC 1(2C) is redundant.

It was noted by the Court that section CC 1B – introduced with effect from 1 April 2013 – would have captured the amount for the grant of the easements in *Vector* had it existed at the time of the transaction. Officials were similarly of the view that section CC 1B captured payments for the grant of a land right. However, doubts have arisen as to whether this is the case.

Section CC 1B should be amended to ensure that payments for the grant of a land right (such as a licence or a limited term easement) are taxable, because economically, such payments can be substituted for a taxable rental stream. This amendment is also necessary to ensure that relocated section CC 1(2C) (proposed section CC 1B(6)) has its intended effect of carving out a one-off payment for the grant of a permanent easement from tax in a legislative scheme that would otherwise tax such a payment.

The proposed amendment should apply retrospectively from 1 April 2013, the date that section CC 1B became effective. However, a savings provision should be included so that taxpayers who have already filed a tax return, or been given a binding ruling, on the basis that section CC 1B does not tax these payments, are not affected by the amendment. The savings provision should only apply to positions taken before the date of announcement of the proposed amendment by the Minister of Revenue, which was 23 August 2019.

Officials consider this proposed amendment should be included in the current Bill rather than the next bill that is introduced to preclude what could otherwise be a significant fiscal risk.

#### Recommendation

That the submission be accepted.

## Employee share schemes

(Clauses 69 − 71)

### Issue: General support

Submitters generally support the proposed amendments to the employee share scheme (ESS) rules. However, they also recommend some further changes to improve the workability of the rules.

#### Recommendation

That the submission be noted.

## Employee share schemes – definition of market value

(Clauses 69 and 71)

### Issue: Refreshed valuation statement should be released

#### Submission

(PwC)

In conjunction with the introduction of the new definition of “market value”, the Commissioner should release a refreshed valuation statement (replacing CS 17/01) that sets out a volume weighted average price (VWAP) equivalent and other valuation methods accepted by the Commissioner. Also, prior to releasing this refreshed valuation statement, the Commissioner should consult with taxpayers to ensure that the approaches included in it are practical and workable.

#### Comment

Officials understand that the valuation methods approved in the existing valuation statement reduce compliance costs, and in most cases will be practical and workable for companies that choose to use them. However, officials can see value in reviewing the content of the statement and consulting further with taxpayers to ensure that the list of available methods is as practical as it can be. A refreshed list of methods could potentially be published as a *Tax Information Bulletin* item, or as a new valuation statement, as the submitter suggests. Officials will consult further to determine the best approach.

#### Recommendation

That the submission be accepted.

### Issue: Section CE 2(4) should be amended

#### Submission

(Russell McVeagh)

Section CE 2(4) should be amended so that where an employee disposes of shares under an employee share scheme (or exempt ESS) immediately upon acquisition (often to fund the payment of PAYE), the employee is not treated as having a further gain or loss for tax purposes (as a result of the way the shares are valued) where the shares are on revenue account. Currently, the cost base for shares is determined with reference to their “market value”, but this market value – however it is determined – is unlikely to match the actual proceeds derived by the employee on sale. The most administratively simple solution would be to deem the value of the shares to be equal to the sale proceeds for cost base purposes but continue to use “market value” for PAYE purposes.

#### Comment

Officials acknowledge the concerns raised by the submitter, but do not consider that the problem is significant enough to warrant specific legislative change. Officials consider that in the vast majority of cases, shares acquired by an employee under an ESS will be on capital account, as an employee normally holds these shares because their employer has chosen to remunerate them that way, rather than because the employee has a particular intention of resale. Any further gain or loss made on the sale of the shares will therefore not be taxable.

In the uncommon case that the employee holds the shares on revenue account and sells them immediately, a further gain or loss on the sale of the shares represents a real positive or negative difference in the economic benefit to the employee against the market value. While compliance costs would be reduced by not taxing this additional amount, taxing it is technically correct and officials do not think that position should be departed from.

Officials note that in the current Commissioner’s statement on the valuation of ESS shares (CS 17/01), one of the options for valuing listed shares is to use the sale proceeds (for both cost base and PAYE purposes), if the employee disposes of the shares on a recognised exchange on the date of acquisition. This option may be expanded as part of a refresh of the statement.

#### Recommendation

That the submission be declined.

## Employee share schemes – flexibility to allow employees to keep shares if they leave employment

(Clause 70)

### Issue: Use of the word “purchase” does not allow for nil consideration

#### Submission

(Corporate Taxpayers Group, Deloitte)

The proposed amendment to section CW 26C(8) provides for arrangements in which, if an employee who is not currently employed breaches the restricted period for an exempt employee share scheme, the employee’s shares must be “purchased” back by the employer for the lesser of the cost of the shares to the employee or the market value of the shares on the date the period of restriction ends. The use of the word “purchase” in this context is problematic if an employee was granted shares for nil consideration, as the employer must “purchase” the shares back for that nil consideration, but definitionally, a “purchase” requires a contract and consideration. As a workaround, employers can grant shares for a nominal amount such as $1, and subsequently “purchase” the shares back for that amount. But this fix creates onerous compliance costs and is often questioned by Boards. To correct this issue, references to “purchased” or “bought” should be replaced with either “acquired” or “transferred”.

#### Comment

Officials agree that the use of the word “purchased” in the legislation may be problematic where shares are granted for nil consideration. The exempt employee share scheme rules were not intended to preclude such arrangements, and officials agree that using the word “acquired” or “transferred” instead would resolve the issue.

#### Recommendation

That the submission be accepted.

### Issue: Proposed section CW 26C(8) is unclear

#### Submission

(Chartered Accountants Australia and New Zealand)

Proposed section CW 26C(8) is unclear and should be rewritten. The new drafting could be:

*When the period of restriction ends, the arrangement must provide:*

*if the employee is currently employed that the shares are transferred to the employee, or if the employee chooses, that the shares are purchased for the lesser of*

* *the cost of the shares to the employee;*
* *the market value of the shares on the date the period of restriction ends; or:*
* *if the employee is not currently employed and the employee chooses, that the shares are transferred to the employee or purchased for the lesser of:*
  + *the cost of the shares to the employee; or*
  + *the market value of the shares on the date the period of restriction ends.*

#### Comment

Proposed section CW 26C(8) is complex, as it has to provide for two possible arrangements from which the employer can choose (in relation to an early termination of the “restricted period”).

One of these options distinguishes between an employee who is currently employed and an employee who is not currently employed. The other does not.

This is because the policy intent of the proposed amendment is to allow companies to choose whether a particular subset of employees – those who are not currently employed – (a) have a choice between keeping their shares or having the company buy them back, **or** (b) are required to have them bought back.

While complex, officials consider that the current drafting covers all of the permutations that are intended to be allowed under the amendment. Officials do not consider that the submitter’s suggested drafting covers all of the possibilities. However, we will investigate whether there is a simpler way to draft the provision, while still ensuring that it covers all of the arrangements intended to be permitted.

#### Recommendation

That the submission be accepted.

### Issue: Potential unintended change in the 2004−2008 rewrite

#### Submission

(Deloitte)

In section CW 26C, there is no requirement for dividends paid during the restricted period to flow to employees. In the prior version of the section – section DC 12(5) of the Income Tax Act 2004 – this requirement was included as part of the requirement to have a trustee to hold the shares during the restrictive period. The requirement to have a trust was (sensibly) deleted when the rules relating to tax-exempt ESS were amended, as a trustee should not be required for a scheme to qualify. However, with it, it appears that the dividend requirement was also removed. This deletion does not seem likely to have been a policy intention during the rewrite. Section CW 26C should be revised to clarify and confirm the original policy intention.

#### Comment

Officials agree that removing the requirement for dividends to flow to employees was unlikely to have been a policy intention. Section CW 26(C) should be revised to clarify the original policy intent that dividends must flow to the employees holding the shares.

#### Recommendation

That the submission be accepted.

## Overseas donee status – schedule 32

(Clause 114)

### Issue: Updates to the list

#### Submission

(Matter raised by officials)

Two changes are required to the existing list of organisations named on schedule 32 of the Income Tax Act 2007:

1. Remove “Onesight New Zealand” with effect from 30 May 2019. This trust was wound up on that date.
2. Remove “Orphans Refugees and Aid of New Zealand Charitable Trust” and replace the reference with “Hope Street Charitable Trust” with effect 15 June 2019, the date the charity was rebranded.

#### Comment

The proposed changes are recommended by officials ensure the statutory list remains current. The proposed changes are not new additions to the list of donee organisations and update existing references to reflect changes in the named charities’ circumstances.

#### Recommendation

That the submission be accepted.

## Taxation of life insurance business – transitional relief

### Issue: Implementation concerns

#### Submission

(AIA New Zealand Ltd, Cigna Life Insurance New Zealand Ltd, Financial Services Council)

Submissions raise three matters with the implementation of an amendment made by the Taxation (Annual Rates 2019−20, GST Offshore Registration, and Remedial Matters) Act 2019 at it applies to transitional relief for level premium life insurance policies sold before 1 July 2010.

The issues are:

1. The current description for CPI movements in section EY 30(5BA) of the Income Tax Act 2007 do not reflect life insurer practices. (*AIA New Zealand Ltd, Financial Services Council*)
2. The savings provision that accompanied the legislative change made by the Taxation (Annual Rates 2019−20, GST Offshore Registration, and Remedial Matters) Act 2019 is too limiting for some life insurers to take advantage of the amendment to section E 30. (*Financial Services Council*)
3. Transitional relief should be available for life insurance policies that were sold as “level premium” and provided life cover indexing benefits of more than three percent. (*AIA New Zealand Ltd, Financial Services Council, Cigna Life Insurance New Zealand Ltd*)

#### Comment

In 2010 the taxation of life insurance business was substantially reformed. Accompanying the reform was transitional relief for life insurance policies sold before the start of the new rules (1 July 2010). The transitional relief provides life insurers with a tax deduction to reflect the tax that would otherwise be paid before the 2010 tax reforms.

One form of term life insurance policy offers premiums that remain at a set level over the term of the cover. Section EY 30(5)(b) allows life insurers tax transitional relief for these “level premium” policies sold on or before 30 June 2010. Section EY 30(5)(b) allows for increases in the base premium for such policies if the increase is a result of increasing the amount of life cover for movements in the consumer price index (CPI). The base premium is the premium agreed at the time the life insurance policy is sold. Such increases are annually activated by the life insurer unless the policyholder expressly cancels it.

The rule did not adequately respond to situations when, because of a low-inflation environment, increases in the sum assured under the formula were higher than percentage changes in CPI.

Most level premium policies allow for an incremental increase in premiums over its contractual duration by a formula to reflect percentage changes in the CPI to maintain the real value of life insurance cover. These increases are typically framed by an increase of 3 percent or movement in the CPI index − whichever was the higher.

The amendments made by the Taxation (Annual Rates 2019−20, GST Offshore Registration, and Remedial Matters) Act preserved transitional relief for life insurance policies that provided benefits giving an increase in the amount of life cover where that increase does not exceed three percent or the percentage increase in the CPI (whichever percentage is the higher).

Officials have had ongoing discussions with life insurers regarding the implementation of the amendments made by the Taxation (Annual Rates 2019−20, GST Offshore Registration, and Remedial Matters) Act 2019 and agree that improvements can be made to the wording of the legislation in respect of the first two submission points to ensure the amendments made by that Act operate correctly.

Officials recommend two remedial changes be included in the Bill to:

* Replace the current description of the CPI period being, “consisting of the last 4 quarters preceding the year”, with a reference to the CPI percentage change movement to the annual rate specified in the formula in the life policy.
* Revise the application section (section 65(4) of Taxation (Annual Rates 2019−20, GST Offshore Registration, and Remedial Matters) Act 2019) to ensure that life insurers wanting to use the amendment can do so.

Regarding the third matter raised by submitters, officials’ discussions with affected life insurers and the Financial Services Council on the implementation of the amendment to section EY 30 has revealed a moderately complex background. An array of understandings and expectations exist about the outcomes of the 2010 reforms to the taxation of life insurers, including the extent to which transitional relief is available for level premium life insurance policies sold and in existence immediately before the reforms took effect. To further complicate matters, life insurers have taken different approaches in terms of their compliance systems and the matters on which Inland Revenue’s view has been sought. An illustration of this point can be found in the different recommendations put forward by AIA and Cigna.

Officials consider the solution sought by submitters for the third matter goes beyond the scope of a remedial matter that can be included in this Bill and warrants deeper consideration. Officials recommend, subject to current priorities on the Government’s tax policy work programme, that submitter concerns regarding transitional relief for level premium life insurance policies be considered for a later bill.

#### Recommendation

That the submission be accepted in part, subject to officials’ comments.

## Bright-line main home exclusion

(Clause 60)

### Issue: Support for the proposal

#### Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to amend the main home exclusion for the bright-line test to align the period considered for the exclusion with the period in the bright-line test itself.

#### Recommendation

That the submission be noted.

### Issue: Suggestion for different period

#### Submission

(KPMG)

The submitter agrees that the applicable period for the main home exclusion for the bright-line test should be aligned with the date the five-year period for the bright-line test begins but suggests the period should extend to the date of settlement of any sale.

The submitter agrees that the period from which a mere equitable interest in the property is acquired to when settlement on purchase occurs should be excluded from consideration for the main home exclusion. This is because the owner does not have occupancy rights during that period. However, the submitter suggests that the period considered for the bright-line test artificially curtails the period of use because it ends when an agreement for sale and purchase is entered into. The submitter suggests that where a bright-line property is subject to an extended settlement period on sale and the owners continue to reside in the property it would be inappropriate to exclude this period from consideration for the main home exclusion.

#### Comment

The main home exclusion for the bright-line test in section CB 16A applies where land has been used predominantly, for most of the time, for a dwelling that was the main home for the person. Therefore, the time period that the property is used as a main home is important in determining whether the main home exclusion will apply. Officials consider it is important that this time period is consistent with the period that the bright-line test applies to. This is to ensure that a person cannot manipulate the application of the main home exclusion by occupying the property after the period considered for the bright-line test has ended.

#### Recommendation

That the submission be declined.

### Issue: Settlements of relationship property

#### Submission

(Matter raised by officials)

Clause 60 of the Bill contains an amendment to the main home exclusion for the bright-line test to align the period considered for the exclusion with the period in the bright-line test itself. A further amendment is needed to clarify when this period starts when land is transferred on a settlement of relationship property as defined in section FB 1B.

#### Comment

Section FB 3A applies where residential land that may be subject to the bright-line test is transferred on a settlement of relationship property. It clarifies that the transfer will be treated as occurring for an amount equal to the cost of the land to the transferor, and at the date the transferor acquired the land. Section FB 3A currently applies for the purposes of section CB 6A (the bright-line test). Section FB 3A should be amended to clarify that it also applies for the purpose of section CB 16A (the main home exclusion for the bright-line test).

The proposed amendment would apply from the date of enactment.

#### Recommendation

That the submission be accepted.

## Interest limitation

### Issue: Restricted transfer pricing – optional credit rating method

#### Submission

(Corporate Taxpayers Group, Deloitte, Russell McVeagh)

Section GC 16(11) of the Income Tax Act was amended by the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 to extend the optional credit rating method to long-term senior debt that is “secured”. However, section GC 16(5) still makes specific mention of the requirement for the long-term senior debt to be “unsecured”, with the unintended consequence that taxpayers with only secured debt are excluded from using the optional credit rating method on the basis that they do not meet the strict requirements of section GC 16(5).

Section GC 16(5) should also have the word “unsecured” removed so that taxpayers with secured debt are then able to use the optional credit rating method in section GC 16(11).

#### Comment

As noted by the submitters, amendments to section GC 16(11) in the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 were intended to allow taxpayers to apply the optional credit rating method based on long-term senior debt whether it was secured or unsecured. As a taxpayer can only calculate their interest rate under the optional credit rating method in section GC 16(11) if they satisfy the criteria in section GC 16(5) the word “unsecured” should have been removed from both sections.

#### Recommendation

That the submission be accepted.

### Issue: Non-debt liabilities – shareholder loans

#### Submission

(Deloitte)

The wording “a shareholder that is a member of the group” in section FE 16B(1)(b) should read “a shareholder”. This wording is likely to be an unintentional drafting error. This is because the wording will, essentially make the provision redundant as, if the shareholder was a member of the New Zealand group, the debt would be consolidated away.

#### Comment

Section FE 16B(1)(b) excludes from non-debt liabilities, in the thin capitalisation rules, financial arrangements providing funding that are pro rata with shareholding or by a substantial shareholder.

As thin capitalisation is calculated on a group basis, a financial arrangement between a company and a shareholder where both were members of the group would not increase the debt of the group as the arrangement would disappear upon consolidation. Therefore, the submitter is correct that the current wording would apply only to arrangements that would not affect the group’s debt levels.

Also, officials have been made aware of situations where two members of a wholly-owned group exist where the first member is a shareholder of a New Zealand group member and the second member provides either an interest free loan or redeemable preference shares in proportion with the first members shareholding. By removing the wording discussed in the paragraph above this situation will be covered by the associated person reference in section FE 16B(1)(b)(ii) and (c)(ii) but there is no equivalent for proportional shareholdings where the total shareholding in the New Zealand group member is less than ten percent. Officials recommend changes to section FE 16B(1)(b)(i) and (c)(i) to ensure this situation is also excluded from being a non-debt liability.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

(Clause 83)

### Issue: Dividend paid out of previously attributed income

#### Submission

(Matter raised by officials)

That the proposed amendment in clause 83 does not achieve the policy intent.

#### Comment

A submitter on the Bill has queried whether the proposed amendment in clause 83, relating to the income attribution rules, achieves its policy intent.

As set out in the commentary on the Bill, the policy intent for this proposed amendment is to ensure that a dividend paid by a company (“associated entity”) that has previously attributed income to a shareholder (“working person”) is exempt income of the recipient if it is paid out of the previously attributed income, and the company’s records demonstrate this.

Officials agree that the wording proposed does not clearly identify that the dividend is exempt only if it represents a distribution from income attributed to and taxed to a working person in an earlier income year. We recommend that the drafting be updated to clarify this intent.

#### Recommendation

That the submission be accepted.

# New matters raised at Select Committee

## Ring-fencing residential property deductions

### Issue: Residential income that deductions can be used against

#### Submission

(Matter raised by officials)

The definition of “residential income” should be amended to ensure that residential property deductions can be used against net land sale income from residential property that is outside the ring-fencing rules because it is held on revenue account.

#### Comment

There is a cross-referencing error in the definition of “residential land” in section EL 3. As the definition is currently worded, deductions for residential property in the ring-fencing rules can be used against income from the property (or portfolio) and against net rental income and net depreciation recovery income from residential property that is outside the rules because it is held on revenue account. Deductions should also be able to be used against net sale income from such revenue account property.

#### Recommendation

That the submission be accepted.

### Issue: Clarifying that amounts of residential income can only be counted once

#### Submission

(Matter raised by officials)

It should be clarified that amounts of residential income from residential property outside the ring-fencing rules can only be counted once for the deduction allocation rules.

#### Comment

The definition of “residential income” in section EL 3 includes four components. These are:

(a) rental income from the portfolio (or individual property);

(b) depreciation recovery income from the portfolio (or individual property);

(c) net land sale income from the portfolio (or individual property); and

(d) net rental income and depreciation recovery income from residential property that is outside the ring-fencing rules because it is held on revenue account.

As noted in *Issue: Residential income that deductions can be used against*, item (d) should also include net land sale income from residential property that is outside the ring-fencing rules because it is held on revenue account.

There is a clarification required, to ensure taxpayers can only count amounts of “residential income” once. This is because a taxpayer may apply the ring-fencing rules on a portfolio basis for some properties and on a property-by-property basis for another property, or they may have two or more properties on a property-by-property basis. In these situations, the deduction allocation rule is applied to each property (or a property and the portfolio) separately.

Items (a) to (c) of “residential income” are amounts from the particular property or portfolio, so cannot be counted when looking at another property or portfolio.

However, item (d) includes amounts of income from property outside the rules. On the face of it, there is nothing to preclude a taxpayer counting such amounts more than once – for example, once in ascertaining their “residential income” for their portfolio, and once in ascertaining their “residential income” for a property-by-property basis property. It should be clarified that if an amount of residential income has been counted, it cannot be counted again for allocating deductions for another property.

#### Recommendation

That the submission be accepted.

### Issue: Unused excess deductions not released on taxable sale of portfolio or property

#### Submission

(Matter raised by officials)

An amendment should be made to ensure the carry forward of unused deductions that are not released on a taxable sale of a residential property or portfolio.

#### Comment

If a property-by-property basis residential property is taxed on sale, or if all of the properties are sold and all sales were taxed, any excess deductions remaining (after use against the rental income and net land sale income) are released from the ring-fencing rules. This means those amounts can be used against income from other sources, such as salary and wages. However, if there has been an unused excess transferred to the property or portfolio from another property or portfolio that was not taxed (or not fully-taxed) on sale, the amount transferred is not released. Currently, there is no mechanism for any unfenced amount remaining after a taxable sale to be treated as relating to (and transferred to) another property. There should be such a mechanism, as there is for excess amounts remaining after non-taxed disposals.

If this amendment is made, the opportunity could be taken to incorporate what is now section EL 8 (which deals with the treatment of previously transferred amounts on a fully-taxed disposal) into sections EL 5 and EL 7, which deal with sales of portfolios and property-by-property basis residential properties, respectively.

There is also a cross-referencing error in section EL 7(2), which should be amended.

#### Recommendation

That the submission be accepted.

### Issue: Operation of the interposed entity rules

#### Submission

(Matter raised by officials)

Some amendments are required to the interposed entity rules to ensure they operate as intended.

#### Comment

Section EL 16(2) suspends excess interest deductions related to investing in a land-rich entity. These are deductions that exceed the person’s share of the entity’s residential income, taking into account the level of capital used to acquire the residential property.

Currently the suspended deductions are carried forward to a later income year in which the person derives residential income or a distribution from the entity (to the extent such distribution relates to residential land). But the excess deductions are then not used against either of those types of income, but rather added to the person’s interest expenditure and used against the person’s share (effectively) of the “entity’s net residential income”.

Section EL 16(2)(b)(i) and (ii) therefore do not bear any relation to the income the excess deductions can be used against. What section EL 16(2)(b) should instead do is carry the excess deduction forward to a later income year in which the **entity** derives residential income. Subparagraphs (b)(i) and (ii) do not serve any purpose and should be removed.

There is a related issue in respect of section EL 18(a). In that provision (which modifies the interposed entity rules for transparent entities), the person’s residential income for the year is treated as their share of “net residential income”. That is fine when the only residential property the person has is held in the entity. But the person may also hold other residential property directly. If they do, they should not be able to use excess interest deductions related to the investment in the entity against that other residential income. Section EL 18(a) should instead provide that the person’s residential income for the income year f**rom the property held in the entity** is what is treated as their share of net residential income.

#### Recommendation

That the submission be accepted.

## Taxation of trusts

### Issue: Generic tax policy process not followed

#### Submission

(Chartered Accountants Australia and New Zealand, KPMG)

That the proposed amendments should be deferred for full consultation under the generic tax policy process. (*Chartered Accountants Australia and New Zealand*)

Only matters which are properly clarification should proceed. Other proposals should be deferred for proper consideration through the generic tax policy process.

Alignment of the legislation with *IS 18/01 Taxation of trusts – income tax* (a Commissioner’s interpretation statement) should not be accepted as justification for any proposed amendment. (*KPMG*)

#### Comment

All of the proposed amendments are of a remedial nature and are consistent with the policy intent.

The proposed trust remedial measures arise from a detailed administrative review of the Commissioner’s application of the existing law and do not represent a proposal to change the policy intent for the taxation of trusts. In general, the trust rules have always modified the common law approach relating to the treatment of income and capital to align the taxation of trusts with the general tax rules for the taxation of income (as defined in the Income Tax Act 2007).

Stakeholders have been extensively consulted with through the process of the administrative review and some have made further submissions on the remedial measures proposed in the Bill that reflect the outcome of that review.

In developing the Commissioner’s interpretation statement (*IS 18/01 Taxation of trusts – income tax*), stakeholders were consulted on the application of the current law, and their views considered in developing the Commissioner’s administrative practice for the taxation of trusts.

The Commissioner applied normal interpretive principles in arriving at her application of the law for the taxation of trusts. This review culminated with the release of an interpretation statement, *IS 18/01 Taxation of trusts – income tax* earlier in 2018 which identified a small number of changes in the way the Commissioner applies the existing law, within the scope of the current policy framework for the taxation of trusts.

Officials also note that the generic tax policy process contemplates that provisions in Taxation Acts need to be maintained or updated in response to changing business practices, jurisprudence or other factors (<http://taxpolicy.ird.govt.nz/work-programme#remedials>).

Clear, unambiguous legislation that keeps up to date with changing business and administrative practices reduces both administrative and compliance cost as it reduces uncertainty and reduces the risk of litigation being undertaken to clarify the meaning of the current law as it is applied by the Commissioner.

#### Recommendation

That the submission be declined.

### Issue: Definition of trust and trustee

#### Submission

(KPMG)

The amendment to the definitions of trust and trustee made by the Trusts Act 2019 should be considered for whether amendments to the Income Tax Act 2007 are required.

#### Comment

Officials have followed the progress of the Trusts Bill through the legislative process and are currently reviewing the effect for taxation purposes, if any, of the changes to the definitions of trust and trustee in the Trusts Act 2019.

#### Recommendation

That the submission be noted.

### Issue: Trusts taxed twice on New Zealand sourced income.

#### Submission

(nsaTax)

Section HC 15(2) of the Income Tax Act 2007 should be amended to exclude distributions of tax-paid New Zealand sourced income from the definition of “taxable distribution”.

#### Comment

The policy for the taxation of taxable distributions does not provide a tax credit for New Zealand tax previously paid on trustee income. This double taxation effect (tax on trustee income and tax on the beneficiary on distribution) is an intended effect.

This effect is part of the policy design of the trust rules to encourage a trustee of a foreign trust or a non-complying trust to elect to pay New Zealand tax on the world-wide trustee income (for example, to become a complying trust). This is because distributions from a complying trust are taxed only once – either as tax on trustee income or as tax on beneficiary income. All other distributions from a complying trust are not taxed to the beneficiary.

The objective of this policy in relation to New Zealand sourced income is to mitigate against the accumulation of that income offshore in a way that benefits a New Zealand resident beneficiary because the New Zealand tax on that income is limited to non-resident withholding tax rates.

#### Recommendation

That the submission be declined.

### Issue: A person treated as a settlor under section HC 27(6) of the Income Tax Act 2007

#### Submission

(nsaTax)

Section HC 27(6) should be amended to clarify that the interest paid should be within 12 months after the end of the income year.

Section YB 10 of the Income Tax Act 2007 (when a person is associated with another person) should be amended to exclude persons that are settlors by virtue of section HC 27(6) of the land provisions.

#### Comment

Officials agree that the wording of section HC 27(6) of the Income Tax Act 2007 should be clarified to better reflect the timing issues.

Officials consider that a person who is treated as a settlor of a trust is intended to be included in the associated persons rules for the purpose of the land sales rules.

#### Recommendations

That the submission about the temporal element be accepted, subject to officials’ comments.

That the submission about the associated persons rules be declined.

## GST on low-value imported goods

### Issue: Reverse charge – GST-registered recipient returns the GST

#### Submission

(Matter raised by officials)

An amendment should be made so that the reverse charge in the Goods and Services Tax Act 1985 (the GST Act) only applies to a supply of goods when:

* the goods are imported by the recipient of the supply in a consignment with a total value of $1,000 or less; and
* the recipient does not pay GST to Customs, nor to the supplier of the goods.

#### Comment

The new GST rules applying to supplies of low-value imported goods by offshore suppliers contain an exclusion for supplies to New Zealand GST-registered businesses. The rationale for this is that the application of GST to business-to-business supplies is broadly revenue neutral, as GST-registered businesses purchasing goods and services will generally claim back any GST charged by the supplier as a credit in their GST returns.

However, in some cases, a GST-registered person may purchase goods from an offshore supplier for non-taxable use (for example, private use). Amendments were made to ensure that, in the situation where a GST-registered person purchases low-value imported goods from an offshore supplier for partial private use, the GST-registered New Zealand business is required to return GST under the reverse charge. However, the scope of the amendments to the reverse charge are wider than what was intended, meaning that there is potential for double taxation to occur in some instances.

To rectify this, officials recommend that the proposed amendment should apply from 1 December 2019 (the date the GST on low-value imported goods rules came into force) with an optional savings provision to ensure that taxpayers are not disadvantaged.

#### Recommendation

That the submission be accepted.

### Issue: Interaction of marketplace rules with existing agency rules

#### Submission

(Matter raised by officials)

Officials recommend an amendment to provide an exclusion from the marketplace rules in the GST Act for supplies of remote services made by New Zealand-resident underlying suppliers through marketplaces operated by New Zealand residents.

#### Comment

The electronic marketplace rules in the GST Act currently only apply to electronic marketplaces for remotely-supplied services and digital products (remote services) operated by non-residents. A recent amendment will extend the marketplace rules to electronic marketplaces operated by New Zealand residents, so that as of 1 December 2019 New Zealand-resident marketplace operators will be liable to return GST on supplies of remote services and low-value imported goods made through their platforms by non-residents to consumers in New Zealand.

An unintended consequence of the recent amendment is that the electronic marketplace rules will also apply to arrangements that are purely domestic in nature and which are already covered by existing agency rules in the GST Act. Because there is only a very limited ability to opt out of the electronic marketplace rules, the effect is that the electronic marketplace rules will override the existing agency rules as they apply to these domestic arrangements, which was not intended.

As the suggested amendment is taxpayer-friendly and aligns the law with the policy intention, officials recommend that the suggested amendment should apply from 1 December 2019 with a savings provision to protect tax positions taken by taxpayers in reliance on the amendment made in the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019.

#### Recommendation

That the submission be accepted.

### Issue: Knowledge offence for consumers and underlying suppliers providing incorrect or misleading information

#### Submission

(Matter raised by officials)

Officials recommend an amendment to the knowledge offences in the Tax Administration Act 1994 to provide that a recipient of a supply of low-value imported goods commits a knowledge offence if he or she knowingly provides altered, false or misleading information for the purpose of avoiding paying GST.

Officials also recommend a further amendment to provide that a non-resident underlying supplier selling low-value goods through an electronic marketplace commits a knowledge offence if it knowingly provides false or misleading information which results in the operator of the marketplace underpaying GST to Inland Revenue.

#### Comment

Section 143A(1)(g) of the Tax Administration Act 1994 provides that a recipient of a supply of remote services commits a knowledge offence if he or she knowingly provides altered, false or misleading information about his or her residency or GST registration status to avoid being charged GST.

This provision was overlooked when the GST on low-value imported goods legislation was drafted, largely because it was presumed that section 143A(1)(c)[[14]](#footnote-15) would be sufficient to cover the situation where a recipient of a supply of low-value imported goods provides incorrect or misleading information to avoid being charged GST. However, given the existence of section 143A(1)(g) for remote services, officials consider that it would be clearer and more transparent if the scope of section 143A(1)(g) was extended to low-value imported goods, or if a similar provision specifically for low-value imported goods was inserted.

The suggested amendments to the knowledge offence provisions would also be in keeping with recent amendments to the GST Act that provide the Commissioner of Inland Revenue with discretion to require a person (being the recipient of a supply of low-value imported goods or a non-resident underlying supplier selling through an electronic marketplace) to register and pay GST that should have been charged when:

* the person knowingly provides altered, false or misleading information which has resulted in GST being underpaid; and
* the amount of GST is substantial or the behaviour is repeated.

Officials propose that this amendment would apply from the date of enactment.

#### Recommendation

That the submission be accepted.

### Issue: Requirement to include GST information in import documentation

#### Submission

(Matter raised by officials)

The requirement for a supplier of low-value imported goods to take reasonable steps to ensure that its GST registration number and information about whether GST was paid at the point of sale should only apply if GST is required to be charged on the supply of all or some of the goods in the consignment.

#### Comment

For the purpose of preventing double taxation, new section 24BAC requires suppliers of low-value imported goods to take reasonable steps to ensure that its GST registration number is included in the import documentation for a consignment of low-value imported goods, along with an indication of whether GST was paid at the point of sale on each item being shipped.

This requirement applies broadly to all supplies of low-value imported goods – including supplies that are generally excluded from the requirement to charge GST at the point of sale, such as supplies to GST-registered businesses. This potentially creates unnecessary compliance costs in respect of bulk shipments of many low-value items to GST-registered businesses in New Zealand where Customs will collect GST on the consignment regardless of whether this information is included in the import documentation.

Given that the proposed amendment is taxpayer-friendly and is purely administrative in nature, officials recommend that the proposed amendment should apply from 1 December 2019 to avoid imposing unnecessary compliance costs on suppliers of low-value imported goods.

#### Recommendation

That the submission be accepted.

### Issue: Requirement to include amount of tax charged on receipt

#### Submission

(Matter raised by officials)

Officials recommend removing the requirement for suppliers of low-value imported goods to include the amount of GST charged on receipts issued to consumers. Given the requirement for the receipt to include an indication of which items listed on the receipt had GST charged at the point of sale and which had not, the separate requirement to include the amount of tax on the receipt is not needed and may lead to unnecessary compliance costs for suppliers in some instances.

#### Comment

For the purpose of preventing double taxation, new section 24BAB requires a supplier of low-value imported goods to issue a receipt if GST has been charged on a supply. This provides the consumer purchasing the goods with documentation that they can provide to Customs as evidence that GST was charged at the point of sale so that Customs does not collect GST again when the goods are imported into New Zealand.

If GST has been charged on all the goods included on the receipt, the requirement to indicate those items that had GST charged at the point of sale and those that did not can be met by simply including the total GST-inclusive price on the receipt and stating that this price includes GST – making the additional requirement to state the amount of GST charged unnecessary. As some suppliers will simply charge GST on all goods they supply to consumers in New Zealand, there is no benefit from requiring them to make changes so that their receipts will include the amount of GST charged when a statement that the price is inclusive of GST should suffice.

Given that the proposed amendment is taxpayer-friendly and is purely administrative in nature, officials recommend that the proposed amendment should apply from 1 December 2019 to avoid imposing unnecessary compliance costs on suppliers of low-value imported goods.

#### Recommendation

That the submission be accepted.

## Other GST issues

### Issue: Removing a GST barrier to buying homes using co-ownership and rent-to-buy arrangements

#### Submission

(Russell McVeagh)

Co-ownership and rent-to-buy arrangements under which a third party investor (not related to the home buyer or developer of the house) co-owns the house to assist the home buyer to become a full owner over time should be afforded the same GST treatment as a “financial service”.

The current GST laws are likely to impose a barrier to using co-ownership and rent-to-buy arrangements because:

* compliance with the relevant GST rules can be highly complex;
* it treats a co-owner as if they were a dealer in property, whereas in substance the arrangement is to provide funding; and
* there would be increased volatility that will be priced into the cost of housing for the home owner.

#### Comment

Officials agree that the current GST laws are likely to disadvantage these arrangements compared to more traditional mortgage financing.

However, rather than introducing an amendment to the current Bill, officials consider that further policy work and consultation would be required to:

* determine whether or not “financial services” is the most appropriate GST treatment (as opposed to other policy options);
* design a proposed definition or set of rules;
* check that the proposal would accommodate the full range of existing and potential rent-to-buy and co-ownership arrangements. As the submitter points out, a “range of legal arrangements for co-ownership and rent-to-buy models are possible”. The Government has announced an intention to develop a progressive home ownership scheme (which could take the form of a rent-to-buy arrangement), but at this time the details of this proposal are still being developed; and
* check that the proposal does not create unintended consequences such as creating a mechanism that enables property developers to avoid paying GST on their profits from their property development activities.

#### Recommendation

That the submission be declined, subject to officials’ comments.

### Issue: GST deductions for capital raising costs – remedial reference to participatory securities

#### Submission

(Matter raised by officials)

A special rule allows GST deductions for capital raising costs associated with issuing equity or debt securities. A remedial amendment should be made so this rule also applies to participatory securities.

#### Comment

In 2017 a provision was introduced to allow a GST registered person who principally makes taxable supplies to recover GST incurred in the issue of a debt security or an equity security. However, because of an oversight, the provision does not refer to the issue of a participatory security, despite the fact that the corresponding financial services definition refers to “the issue of… an equity security or participatory security”.

Like equity and debt securities, participatory securities can be issued by businesses to raise capital. Adding a reference to “participatory securities” would be consistent with the policy intention of allowing GST deductions for capital raising costs.

The proposed remedial amendment should apply from 1 April 2017 as this is the date that the rule allowing GST deductions for capital raising costs took effect.

#### Recommendation

That the submission be accepted.

### Issue: Clarifying the scope of an exemption for certain government grants provided to social housing providers

#### Submission

(Matter raised by officials)

Section 5(6F) of the GST Act should be amended to clarify that all types of payments by Government to social housing providers under a tailored agreement to provide social housing are exempt from GST.

#### Comment

Like other residential landlords, social housing providers are exempt from GST for their supplies of accommodation in dwellings provided to their tenants.

In 2015, a provision was added to the GST Act to ensure that payments made by the Government to social housing providers under reimbursement agreements and tailored agreements to provide social housing are treated as consideration for an exempt supply of accommodation in a dwelling.

The tailored agreements that have subsequently been agreed include several types of payment: a rent subsidy, an operating supplement, and in limited cases, a capital grant. There is uncertainty as to whether or not all of these types of payment would qualify for the existing GST exemption in section 5(6F). If the GST exemption was found to not apply to some types of payment, the Government would need to gross up these payments to social housing providers in order to subsidise the same amount of tenancies in social housing accommodation.

From a policy perspective, the overall purpose of the tailored agreement is to provide social housing tenancies so it would be appropriate to clarify that all the payments made under a tailored agreement are deemed to be consideration for an exempt supply. The proposed remedial change would provide certainty and reduce compliance costs for social housing providers and the Government. As it would align with existing practices, the remedial amendment should apply from May 2015, when section 5(6F) was introduced.

#### Recommendation

That the submission be accepted.

## Hybrid and branch mismatch rules

### Issue: Disregarded hybrid payment rule – no deduction denial for reimbursement of external group costs

#### Submission

(Corporate Taxpayers Group, Deloitte, Russell McVeagh)

The disregarded hybrid payment (primary) rule, which is contained in section FH 5 of the Income Tax Act 2007, should be amended to ensure that the New Zealand branch of a non-resident company or a New Zealand resident hybrid entity is allowed a deduction for a payment to the extent that:

* the payment reimburses third party expenditure of a group member; and
* the third-party expenditure is non-deductible (in New Zealand and in the foreign jurisdiction).

This amendment should be retrospective to the application date of the provision. That is, it should apply for income years beginning on or after 1 July 2018.

#### Comment

Officials agree with this submission because the current rule would apply to payments that, when considered alongside the third-party expenditure described above, do not produce the net deduction-no inclusion hybrid outcome that the rule is targeted at.

However, officials believe that this amendment should only apply when the third-party expenditure is non-deductible because the income of the branch or hybrid entity is not taxable in the foreign jurisdiction.

#### Recommendation

That the submission be accepted, subject to officials’ comments.

### Issue: Opaque election – exemption for transitional expenditure

#### Submission

(Deloitte)

Expenditure arising from the transition of a foreign hybrid entity (with transparent tax treatment in New Zealand) to an opaque entity under section FH 14 should not be subject to deduction denial under the hybrid and branch mismatch rules.

#### Comment

The opaque election rule was designed as a mismatch-eliminating option for taxpayers which would reduce their compliance costs. It is therefore inappropriate for the hybrid and branch mismatch rules to apply on a one-time basis to expenditure that arises from making an opaque election under section FH 14.

Officials consider that this amendment should be retrospective to the application date of the provision. That is, it should apply for income years beginning on or after 1 July 2018.

#### Recommendation

That the submission be accepted.

### Issue: Defensive branch rule – counteraction should be for margin on branch charge rather than gross amount

#### Submission

(Corporate Taxpayers Group)

The drafting of the defensive branch rule contained in section FH 6 should be amended to ensure that the included income for the taxpayer is the margin on the branch charge, not the entire amount.

#### Comment

Officials have not yet seen practical examples demonstrating the problem this issue causes, and as a result the need for including an amendment to this Bill is not established. Officials will consider the issue further.

#### Recommendation

That the submission be declined.

### Issue: Defensive branch rule – limitation of scope to foreign offset situations

#### Submission

(Corporate Taxpayers Group)

Consistent with the approach taken to section FH 8, the scope of section FH 6 should be limited such that it does not apply in the case of a foreign branch of a New Zealand entity that is making losses and cannot offset those losses against the income of another person or entity in the foreign country.

#### Comment

Officials have not yet seen practical examples demonstrating the problem this issue causes, and as a result the need for including an amendment to this Bill is not established. Officials will consider the issue further.

#### Recommendation

That the submission be declined.

### Issue: Exemption from hybrid and branch mismatch rules for small businesses

#### Submission

(Russell McVeagh)

To reduce compliance costs, small businesses should be exempt from the application of the hybrid rules.

The submitter suggested in oral submission to the Committee that this exemption could take the form of a de minimis based on the turnover or net income/loss of the business.

#### Comment

The hybrid and branch mismatch rules, which were introduced in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018, are based on the OECD recommendations on hybrid and branch mismatch arrangements. Those recommendations did not contain a recommendation for a small business exemption or de minimis threshold. Officials are not aware that any other countries have adopted or proposed such an approach for their hybrid mismatch rules.

The rules apply to complex cross-border structuring and this fact should generally exclude small businesses from interacting with the complexity of the provisions. Section FH 8 has a specific exclusion for New Zealand companies that operate in foreign countries through a branch or a hybrid entity but do not have the ability to offset foreign losses against the income of another entity. This exclusion is designed as a safe harbour for small businesses that conduct their operations in a foreign jurisdiction.

The OECD-designed framework of hybrid and branch mismatch rules also weighs against such an exemption. This is because of the primary and defensive rules interface; most mismatches can be addressed by more than one country. If New Zealand’s primary rule does not apply because we have an exemption, then a foreign jurisdiction’s defensive rule will apply. For this reason, a small business exemption would be unlikely to have an effect, because New Zealand’s exemption could be undone by a foreign jurisdiction’s rule. For New Zealand-based businesses, overall compliance costs could be increased by an exemption as it may become necessary to apply a foreign jurisdiction’s hybrid and branch mismatch rules instead of New Zealand’s rules.

#### Recommendation

That the submission be declined.

## Working for Families tax credit matters

### Issue: Adjusting payment due dates for some Working for Families tax credit recipients

#### Submission

(Matter raised by officials)

An amendment should be made to adjust the payment due date for some tax credit recipients, if their income tax assessment cannot be finalised because Inland Revenue needs to complete another person’s assessment first to determine their entitlement to tax credits.

#### Comment

Eligibility for Working for Families requires an assessment of family income. This requires both partners to be assessed for income tax. This can result in a timing issue where one partner has an extension of time for their tax obligations. This results in some peoples’ income tax assessments being unable to be finalised by their tax due date, because they are dependent on another person’s income tax assessment being completed first. Those people affected are:

* Working for Families (WfF) recipients who had a partner at any time during the year; and
* those with potential entitlement to the independent earner tax credit (IETC) who were a partner of a WfF recipient during the tax year.

Under current rules, any tax payable of $100 or more is subject to penalties and interest from the original payment due date.

Officials consider that Inland Revenue should be able to adjust the terminal tax due date for some tax credit recipients, to provide 30 days to pay any debit amount, from the date their assessment is finalised.

The proposed amendment would ensure that a person will not be subject to interest and penalties from the original due date, in situations where their assessment cannot be finalised because of dependence on another person’s assessment.

The proposed change in due date would impact any payment due for that person on the terminal tax date, that is WfF, income tax, and student loan.

The proposed change would apply for assessments for the 2020 tax year onwards.

#### Recommendation

That the submission be accepted.

### Issue: Use of current Working for Families tax credits entitlement to repay prior year overpayments

#### Submission

(Matter raised by officials)

An amendment should allow recipients to use their Working for Families (WfF) current entitlement to offset earlier overpayments, paid by either Inland Revenue or the Ministry of Social Development, in the year the overpayment occurred.

#### Comment

Current provisions allow WfF recipients to use their current entitlement to repay overpayments from an earlier year, if they received their WfF from Inland Revenue in the year the overpayment occurred. However, WfF recipients who were beneficiaries receiving their WfF from MSD in the year the overpayment occurred cannot use their entitlement in this way.

Officials consider that all WfF recipients who are receiving their payments from Inland Revenue should be able to use their current WfF entitlement to offset prior year overpayments, regardless of which agency made the WfF payments in the year the overpayment occurred.

The proposed amendment would ensure that all WfF recipients paid by Inland Revenue have the same options available to them to manage any overpayments.

The option for Inland Revenue paid WfF recipients to use their current entitlement to repay prior year overpayments would be available from the 2020 tax year onwards.

#### Recommendation

That the submission be accepted.

## Application of section 120KBB guidance

### Issue: Further guidance would be desirable

#### Submission

(KPMG)

We consider that further guidance and examples would be desirable on application of the “interest concession rules” in section 120KBB of the Tax Administration Act 1994.

While a *Tax Information Bulletin* was prepared following the enactment of those rules, there are a number of nuances and practical issues that are not covered, which could usefully be clarified so that there is consistent understanding of how the interest concession rules apply.

#### Comment

Officials will look at including examples in the *Tax Information Bulletin* that covers this Bill.

#### Recommendation

That the submission be noted.

## Clarification for taxpayers who pay provisional tax in one or two instalments

### Issue: An interpretation issue exists with sections RC 13(3), RC 14 (2) and RC 9(9)

#### Submission

(Deloitte)

There is an interpretation issue with sections RC 13(3) and RC 14(2) of the Income Tax Act 2007 which reference section RC 9(9)(b) and (c).

Section RC 9(4)(c) applies where a person is liable to pay provisional tax but has not provided a return in the preceding year and whose residual income tax (RIT) in the year before the preceding year is less than $2,500. It means that sections RC 13(1)(b) or RC 14 (1)(b) will apply so that provisional tax is payable in either two or one instalment(s), depending on when the prior year’s return is filed.

It appears there is a missing link for these scenarios in sections RC 13(3) and RC 14 (3) respectively. These sections refer only to initial provisional taxpayers, so taxpayers are not provided legislative guidance as to how many instalments to pay or how to apply sections RC 13 or RC 14 in other cases.

#### Comment

While we understand taxpayers’ and Inland Revenue’s administrative practice is to ignore the fact that section RC 9(9) only technically applies to initial provisional taxpayers, we agree this should be corrected so that it is clear how many provisional tax instalments are payable in those situations.

For those taxpayers, use-of-money interest will apply across three instalments rather than the number of instalments. However, the distinction is important when considering the application of late payment penalties and whether taxpayers have met conditions for interest concession rules, such as the safe harbour to apply.

#### Recommendation

That the submission be accepted.

## Clarifying the amount on which interest and late payment penalties are applied

### Issue: Inland Revenue’s systems are not calculating interest in accordance with legislation

#### Submission

(Tax Management New Zealand Limited)

Inland Revenue’s system is coded to use the formula found in section RC 10(2) of the Income Tax Act 2007 to calculate the amount due at an instalment. The system also replaces the term “residual income tax” (RIT) as defined in subsection 3 with the actual RIT for the year if this figure turns out to be lower.

As a result, an issue arises in situations where:

* a taxpayer files the previous year’s return – which has a significantly higher RIT than the return from two years ago which they used as the basis to calculate their first instalment – between their first and second instalment dates; and
* a third of the current year RIT turns out to be lower than the uplift amount due at the second instalment.

That is because Inland Revenue systems are calculating the amount payable at the second instalment based on the lesser of:

* the actual RIT for the year, multiplied by two and divided by three, minus the 110 percent uplift amount at the first instalment; or
* the previous year’s RIT uplifted by 105 percent, multiplied by two and divided by three, minus the 110 percent uplift amount at the first instalment.

We believe what Inland Revenue is doing operationally to calculate the amount payable at the second instalment is not consistent with section 120KBB(3)(b). Either the system or the legislation should be clarified.

#### Comment

This issue has been raised with officials previously by the submitter and it was confirmed to them that for the 2017−18 income year there was a programming issue with the old technology platform, FIRST. We have identified the affected taxpayers, and this is being corrected where those taxpayers have been overcharged penalties or interest. In the unlikely situation where a taxpayer has been undercharged penalties and interest no action is being taken.

This issue has been corrected in Inland Revenue’s new technology platform, again the submitter has been previously informed of that.

#### Recommendation

That the submission be declined.

## Other matters

### Issue: Clarification to the filing rules for individuals

#### Submission

(Matter raised by officials)

Section 22H of the Tax Administration Act 1994 sets out the process for finalising accounts under the individuals’ income tax rules that were enacted as part of the Taxation (Annual Rates for 2018−19, Modernising Tax Administration and Remedial Matters) Act 2019.

Officials consider that this section requires two amendments. The first is to ensure that an individual can finalise their account up to and including 7 July. The second is that a further provision is required to allow for late filing, as this has been inadvertently removed.

These proposed amendments ensure that the law will not cut short a taxpayer’s ability to file a return and will permit them to late file, if required.

The proposed application date for this change should be retrospective to 1 April 2019, the date that the income tax changes for individuals were enacted.

#### Recommendation

That the submission be accepted.

### Issue: Clarifying when interest starts for individuals

#### Submission

(Matter raised by officials)

Section 120C(1)(iib), which defines the date interest starts, refers to a “qualifying individual” but this needs to be amended to “qualifying individual, or an individual who is treated as a qualifying individual”.

#### Comment

This amendment is necessary to ensure that the date interest starts is aligned for qualifying individuals and individuals who are treated as qualifying individuals. This accords with the policy intent which is to provide the same rules across the individuals’ income tax regime to both qualifying individuals, and individuals that have been treated as qualifying individuals.

A person is a qualifying individual if they only earn income that has been reported to Inland Revenue within a short time after the end of the tax year such as salary and interest income. If a person earns other income such as overseas income or rental income, they do not meet the definition of a qualifying individual.

In some instances, a person who is not a qualifying individual may be treated as such by Inland Revenue. The policy intent is that that person should have the same rights as a qualifying individual. That is, they would be able to make changes and update information held by Inland Revenue without being subjected to penalties or interest. This applies until the terminal tax date which is usually 7 February of the year following the end of the tax year.

The proposed application date for this change should be retrospective to 1 April 2019, the date that the income tax changes for individuals were enacted.

#### Recommendation

That the submission be accepted.

### Issue: Clarifying when the Commissioner is required to issue a notice of proposed adjustment

#### Submission

(Matter raised by officials)

Section 89C requires an amendment to make it clear that the Commissioner is not required to issue a notice of proposed adjustment (NOPA) before making an assessment under section 22H(1).

#### Comment

Section 89C(l) was amended by the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 to say that the Commissioner does not need to issue a NOPA to amend a qualifying individual’s assessment and, in accordance with section 22G(6) can amend a qualifying individual’s assessment at any time up to the timebar by notifying the individual.

This type of amendment will occur when the Commissioner has automatically calculated a person’s tax assessment and the Commissioner subsequently becomes aware of further information that changes the person’s tax position. The Commissioner would add the additional information into the person’s tax information and would finalise their tax position based on the information held. The Commissioner would notify the person of the assessment and they would be able to challenge the assessment if they did not agree with it.

The problem that arises is that the amendment made is not the correct equivalent to the prior section. Pre-amendment the section deals with issuing an assessment, but post-amendment the section sets out the ability of the Commissioner to amend an assessment that has already been made.

An additional provision is also required specifying that the Commissioner is not required to issue a NOPA before assessing a qualifying individual. This is necessary to make it clear that the Commissioner does not have to issue a NOPA before making an amendment and finalising a qualifying individual’s tax assessment.

The proposed application date for this change should be retrospective to 1 April 2019, the date that the income tax changes for individuals were enacted.

#### Recommendation

That the submission be accepted.

### Issue: Repealing a redundant provision that relates to “non-filing” taxpayers

#### Submission

(Matter raised by officials)

Section 141JA is redundant and should be repealed. This section covers the application of penalties to non-filing taxpayers and was updated in the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 to reflect a change in terminology when the law on income statements was abolished and replaced with the new individuals’ income tax regime.

The current law says that penalties will not apply to a non-filing taxpayer who has withheld their own PAYE and who is required to provide other income information where the Commissioner considers that other income information to be correct.

The problem is that a taxpayer who provides “other income” information, or one who earns PAYE income, is not a “non-filing taxpayer”. These taxpayers will be squared up at the end of the year under the new rules.

The section as drafted is in conflict because it deals with the application of penalties to a non-filing taxpayer but requires the taxpayer to provide other income information to satisfy the section (which makes them a filer).

Under previous law, there was a rationale for this section, but it no longer exists.

#### Comment

Officials consider that section 141JA should be repealed.

#### Recommendation

That the submission be accepted.

### Issue: Minor amendment to the write off rules for individuals

#### Submission

(Matter raised by officials)

An amendment is proposed to schedule 8 of the Tax Administration Act 1994 to ensure that the Commissioner has discretion to write off small amounts of tax payable.

Schedule 8 Part B of the Tax Administration Act 1994 sets out a number of provisions that provide for a write off of tax payable. These rules largely apply from 1 April 2019. As per section 112 of the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019, an updated version of schedule 8 is set to apply from 1 April 2020 to make provision for the “extra pay period” write-off which applies from that date. The updated version that comes into force on 1 April 2020 also includes a clause to allow for the Commissioner to write off small amounts of tax payable. Officials consider that this provision should have come into force on 1 April 2019.

#### Comment

Officials consider that Schedule 8 Part B clause 3 as contained in section 112 of the amending Act, which is set to apply from 1 April 2020, should apply retrospectively to 1 April 2019. A 2019 application date is necessary to support the efficacy of some of the other write off provisions that were enacted for 1 April 2019. For example, the policy intent is not to exclude a taxpayer from a write off under the income tested benefit write-off rule where they had a few dollars of interest income taxed at a rate lower than their marginal tax rate (schedule 8 Part B clause 1(b)(i)).

#### Recommendation

That the submission be accepted.

### Issue: Minor amendments to the refund rules for back years

#### Submission

(Matter raised by officials)

Two amendments are proposed to section MD 1 of the Income Tax Act (1994 and 2004 versions). First, sections 362 and 370 of the Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 replace section MD 1(b) of the Income Tax Act 2004 and 1994 respectively. This is an error. The sections are intended to replace section MD 1(1)(b). Section MD 1(b) does not exist. Second, a small change is proposed to both iterations of section MD 1 to ensure that the timebar does not restrict a taxpayer’s ability to obtain a refund at any point in time, provided the Commissioner was satisfied of the taxpayer’s entitlement to the refund within the time bar period.

#### Comment

Officials consider that the first proposed amendment is a simple drafting matter.

For the second proposed amendment, the effect of section MD 1 as it has been amended, is that for a certain period of time refunds that arise from amended assessments are still timebarred in circumstances where they should not be. This is because the law currently requires the time bar period to have not ended for a refund to be paid out for an amended assessment. The timebar restriction to amended assessments is meant to prevent a taxpayer from amending outside the timebar period to receive a refund, not from being able to be paid out a refund outside the timebar where the Commissioner was satisfied within that timeframe of their entitlement to the refund. This amendment is necessary to ensure that taxpayers are treated fairly and can receive the refunds they are entitled to.

The proposed amendments to the Income Tax Act 1994 should apply from 1 April 2005. The proposed amendments to the Income Tax Act 2004 should apply from 1 April 2000. This accords with the application dates given to the original changes as applied in the amending Act.

#### Recommendation

That the submission be accepted.

### Issue: New provision required to be added to the Income Tax Act 1994 – refund rules

#### Submission

(Matter raised by officials)

The Taxation (Annual Rates for 2018−19, Modernising Tax Administration, and Remedial Matters) Act 2019 added a number of provisions for back year periods that provide that, where the law previously acted as an impediment to a refund, that amount may now be refunded. The provisions added do not cover the period from 1 October 2004, the start of the inconsistent refund period, to 1 April 2005, the date that section 364 of the amending Act starts its coverage for. An additional provision is proposed to cover the period from 1 October 2004 to 31 March 2005 to ensure that taxpayers that are seeking refunds in respect of this period are not treated unfairly.

#### Recommendation

That the submission be accepted.

### Issue: Investment income reporting – dividends paid by a listed PIE

#### Submission

(Matter raised by officials)

The Taxation (Annual Rates for 2017−18, Employment and Investment Income, and Remedial Matters) Act 2018 added section 25G to the Tax Administration Act 1994 (“TAA”), which, as part of a wider reporting framework, requires payers of dividends to report “investment income information” in relation to the payments. An unintended consequence of the provisions is that information in relation to dividends paid by a listed PIE is not required to be reported.

An amendment is proposed to ensure that dividends paid by listed PIEs fall under the definition of investment income. The amendment should apply from 1 April 2020, being the date that mandatory reporting for investment income applies from.

#### Recommendation

That the submission be accepted.

### Issue: Definition of “custodial institution”

#### Submission

(Matter raised by officials)

A definition of “custodial institution” should be added to the Income Tax Act 2007 and the Tax Administration Act 1994 so that the obligations of custodians can be clarified and distinguished from those imposed on payers of investment income. This provision will be optional from 1 April 2020 and mandatory from 1 April 2021.

#### Comment

A custodial institution acts as a conduit between an investment income payer (for example, a company paying a dividend) and an investor. Custodians undertake various functions including settlement services and asset management.

Inland Revenue has received feedback that where a custodian is interposed between the payer and the investor, the investment income withholding and reporting rules are a poor fit for custodians’ business models. As a result, officials seek to clarify how the withholding and reporting rules apply to custodial institutions. A definition of a “custodial institution” is required for this purpose and will be introduced at Select Committee.

#### Recommendation

That the submission be accepted.

### Issue: End investor treatment of foreign custodians and aggregation of the underlying investors

#### Submission

(Matter raised by officials)

Officials propose that a foreign custodial institution is treated as an end investor for investment income withholding and reporting purposes. Officials further propose that where the foreign custodian is treated as an end investor, withholding and reporting is undertaken at an aggregated level.

It is proposed that these changes should be voluntary from 1 April 2020 (which is the date that the investment income reporting regime applies) and compulsory from 1 April 2021.

#### Comment

##### Treating a foreign custodian as the end investor for withholding and reporting purposes

Officials propose that a foreign custodian is treated as the end investor for investment income withholding and reporting purposes. This means that the investment income payer is only required to report that the payment has been made to the foreign custodian, and is not required to report details of each underlying investor. The end investor proposal is intended to reduce the compliance burden on the New Zealand custodian whilst ensuring the obligation for accurate withholding is retained. Further, officials note that Inland Revenue does not need to obtain details of a non-resident investor for investment income reporting purposes.

Officials are of the view that requiring a custodian to look through the foreign custodian for withholding and reporting purposes would create an undue compliance burden.

Officials note that custodial institutions are subject to international tax compliance and other requirements which form a safeguard preventing misuse of the proposed relaxation. These requirements include reporting requirements under the Common Reporting Standard and US Foreign Account Tax Compliance Act which ensure that information which identifies investments is passed to the ultimate investor’s country of residence.

##### Aggregate level withholding and reporting

Officials propose that where a New Zealand custodial institution pays income offshore to another custodial institution the withholding is operated at an aggregated level. In many cases, a non-resident investor’s liability to New Zealand tax is fully satisfied by NRWT or AIL and the taxpayer will not be required to file a return. This means that where the payment passes into the hands of another custodial institution, which is treated as the end investor, the withholding would only take account of types of investment income (for example, dividends or interest) and classes of taxpayers (for example, for a dividend, those investors entitled to the benefit of particular treaty rates and those subject to NRWT in full).

**Example**

Tony is tax resident in the United Kingdom. He has invested via custodians into Savoury Mints Ltd, a New Zealand listed company.

**Figure 2**



Savoury pays a gross dividend of $100 to the New Zealand custodian as the New Zealand custodian has RWT exempt status. The New Zealand custodian treats the United Kingdom custodian as the end investor for withholding and reporting purposes.

1. For reporting purposes, the report will only contain the details necessary to identify the United Kingdom custodian as the recipient of the payment. Tony’s details do not need to be provided to the New Zealand custodian or to Inland Revenue.

2. For reporting purposes, the United Kingdom custodian has told the New Zealand custodian that the ultimate investors are all United Kingdom tax residents entitled to the benefit of a 15% rate of withholding under the NZ-UK Double Taxation Agreement. The New Zealand custodian therefore withholds NRWT at the 15% rate and remits this to Inland Revenue

This proposal is subject to the condition that the New Zealand custodial institution that operates aggregate level withholding must be satisfied that the foreign custodian has supplied sufficient information to support the rate of withholding.

#### Recommendation

That the submission be accepted.

### Issue: Transfer of investment income withholding and reporting requirements for RWT and NRWT

#### Submission

(Matter raised by officials)

Officials recommend that provisions are introduced into the Income Tax Act 2007 and Tax Administration Act 1994 to clarify how the withholding and reporting obligations for investment income will pass from the payer to a custodial institution.

It is proposed that these provisions are voluntary from 1 April 2020 (which is the date that the investment income reporting regime applies) and compulsory from 1 April 2021.

#### Comment

Under current law, the investment income payer is required to withhold tax from investment income and remit it to Inland Revenue. Under certain conditions, that obligation can be passed on to a custodial institution interposed between the payer and the end investor. However, the current provisions lack clarity where custodial institutions sit between the payer and the ultimate investor, particularly where the income passes through the hands of more than one custodial institution before being paid to the ultimate investor.

There is also an obligation for investment income payers to report to Inland Revenue, but there is no ability under current rules to permit a payer to pass on the reporting obligation.

Accurate reporting of withholding tax is an important part of Inland Revenue’s ability to automatically assess refunds and tax to pay. Providing for transferable obligations will support this objective. The framework will have the following features:

* Withholding and reporting will be undertaken by one entity. An ability to provide for variations to this rule will be provided.
* Withholding and reporting must take place before the income passes to the end investor. The end investor may be a direct investor (New Zealand resident or non-resident) or a foreign custodian.
* If the payer and subsequent custodians do not determine which has the obligation for withholding or reporting, the custodial institution which pays to an end investor (whether a direct investor or a foreign custodian) will be responsible for the payment of RWT and NRWT and reporting to Inland Revenue.

#### Recommendation

That the submission be accepted.

### Issue: Relaxation of investment income reporting requirements for custodial institutions

#### Submission

(Matter raised by officials)

In order to support officials’ proposal to allow reporting requirements to be transferred to custodial institutions, it is further proposed to limit the reporting requirements for custodial institutions to information that they hold or can reasonably obtain.

It is proposed that these amendments should be voluntary from 1 April 2020 (which is the date that the investment income reporting regime applies) and compulsory from 1 April 2021.

#### Comment

The reporting requirements for investment income information are set out in Schedule 6 of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018. Under current law, the payer must provide the prescribed information.

A custodian may not have access to the same information as a payer and may be unable to obtain this information through reasonable efforts. It is proposed that the reporting requirement be relaxed where the information cannot reasonably be obtained by the custodial institution.

#### Recommendation

That the submission be accepted.

### Issue: Clarification of the investment income error correction rules in relation to approved issuer levy

#### Submission

(Matter raised by officials)

Officials propose an amendment to clarify how the error correction rules apply in relation to approved issuer levy (AIL). It is proposed that section RF 12 of the Income Tax Act 2007 be amended to clarify that an AIL election must have been received prior to an interest payment for a 0% NRWT rate to apply. Officials propose that this provision would apply from the date of enactment.

#### Comment

Payers of investment income and custodians are uncertain whether the current investment income error correction rules can be used to remediate NRWT previously withheld in favour of a late election into AIL.

Officials consider that the proposed clarification will make it clear that the error correction rules cannot be used to allow remediation of a failure to meet the requirements for AIL treatment. It is intended that the error correction rules only be used to correct a tax position in circumstances where the correction will put the taxpayer into a position to which they were always entitled. For example, error correction could be used where on the payment date the payer of AIL understood that 47% of investors were eligible for AIL treatment, but after the payment it becomes apparent that 51% were eligible.

#### Recommendation

That the submission be accepted.

### Issue: RWT – additional foreign exchange rate

#### Submission

(Matter raised by officials)

Officials propose an amendment to allow payers and custodians to withhold and report investment income at the foreign exchange rate on the transaction date. Officials propose that this provision would apply from the date of enactment.

#### Comment

Under current law, where RWT is withheld in a currency other than New Zealand dollars (NZD), the amount of RWT to be paid to Inland Revenue is calculated at the close of trading spot rate on the first working day after the month in which RWT was withheld, or if the withholding is an Australian imputation credit account company, a specific conversion rate chosen by the company.

Payers and custodians will typically use a transaction date foreign exchange rate in investor statements. This means that the investor may see a different NZD value in their investment statement from the value in myIR. This can result in the investor having to make an adjustment for any difference.

Under the proposed amendment, the payer will have the option to withhold and report investment income to Inland Revenue using the foreign exchange rate which applied on the date of the transaction. Aligning the rate provided to Inland Revenue with the rate reported to the investor will aid accurate pre-population of taxpayers’ accounts. This means that a taxpayer will be less likely to have to account for any difference in their tax return at year end.

#### Recommendation

That the submission be accepted.

### Issue: Repeal of information sharing legislative provision

#### Submission

(Matter raised by officials)

The current information sharing provision between Inland Revenue and the Serious Fraud Office (Schedule 7, clause 7 of the Tax Administration Act 1994) must be repealed to avoid conflicting legislation with the serious crime approved information sharing agreement (AISA) between Inland Revenue (and the New Zealand Police, currently being extended to include the Serious Fraud Office and New Zealand Customs Service.

#### Comment

Officials from Inland Revenue, the Serious Fraud Office and Customs are working on extending the current serious crime information sharing agreement between Inland Revenue and the Police agreement under the Privacy Act 1993. The agreement extension will enable information from Inland Revenue to be shared with these two agencies to tackle serious crime.

The current legislation governing information sharing between Inland Revenue and the Serious Fraud Office will need to be repealed with effect from the same date the new AISA applies from. The date the AISA will apply from will be determined by Order in Council. If the provision is not repealed then it will conflict with the AISA, affecting its operation.

Cabinet approved the repeal on 23 September 2019.

The Parliamentary Counsel Office will prepare Orders in Council, which will approve the information sharing agreement, in accordance with the Privacy Act 1993, as well as the consequential Order to repeal the existing sharing legislative provision between Inland Revenue and the Serious Fraud Office.

Application date is the date of assent.

#### Recommendation

That the submission be accepted.

### Issue: Fringe benefit tax and private vehicle use

#### Submission

(Tim Hewitt)

The exemption from fringe benefit tax for work-related vehicles should be repealed. The current exemption for work related vehicles creates incentives for businesses to purchase or lease vehicles such as utes, which have a generally larger carbon footprint than cars which are typically non-exempt.

#### Comment

Officials note that this submission raises issues that would require prioritising and resourcing as part of the Government’s tax policy work programme.

#### Recommendation

That the submission be declined.

### Issue: The number of remedial amendments

#### Submission

(Corporate Taxpayers Group)

The number of remedial amendments is a concern. While tax is a complex subject area and remedial amendments will always be necessary, the volume of amendments suggests that the policy development process is not always working as required.

That a thorough consultation process needs to be undertaken, where appropriate, to prevent remedial changes in the future.

#### Comment

Officials agree that the complexity of tax does mean that a number of remedial amendments will be necessary to ensure that the tax legislation is consistent with the policy intent. This in turn helps ensure that the tax system continues to be fit for purpose. Officials do not agree that more consultation would necessarily reduce the number of remedial amendments, as many of the amendments contained in the Bill have arisen as a result of ongoing consultation. The Business Transformation change process within Inland Revenue has also identified many remedial issues and some of these are included in this report.

#### Recommendation

That the submission be noted.

### Issue: Securitisation vehicle amendments

#### Submission

(PwC supplementary)

That there should be an ability (but not a requirement) to make a formal election into the transparency regime at the time an arrangement is established and the assets are transferred. For existing special purpose vehicles (SPVs) established before the new rules came into effect, there should be an ability (but not requirement) to make a formal election into the transparency regime from the date of the election or from the beginning of the subsequent income year.

That the requirement that all originators be members of the same wholly-owned group of companies be removed from the definition of “originator” in section YA1 of the Income Tax Act 2007. The key requirement should be that assets appear on the consolidated financial statements of the person assuming the tax obligations of the SPV, or the consolidated financial statements of a wholly-owned group company.

Alternatively, if the restriction on third party originated receivables is not completely relaxed, the definition of “originator” should be amended so that the requirements are only required to be met form the effective date of the election.

#### Comment

Officials note that the submission raises issues that would require prioritisation and resourcing as part of the Government’s tax policy work programme.

#### Recommendation

That the submission be declined.

### Issue: Amend sections RC 29 and RC 33 to ensure provisional tax is correctly calculated

#### Submission

(Matter raised by officials)

Sections RC 29 and RC 33 of the Income Tax Act 2007 outline how a new consolidated group or amalgamated company should calculate their standard method uplift amount of provisional tax.

The standard method uses either 105% of the preceding year current year-1 (CY-1) or 110% of the year prior to the preceding year (CY-2). Currently both sections RC 29 and 33 only refer to the CY-1 calculation. These should also refer to the CY-2 year where the entities forming the group or amalgamated company have yet to file their CY-1 tax return and can therefore only base their provisional tax on the CY-2 residual income tax.

It is recommended sections RC 29 and 33 be amended to refer to both the CY-1 and CY-2 calculations “as applicable” for the 2020−21 and later income years.

#### Comment

Although taxpayers have practically been applying this rule it should be corrected in the legislation. A number of tax agents have raised this with us as an issue that should be clarified.

#### Recommendation

That the submission be accepted.

### Issue: Standardise the term “person with an initial provisional tax liability”

#### Submission

(Matter raised by officials)

A person with an initial provisional tax liability is essentially a person who is in the provisional tax regime for the first time. The Tax Administration Act 1994 and the Income Tax Act 2007 use a number of different terms for a “person with an initial provisional tax liability” including “new provisional taxpayer” and “person with a new provisional tax liability”.

This can create confusion when all these terms mean the same thing.

It is recommended these terms be standardised as “person with an initial provisional tax liability”, to avoid confusion, from the 2020−21 and later income years.

#### Recommendation

That the submission be accepted.

### Issue: Ensure the definition of “taxable activity” includes partners in a partnership and members of unincorporated bodies

#### Submission

(Matter raised by officials)

In determining whether a person has an initial provisional tax liability the definition of “taxable activity” is used to determine if someone has started a business.

This definition refers to the definition in the Goods and Services Tax Act 1985. This Act, however, excludes partners of partnerships and members of other unincorporated bodies as, for GST purposes, it is the partnership/unincorporated body which is carrying on the taxable activity. This appears to be a loophole which is not consistent with the framework of the provisional tax regime as these entities are look-through entities they are not themselves subject to provisional tax.

It is recommended this definition be amended to ensure that for the purposes of the provisional tax rules partners and members of unincorporated bodies are considered to be undertaking the taxable activity rather than the partnership from the 2020−21 and later income years.

#### Recommendation

That the submission be accepted.

### Issue: Ensure the early payment discount applies as intended

#### Submission

(Matter raised by officials)

Inland Revenue’s legal team have identified an issue with the legislation and the application of the early payment discount to taxpayers who meet the criteria. Inland Revenue’s systems are currently applying the law as it should apply, however, to improve certainty for taxpayers we recommend that the legislation be aligned.

It is proposed that section RC 37 of the Income Tax Act 2007 is amended to ensure that the early payment discount applies as intended by changing the wording “not liable to pay provisional tax” to “liable to pay provisional tax under section RC 3(1)(a) but not obligated to make any payments under section RC 3(3)”.

The proposed amendment would apply from the 2020−21 and later income years.

#### Recommendation

That the submission be accepted.

### Issue: Clarify the definition of “provisional tax”

#### Submission

(Matter raised by officials)

The current wording of section 120L of the Tax Administration Act 1994 refers to “provisional tax” which is not defined. This item should include both provisional tax and any late payment penalties on that provisional tax.

It is proposed that section 120L of the Income Tax Act 2007 is amended to ensure that the term “provisional tax” includes any late payment penalties in relation to that provisional tax from the 2020−21 and later income years.

#### Recommendation

That the submission be accepted.

### Issue: Align the treatment of overpaid tax by a company using the accounting income method (AIM) with tax paid on behalf of AIM shareholders

#### Submission

(Matter raised by officials)

There are two ways in which an AIM company can transfer overpaid tax to its shareholders.

The first is where the company creates a provision for shareholder employees’ salary and pays tax on that on behalf of the shareholders to enable the company to take a tax deduction for the provision. In this situation the company acts as an “agent” for the shareholder employee and the tax is “transferred” as a tax credit reducing the shareholder employee’s residual tax liability.

The second situation is where the company overpays tax most likely because shareholder remuneration is not deducted by the company until the end of the year in which case the overpayment transfers at the shareholder’s provisional tax dates.

These rules should be standardised to simplify them for taxpayers and reduce compliance and administration costs.

It is proposed that the treatment of overpayments by an AIM company be standardised so that in both situations the transfer will reduce the residual income tax of the shareholder employee (subject to the safeguards that already exist to reduce the ability to game the rules).

The proposed amendment would apply from the 2019−20 income year.

#### Recommendation

That the submission be accepted.

### Issue: Inclusion of a tolerance for provisional tax instalments

#### Submission

(Matter raised by officials)

The Tax Administration Act 1994 contains a safe harbour provision from the application of use-of-money interest (UOMI) to some provisional taxpayers.

The safe harbour applies where a taxpayer has residual income tax that is less than $60,000, they have used the standard uplift provisional tax calculation method and they paid all their instalments as required.

The result of this concession is that no UOMI is charged on any unpaid tax until the taxpayer’s terminal tax date (which is generally February of the year after the income year where the liability arises).

If the safe harbour does not apply, then UOMI would generally apply from the date of their final instalment of provisional tax for the income year in question. This is generally nine months earlier than the terminal tax date. Thus, the safe harbour provides a significant concession to those who fit the criteria.

Some issues have arisen the result of which is that a small underpayment is providing an adverse result to taxpayers that is disproportionate to the error being made. In one case a taxpayer who accidently underpaid their instalments by 30 cents resulted in a UOMI bill of $2,400 because of the loss of the protection of the safe harbour.

It is proposed that a tolerance be included in the legislation to deal with these issues. This tolerance will allow taxpayers to retain the benefits of the safe harbour even though they underpaid by a small amount.

We recommend the amount of the tolerance be $20 per instalment which aligns to the amount of the small balance write-off amount (for tax other than auto-calculation assessments ). This will ensure that a person who underpays by small amounts will not be disproportionately penalised for that omission.

Officials also recommend this amendment be retrospective to the 2017−18 income year to address the existing cases where this adverse outcome had occurred.

#### Recommendation

That the submission be accepted.

### Issue: Amend the definition of “START tax type” in the Tax Administration Act 1994 to include Release 4 tax types

#### Submission

(Matter raised by officials)

Release 4 of Business Transformation will migrate more tax types onto Inland Revenue’s new technology platform, START. Section 183C of the Tax Administration Act 1994 deals with rules around the cancellation of interest. These rules are specific to the START platform only and as taxes migrate to that platform the rules for cancellation of interest change over what was done in the old technology platform, FIRST.

It is necessary to include those tax types that are being migrated to START as part of Release 4 in the definition of “START tax type” so that the cancellation of interest rules are applied correctly.

It is proposed that these tax types be included in the definition of START tax types in the Tax Administration Act 1994:

* PAYE deductions;
* child support deductions made by an employer;
* student loan deductions made by an employer;
* KiwiSaver deductions made by an employer;
* compulsory employer KiwiSaver contributions; and
* specified superannuation contribution tax (SSCWT or ESCT or both).

The proposed amendment would apply from 1 April 2020 when Release 4 of Business Transformation goes live.

#### Recommendation

That the submission be accepted.

### Issue: Adding START tax types to section 184A(5) of the Tax Administration Act

#### Submission

(Matter raised by officials)

Officials recommend an amendment to section 184A(5) of the Tax Administration Act 1994 to include reserve schemes and unclaimed monies in the definition of tax, for the purpose of this section.

#### Comment

As part of the Business Transformation Release 4, new tax types are being introduced into START. With the inclusion of the new tax types Inland Revenue is able to direct credit returns through section 184A. However, some of the tax types included in Release 4 do not fall within the definition of tax in section 184A(5) but should be added.

The proposed new tax types to be included are:

* reserve schemes (income equalisation schemes and environmental restoration account schemes); and
* unclaimed monies for the purpose of the Unclaimed Money Act 1971.

The proposed amendment would apply from the date of assent.

#### Recommendation

That the submission be accepted.

### Issue: Income tax treatment of Nga Whenua Rahui kawenata

#### Submission

(NSA Tax)

Amounts received in respect of a Nga Whenua Rahui kawenata for a specified term pursuant to section 77A of the Reserves Act 1977 should be excluded from being income.

#### Comment

The intention of the current amendment is to ensure that payments for the grant of a permanent easement are not subject to tax. This submission suggests that a separate exclusion should be provided for a Nga Whenua Rahui kawenata. Officials consider that this submission raises further issues that would require prioritising and resourcing as part of the Government’s tax policy work programme.

#### Recommendation

That the submission be declined.

### Issue: The monetary system

#### Submission

(John Tax)

The submitter raised a number of concerns with the monetary system generally.

#### Comment

Officials consider these concerns to be out of the scope of a tax bill.

#### Recommendation

That the submission be declined.

### Issue: Tax rates

#### Submission

(John Tax, R Craig)

Submitters proposed a flat rate of tax to reduce the complexity of the tax system (*John Tax*) and introducing a tax-free threshold to assist low income earners. (*R Craig*)

#### Comment

It is unlikely that a flat rate of tax would significantly reduce the complexity of the tax system. Much of the complexity of the tax system is because of the need to define what is taxed, rather than the rate at which it should be taxed.

If the objective of introducing a tax-free threshold is to assist low income households, then a tax-free threshold is unlikely to be the most effective policy. Transfers (for example, welfare benefits or tax credits) are generally better targeted than income tax reductions for this group.

#### Recommendation

That the submission be declined.

# Maintenance items

## Maintenance items

(Clauses 7(1), 72–74, 78, 80, 85, 98, 100, 102, 111, 112, 113(3), (4), 113(11), (12), (15), 116–118, 135, and 138)

### Issue: Proposed amendments are supported

#### Submission

(Chartered Accountants Australia and New Zealand)

That the proposed maintenance amendments in the clauses listed above are supported.

#### Recommendation

That the submissions be noted.

(Clause 133)

### Issue: Maintenance item unnecessary

#### Submission

(Chartered Accountants Australia and New Zealand)

That clause 133 does not appear to be necessary.

#### Comment

Officials note that the grammatical error which is the subject of the proposed amendment has been corrected under the editorial powers granted to the Chief Parliamentary Counsel under section 25 of the Legislation Act.

#### Recommendation

That the submission be accepted.

### Issue: Additional maintenance items

#### Submissions

(Matter raised by officials)

The proposed amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

#### Comment

The amendments relate to minor maintenance items to correct any of the following:

* ambiguities;
* compilation issues;
* cross-references;
* drafting consistency, including readers’ aids – for example, the defined terms lists;
* grammar;
* consequential amendments arising from substantive rewrite amendments; or
* the consistent use of terminology and definitions.

**Table 1: Maintenance amendments – schedule of clause numbers and changes to text**

| **Enactment** | **Section** | **Amendment** | **Commencement date** |
| --- | --- | --- | --- |
| **Tax Administration Act 1994** | 22AA and 22AAB | Corrections to ensure that tax records can be held in te reo Māori. | Section 22AA is amended from 27 June 2019  Section 22AAB is amended from 1 April 2020 |
| Schedule 7, clause 46 | Repeal in accordance with Office of Privacy Commissioner’s report on unused provisions. | Date of enactment |
| 80KM | Repeal redundant provision. | Date of enactment |
| 41 (4)(a) | Repeal redundant provision. | Date of enactment |
| 106(1C) | Repeal redundant provision. | Date of enactment |
| **Income Tax Act** | MF 6 | Reinstates a provision inadvertently not carried forward when the changes to individual income tax for the 2019 year onwards were made by the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019. | 1 April 2019 |
| EL 15 | Insert “could be” before the words “carried forward”. | 1 April 2019 |
| CZ 35 | Adding Te Kōwhatu Tū Moana to the list of defined terms. | 17 March 2019 |
| YA 1 | Inserting a definition of Te Kōwhatu Tū Moana. | 17 March 2019 |
| MD 1C | Correct drafting error. | 1 April 2005 |
| Schedule 36 Part A | Replace “Housing New Zealand Corporation” with “Kāinga Ora–Homes and Communities”. | 1 October 2019 |
| **Search and Surveillance Act 2012** |  | Ensures the consistent use of terminology and definitions. | Date of enactment |
| **Goods and Services Tax Act 1985** | 10B(2)(b) | Clarifies the wording of the provision. | 1 December 2019 |
| 10C | Clarifies that the 75 percent test for charging GST on high-value goods is a self-assessed test. | Date of enactment |
| 12(1B) | Removes incorrect cross-reference. | Date of enactment |
| 24(4)(g) and (5D) | Corrects cross-references. | Date of enactment |
| 77(3) | Clarifies that the currency conversion can be done on the date the supply was made. | 1 October 2016 |
| 85C | Inserts omitted cross-reference. | 1 December 2019 |
| **Privacy Act 1993** | Schedule 3 | Corrects cross-references to sections of Tax Administration Act 1994 (sections 46A, 82, 85A, 85B, 85E and 85H become clauses 41, 42, 43 and 45 of Schedule 7 of the TAA). | Date of enactment |

#### Recommendation

That the submission be accepted.

# Appendix

## Summary of recommendations

### KiwiSaver

| Rec # | Recommendation description | Submitter | Page # |
| --- | --- | --- | --- |
| 1. | Defer changing contribution rates through a scheme provider or Inland Revenue | 4 submitters | 18 |
| 2. | That employers should not have to provide ESCT rate information to IRD and that KiwiSaver income information should only be required for new employees | 3 submitters | 24 |
| 3. | Remove the requirement to provide the employer’s name and address for certain situations | Officials | 31 |
| 4. | Align employee address requirements with the Tax Administration Act 1994 | Officials | 33 |
| 5. | Remove the potential separation between the application for withdrawal and the date the withdrawal takes place | 2 submitters | 35 |
| 6. | Require a certificate from a registered medical practitioner as part of the new early withdrawal grounds | 2 submitters | 35 |
| 7. | Clarify that people can withdraw under the new category even if subject to the five-year lock-in period | 2 submitters | 36 |
| 8. | Clarify the definition of “life-shortening congenital condition” | 2 submitters | 38 |

### Student loans

| Rec # | Recommendation description | Submitter | Page # |
| --- | --- | --- | --- |
| 9. | Repeal the requirement for loan repayments to be deducted from schedular, election-day and casual agricultural income | Officials | 44 |
| 10. | Replace the underestimation penalty with a shortfall penalty | Officials | 44 |
| 11. | Allow repayment obligations to continue to be made until the consolidated loan balance is repaid | Officials | 45 |
| 12. | Lower the adjusted net income threshold from $1,500 to $500 | Officials | 46 |
| 13. | That repayment deductions should be credited on the employee’s payday | Officials | 46 |
| 14. | Align the write-off rules for tax and student Loans | Officials | 47 |
| 15. | Do not impose and write off interest for reassessments of periods prior to 1 April 2020 for New Zealand-based borrowers | Officials | 47 |
| 16. | Payments should be allocated against the oldest unpaid period first, and then against interest and then principal | Officials | 48 |
| 17. | Allow early assessments of student loan adjusted net income to be completed | Officials | 49 |
| 18. | Clarify that borrowers can apply to be treated as New Zealand based for previous periods | Officials | 49 |

### Research and development

| Rec # | Recommendation description | Submitter | Page # |
| --- | --- | --- | --- |
| 19. | Change the name of the cap from “payroll-tax based cap” to “refundability cap” | Officials | 57 |
| 20. | Allow payroll taxes paid in year one to be applied when cashing out carried forward non-refundable credits | 3 submitters | 60 |
| 21. | Certain types of exempt income should not make entities ineligible for the tax credit | 5 submitters | 64 |
| 22. | Clarify that foreign tertiary education organisations are ineligible for the tax credit | Officials | 72 |
| 23. | Allow businesses that became associated with or controlled by a growth grant recipient before the restrictions were announced to access the tax credit | 2 submitters | 73 |
| 24. | Make Callaghan Innovation ineligible for the R&D tax credit | Officials | 75 |
| 25. | Make general approval binding on the Commissioner | Officials | 76 |
| 26. | Clarify the scope of general approval in relation to supporting activities | Officials | 77 |
| 27. | Make criteria and methodologies approval mandatory for those that opt out of the general approval regime | Officials | 78 |
| 28. | Only allow entities capable of core R&D activities to become approved research providers | Officials | 81 |

### Other policy and remedial changes

| Rec # | Recommendation description | Submitter | Page # |
| --- | --- | --- | --- |
| 29. | Allow overpaid PIE tax to be refunded | David McLay | 87 |
| 30. | Allow Inland Revenue to notify PIEs of investors’ PIR when Inland Revenue holds sufficient information | Officials | 89 |
| 31. | Clarify a number of technical drafting issues | 2 submitters | 94 |
| 32. | Clarify the definition of corpus | 4 submitters | 100 |
| 33. | Source rules for capital gains should also apply for losses | 2 submitters | 101 |
| 34. | Clarify taxable distributions not subject to the ordering rule | New Zealand Law Society | 102 |
| 35. | Include a reference to non-natural person trustees in section HC25(2)(c) | New Zealand Law Society | 104 |
| 36. | Clarify the application of the rules for settlement by acts of associates | 5 submitters | 106 |
| 37. | Ensure the interest rate is either the prescribed rate or the market rate | 3 submitters | 107 |
| 38. | Allow retrospective election to pay New Zealand tax on world-wide trustee income | 2 submitters | 108 |
| 39. | Limit notification requirements for non-active trusts | New Zealand Law Society | 108 |
| 40. | Change “RIT estimate” to “expected RIT” to avoid confusion | EY | 113 |
| 41. | Move the provision clarifying the application of the use-of-money rules to the Tax Administration Act 1994 | Chartered Accountants Australia and New Zealand | 116 |
| 42. | Allow taxpayers who have short paid their instalments by small amounts to access the safe harbour concessions | 3 submitters | 119 |
| 43. | The truncation amendment should apply retrospectively to the 2017-18 income year | Tax Management New Zealand Limited | 121 |
| 44. | Clarify the points at which truncation occurs | Officials | 122 |
| 45. | The change for taxpayers with a non-standard number of provisional tax instalments should apply from 2017-18 and later income years | Chartered Accountants Australia and New Zealand | 124 |
| 46. | Clarify the drafting for removing tax agents, representatives and nominated persons | Officials | 127 |
| 47. | Clarify the rules that allow for the self-correction of certain errors in subsequent returns | Officials | 128 |
| 48. | Ensure payments for the grant of a land right are taxable | Officials | 130 |
| 49. | Clarify that section CW26C(8) applies where shares are acquired for nil consideration | 2 submitters | 135 |
| 50. | Revise the drafting of CW26C(8) | Chartered Accountants Australia and New Zealand | 135 |
| 51. | Correct an unintended change to CW 26C from the 2004-2008 rewrite | Deloitte | 136 |
| 52. | Update the list of overseas donee organisations | Officials | 138 |
| 53. | Make improvements to the CPI calculation and application of a change to the transitional relief for level premium life insurance policies sold before 1 July 2010 | 3 submitters | 139 |
| 54. | Clarify the application of the bright-line test for settlements of relationship property | Officials | 142 |
| 55. | Remove the word unsecured from section GC 16(5) | 3 submitters | 143 |
| 56. | Change “shareholder that is a member of the group” to “shareholder’ in section FE 16B(1)(b) | Deloitte | 143 |
| 57. | Clarify the drafting of clause 83 | Officials | 144 |

### New matters raised at Select Committee

| Rec # | Recommendation description | | Submitter | Page # |
| --- | --- | --- | --- | --- |
| 58. | Clarify the residential income that residential property deductions can be used against | Officials | | 147 |
| 59. | Clarify that amounts of residential income can only be counted once | Officials | | 147 |
| 60. | Ensure that unused excess deductions that are not released on sale are carried forward | Officials | | 148 |
| 61. | Ensure the interposed entity rules operate as intended | Officials | | 149 |
| 62. | Clarify that the interest paid should be within 12 months of the end of the income year under Section HC27(6) | nsaTax | | 152 |
| 63. | Ensure the reverse charge only applies when the recipient imports goods of less than $1,000 and does not pay GST to Customs or the supplier of the goods | Officials | | 153 |
| 64. | Clarify the interaction of the marketplace rules with the existing agency rules | Officials | | 153 |
| 65. | Expand the knowledge offences in the Tax Administration Act 1994 for consumers and suppliers providing incorrect or misleading information to avoid paying GST | Officials | | 154 |
| 66. | Only require suppliers to include their GST information in import documentation if GST is required to be charged on the goods | Officials | | 155 |
| 67. | Remove the requirement for suppliers of low-value imported goods to include the amount of GST charged on receipts issued to consumers | Officials | | 156 |
| 68. | Allow GST deductions for capital raising costs associated with issuing participatory securities | Officials | | 159 |
| 69. | Clarify that all types of payments by the Government to social housing providers to provide social housing are exempt from GST | Officials | | 159 |
| 70. | Amend the disregarded hybrid payment rule to allow a deduction that reimburses third party expenditure of a group member | 3 submitters | | 161 |
| 71. | Allow an exemption from the hybrid and branch mismatch rules for transitional expenditure related to making an opaque election | Deloitte | | 161 |
| 72. | Adjust due date for some Working for Families tax credit recipients | Officials | | 164 |
| 73. | Allow current Working for Families tax credits to be used to repay prior overpayments | Officials | | 165 |
| 74. | Correct an interpretation issue with sections RC13(3), RC14(2) and RC9(9) | Deloitte | | 167 |
| 75. | Correct minor errors in the drafting of section 22H of the Tax Administration Act 1994 | Officials | | 169 |
| 76. | Ensure section 120C(1)(iib) applies to both qualifying individuals and individuals who are treated as qualifying individuals | Officials | | 169 |
| 77. | Clarify section 89C of the Tax Administration Act 1994 | Officials | | 170 |
| 78. | Repeal redundant section 141JA of the Tax Administration Act 1994 | Officials | | 171 |
| 79. | Correct the application date of an amendment to schedule 8 of the Tax Administration Act 1994 | Officials | | 172 |
| 80. | Clarify section MD1 of the Income Tax Act 1994 and 2004 | Officials | | 172 |
| 81. | Allow overpaid tax from 1 October 2004 to 1 April 2005 to be refunded in certain situations | Officials | | 173 |
| 82. | Ensure section 25G of the Tax Administration Act applies to dividends paid by a listed PIE | Officials | | 173 |
| 83. | Add a definition of “custodial institutions” | Officials | | 174 |
| 84. | Treat foreign custodial institutions as an end investor for investment income withholding and reporting purposes | Officials | | 175 |
| 85. | Clarify how the withholding and reporting obligations for investment income will pass from the payer to a custodial institution | Officials | | 176 |
| 86. | Relax the investment income reporting requirements for custodial institutions | Officials | | 177 |
| 87. | Clarify the error correction rules for the approved issuer levy | Officials | | 178 |
| 88. | Allow payers and custodians to withhold and report investment income at the foreign exchange rate on the transaction date | Officials | | 179 |
| 89. | Repeal an information sharing provision between Inland Revenue and the Serious Fraud Office to avoid conflicting legislation | Officials | | 179 |
| 90. | Amend sections RC29 and RC33 of the Income Tax Act 2007 to ensure that provisional tax is correctly calculated | Officials | | 182 |
| 91. | Standardise the term “person with an initial provisional tax liability” | Officials | | 182 |
| 92. | Ensure that the definition of “taxable activity” includes partners in a partnership and members of unincorporated bodies | Officials | | 183 |
| 93. | Ensure the early payment discount applies as intended | Officials | | 183 |
| 94. | Clarify that provisional tax includes late payment penalties on that tax in section 120L | Officials | | 184 |
| 95. | Align the treatment of overpaid tax by a company using the accounting income method (AIM) with tax paid on behalf of AIM shareholders | Officials | | 184 |
| 96. | Allow taxpayers who underpay their provisional tax by small amounts to still access the safe harbour rules | Officials | | 185 |
| 97. | Include the Release 4 tax types in the definition of “START tax type” | Officials | | 186 |
| 98. | Allow reserve schemes and unclaimed monies to be directly refunded | Officials | | 187 |

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| Rec # | Recommendation description | | Submitter | Page # |
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| 99. | Remove an unnecessary maintenance amendment | Chartered Accountants Australia and New Zealand | | 191 |
| 100. | Make additional maintenance changes | Officials | | 191 |

1. Pharmaceutical Solutions’ submission is supported by Julie Jones (President of the New Zealand Association of Clinical Research), Brandon Capital and the Medical Research Commercialisation Fund (MRCF), Edward Watson (CEO of Middlemore Clinical Trials), Barney Montgomery (CEO of Optimal Clinical Trials), Richard Stubbs (CEO of P3 Research), and Mike Williams and Simon Carson (CEOs of Pacific Clinical Research Network). [↑](#footnote-ref-2)
2. Grouping rules may also apply to allow a claimant to include amounts of tax paid by a member(s) of their wholly-owned corporate group, and/or an entity that controls the claimant, in certain circumstances. [↑](#footnote-ref-3)
3. Available at https://www.gov.uk/government/consultations/preventing-abuse-of-the-rd-tax-relief-for-smes [↑](#footnote-ref-4)
4. Also taking into account any taxes paid that qualify through the proposed new refundability grouping rules. These allow PAYE, ESCT, and FBT paid by members of a claimant’s wholly-owned corporate group, or by entities that control the claimant, to be included in the cap in some circumstances. [↑](#footnote-ref-5)
5. For more information on Callaghan Innovation grants, refer to the section of this report on contractors and sweat equity. [↑](#footnote-ref-6)
6. Note that there is also a specific section of this report regarding submissions on the eligibility of software for the R&D tax credit. [↑](#footnote-ref-7)
7. Although note that similar to other potential claimants of the credit, Māori enterprises would still need to ensure that they or their subsidiaries seeking to claim the credit do not receive tax-exempt income under any of the other provisions in subpart CW of the Income Tax Act 2007 that come within the proposed new tax exempt entity exclusion. [↑](#footnote-ref-8)
8. RDAG is made up of representatives from PwC, Deloitte, KPMG, EY, BDO, Fisher and Paykel Healthcare, and Barkers of Geraldine. Officials discussed this issue with RDAG in late August and with other stakeholders in early September. [↑](#footnote-ref-9)
9. Although note that significant performers do have the option of obtaining general approval for some of their activities, even if they have opted into the significant performer regime. [↑](#footnote-ref-10)
10. The exact requirements of the CAM process and what will be required of R&D certifiers is still being developed. It is expected that part of checking compliance with CAM will involve looking at samples of activities and expenditure, but that this process would be lighter and significantly more straightforward for businesses with CAM (compared with businesses that do not have CAM). Officials will continue to develop the CAM process to ensure it provides certainty to businesses while still reducing the administrative and compliance costs that would otherwise be associated with these businesses obtaining general approval. [↑](#footnote-ref-11)
11. An R&D certifier can have its certifier status revoked in a number of different circumstances, including when the certifier provides a certificate to a business who is later found to have committed tax evasion in relation to R&D tax credits. After having certifier status revoked, a firm cannot reapply for R&D certifier status for two years. The Bill contains proposals to extend the circumstances in which the Commissioner can revoke certifier status, so that certifier status can be revoked where a certificate has been provided to a business who has entered into a tax avoidance arrangement for R&D tax credits, or where allowing the certifier to retain their certifier status would adversely affect the integrity of the tax system. [↑](#footnote-ref-12)
12. *Frascati Manual 2015: Guidelines for collecting and reporting data on research and development*, OECD, page 45. [↑](#footnote-ref-13)
13. Officials note that online guidance is available which addresses the eligibility of software development. The guidance provides examples of software development expenditure that may be eligible for the credit. [↑](#footnote-ref-14)
14. Section 143A(1)(c) provides that a person commits a knowledge offence if the person “provides altered, false, incomplete, or misleading information to the Commissioner or any other person in respect of a tax law or a matter or thing relating to a tax law”. [↑](#footnote-ref-15)