

Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill

Commentary on the Bill

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Minister of Revenue

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Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill; Commentary on the Bill

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Annual rates for 2022–23

ANNUAL SETTING OF INCOME TAX RATES

Clause 3

Summary of proposed amendment

The Bill sets the annual income tax rates that would apply for the 2022–23 tax year. The annual rates to be confirmed are the same as those for the 2021–22 tax year.

Effective date

The proposed amendment would be effective for the 2022–23 tax year.

Key features

The proposed annual income tax rates for the 2022–23 tax year would be set at the rates specified in schedule 1 of the Income Tax Act 2007.

Platform economy

OVERVIEW

The platform economy (also referred to as the gig and sharing economy) refers to economic activity facilitated by digital platforms (such as smartphone apps) that connect buyers with sellers who provide their skills, assets, and labour. Examples include accommodation services (such as short-stay and visitor accommodation), transportation services (such as ride-sharing and delivery services), and personal and professional services (such as tutoring, gardening, web and graphic design) provided through digital platforms.

The platform economy has become an increasingly popular means of enabling people to supplement their income or conduct their business. While the exact size of the platform economy in New Zealand is not known, it is expected that there are tens of thousands of taxpayers who earn income from their activities on digital platforms.

The proposals in this Bill are intended to ensure that New Zealand's tax settings remain fit-for-purpose in light of the platform economy and its expected growth. They do so by ensuring Inland Revenue has better access to information about income earned by sellers on digital platforms based in New Zealand and offshore, and by maintaining and promoting the sustainability of New Zealand's broad-based GST system by requiring digital platforms to charge and collect GST on services provided through them in New Zealand.

The proposals in the Bill follow consultation by the Organisation for Economic Co-operation and Development (OECD). The OECD considered a range of tax implications arising from the growth and popularity of the platform economy. This led to publications by the OECD on issues related to tax administration, information reporting and exchange, and VAT/GST policy and administration. The Government drew on this material in formulating proposals that could be implemented in New Zealand and consulted on the proposals in a March 2022 discussion document, "The role of digital platforms in the taxation of the gig and sharing economy". The proposals in this Bill are set out against this background and include:

- Implementing an OECD information and reporting exchange framework in New Zealand that would require New Zealand-based digital platforms to provide Inland Revenue with information annually about the consideration sellers on those platforms received from relevant activities. Inland Revenue would use that information in its administration of the tax system where the information related to New Zealand tax residents and would share information with foreign tax authorities where the information related to non-residents.
- Extending the GST rules for electronic marketplaces that currently apply to remote services (imported digital services) and low value imported goods to also apply to taxable accommodation, ride-sharing, and food and beverage delivery services that are provided through electronic marketplaces. These proposals also include a flat-rate credit scheme intended to reduce compliance costs for accommodation hosts and drivers (underlying suppliers) who are not required to be registered for GST.

The Bill proposes that the OECD's information reporting and exchange framework would take effect in New Zealand from the 2024 calendar year, with the first information reporting obligations (and exchange) occurring in early 2025. The GST changes are proposed to take effect on 1 April 2024.

These timeframes are intended to provide operators of electronic marketplaces with at least 12 months to make the necessary changes to their systems and services to become compliant with the proposed rules.

INFORMATION REPORTING

Clauses 141(3), (6) and (8), 143, 162(1), 164, 174, 175(2), 180, 181 and 182

Summary of proposed amendments

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

The reporting framework requires platform operators to provide tax authorities with information about sellers and the income they earn from certain activities on digital platforms. This information could then be exchanged between tax authorities.

The proposed amendments would require platform operators based in New Zealand to provide Inland Revenue with information about consideration sellers receive from the following activities provided through digital platforms:

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

Background

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

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

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

Inland Revenue (and other tax authorities) could request this information from digital platforms or use their information demand powers to obtain it. However, this would increase compliance costs for platform operators, who would need to collate this information and provide it to tax authorities. Multinational digital platforms could be subject to requests from multiple tax authorities and that would further increase compliance costs.

To mitigate the costs associated with requiring multinational digital platforms to report to multiple tax authorities, and to ensure that tax authorities have access to information about taxpayers that are directly relevant for tax administration purposes, the OECD developed an information reporting and exchange framework.

The OECD's information reporting and exchange framework requires platform operators that are based in a jurisdiction to provide information to that jurisdiction's tax authority once a year. The information would relate to the activities of sellers providing services (including accommodation rental, personal services, vehicle rentals, and the sale of goods) through the platform. To the extent this information was relevant to them, it would be shared with the other tax authorities that sign up to the framework. The OECD designed the framework to be consistent with rules being applied in Europe from 2023 that were developed by the European Commission.

The proposed timeframe for New Zealand to implement the information reporting and exchange framework is aligned with other jurisdictions, such as the United Kingdom. If the framework is not implemented in New Zealand, European tax authorities may seek information from New Zealand-based digital platforms about European tax residents. This could result in significant compliance costs for New Zealand-based digital platforms.

The information reporting and exchange framework supplements another OECD publication entitled the *Code of Conduct: Co-operation between tax administrations and sharing and gig economy platforms*. This code sets out the core elements of co-operation between tax authorities and platform operators.¹

International context

The exchange of information with other jurisdictions would primarily be conducted under the *Multilateral Convention for Mutual Administrative Assistance in Tax Matters* (the Multilateral Convention), which currently extends to 146 jurisdictions. New Zealand signed the Multilateral Convention in 2012. The Multilateral Convention authorises automatic exchanges of information, subject to detailed terms to be agreed between competent authorities. The competent authority in New Zealand is the Commissioner of Inland Revenue or a delegated authority.

Article 6 of the Multilateral Convention authorises automatic programmes of exchange of information but requires the specific details of such exchanges to be set out in subsidiary instruments. For this purpose, the OECD developed the *Multilateral Competent Authority Agreement on Automatic Exchange of Information on Income Derived through Digital Platforms* (MCAA). The MCAA contains the detail of the reporting standards explained in this Commentary. The MCAA is an agreement that can be signed by competent authorities. The MCAA can be signed before domestic legislation relating to the model reporting standards developed by the OECD (discussed below) is enacted.

Key features

The key features of the amendments include:

- Incorporating model rules developed by the Organisation for Economic Co-operation and Development (OECD) into the Tax Administration Act 1994 (TAA). These rules are defined as the "model reporting standard for digital platforms" and the "extended model reporting standard for digital platforms".

¹ OECD (2020). *Code of Conduct: Co-operation between tax administrations and sharing and gig economy platforms*, OECD, Paris. www.oecd.org/tax/forum-on-tax-administration/publications-and-products/code-of-conduct-co-operation-between-tax-administrations-and-sharing-and-gig-economy-platforms.pdf

- Changes to the TAA necessary to support the interpretation and implementation of both model reporting standards in New Zealand.
- Requiring “reporting platform operators” and “sellers” to comply with the requirements set out in the reporting standards, including due diligence procedures, reporting, and record keeping.
- Adding new civil penalties to the TAA that could apply in circumstances where reporting platform operators and sellers do not comply with their obligations under the reporting standards.
- A regulation-making power that enables the Governor-General to make Orders in Council that provide for the effect of future changes to the reporting standards agreed by the OECD.

Effective date

The proposed regulation-making power would take effect on the day after the date the Bill receives the Royal assent.

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

- New Zealand-based reporting platform operators would be required to collect information on sellers that receive consideration from activities on their platforms from 1 January 2024.
- Reporting platform operators would need to report this information to Inland Revenue in early 2025, and Inland Revenue could exchange information with other tax authorities in early 2025.

Detailed analysis

In summary, the proposals in the Bill would affect:

- sellers on digital platforms that receive consideration for relevant activities, and
- operators of digital platforms that connect buyers with sellers of relevant activities.

Relevant activities include the rental of immoveable property (such as visitor and short-stay accommodation), personal services (such as ride-sharing, food and beverage delivery services), the sale of goods, and vehicle rentals. These activities were identified by the OECD as the most significant in the platform economy currently.

If the reporting standards were implemented in New Zealand, sellers on digital platforms would need to provide additional information to platform operators. This information would include their tax file number, country of tax residence, and other identifying information. New Zealand-based platform operators would then be required to report information to Inland Revenue about the income earned by sellers on their platform. To the extent this information related to New Zealand tax residents, Inland Revenue would use this information for tax administration purposes, such as checking that income had been included in sellers’ income tax returns. Where information related to non-resident sellers, Inland Revenue could share this information with those non-resident sellers’ tax authorities who could also use it for tax administration purposes.

Example 1: Basic operation of the reporting standards in New Zealand

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

Under the proposed amendments, the operator of the digital platform must collect identifying information from Graeme and Lottie and provide this, as well as details of the consideration they receive from relevant activities, to Inland Revenue.

Inland Revenue could:

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

Operators of digital platforms would be required to conduct due diligence procedures for sellers on their platform, collect and collate information, and report this to Inland Revenue. The information would relate to a calendar year and would need to be provided by 31 January following the end of the calendar year. These obligations are set out in the reporting standards, which the Bill proposes would have legislative effect in New Zealand.

Penalties may apply in circumstances where platform operators and sellers do not comply with their obligations under the reporting standards.

The remainder of this Commentary item is intended to provide an overview of how the OECD's information reporting and exchange framework would be implemented in New Zealand. It summarises, rather than replicates, concepts used from the reporting standards themselves. The end of this Commentary item includes information about where the reporting standards, and the associated guidance, can be accessed on the OECD's website.

Implementing the reporting standards in New Zealand

Instead of transposing the text of the reporting standards into the TAA, the Bill proposes amendments that would give legislative effect to the reporting standards in New Zealand. It achieves this with a proposed amendment to section 185E of the TAA, which outlines the purpose of Part 11B (that contains the provisions related to international information sharing agreements), and the insertion of new section 185S (Requirements for reporting platform operators and sellers) of the TAA. The proposed new section would apply to operators of New Zealand-based digital platforms and sellers on those platforms. It would require operators and sellers to comply with all the requirements set out in the reporting standards.

For these purposes, the Bill defines two reporting standards:

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

Model reporting standard for digital platforms

The Bill would insert a definition of "model reporting standard for digital platforms" into section 3(1) of the TAA. This proposed definition refers to the *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig*

Economy. This standard was developed by the OECD and G20 and it was agreed by the Council for the OECD.

This standard contains the rules that require “reporting platform operators” to provide information about tax resident (and non-resident) sellers who provide the rental of immovable property (such as visitor and short-stay accommodation) and personal services (such as ride-sharing).

Extended model reporting standard for digital platforms

The Bill would also insert a definition of “extended model reporting standard for digital platforms” into section 3(1) of the TAA. This proposed definition refers to the *Model Reporting Rules for Digital Platforms: International Exchange Framework and Optional Module for Sale of Goods*.

In addition to the activities covered in the model reporting standard for digital platforms, this standard also includes the sale of goods and vehicle rentals.

This standard was developed by the OECD to match reporting rules designed by the European Commission that apply to members of the European Union from 2023 (known as “DAC7”). Members of the European Union can share information with jurisdictions outside of the European Union to the extent that the receiving jurisdiction has rules of equivalence with the European Union.

Implementation and administration of the reporting standards

Proposed new section 185S of the TAA contains various provisions that are necessary to support the interpretation, administration, and implementation of the two reporting standards in New Zealand. It would:

- provide legislative effect in New Zealand for both the model reporting standard for digital platforms and the extended model reporting standard for digital platforms
- require “reporting platform operators” and “sellers” (as defined in the reporting standards) to comply with their obligations under the standards
- import definitions used in the reporting standards into the TAA for Part 11B (the Part of the TAA that includes the rules for international information exchange agreements)
- require references to a jurisdiction in the reporting standards to be taken as a reference to New Zealand, and
- not give legislative effect to an optional provision in the reporting standards that would exclude smaller-scale platform operators from the reporting requirements.

This approach to implementing the reporting standards in New Zealand was considered preferable to transposing the standards directly into the TAA. This is because transposing the requirements into the TAA increases the risk of interpretive errors and mismatches between the reporting standards and New Zealand’s implementation of the reporting standards. The Bill contains safeguards to ensure that future changes to the rules would be subject to an exclusion process by way of Order in Council (see the heading “Regulations related to the model reporting standards for digital platforms” below).

The Bill proposes amendments to the record-keeping provisions of the TAA that would require “reporting platform operators” to retain records that show the steps undertaken in the operation of the digital platform and the information relied on for the performance of due diligence procedures and reporting requirements as set out in the reporting standards.

“Reporting platform operators” and “sellers”

The Bill would require reporting platform operators and sellers to comply with their obligations under the reporting standards. The reporting standards themselves define the terms “reporting platform operator” and “seller”.

Broadly, a person is a “reporting platform operator” if:

- they are a “platform operator” (as defined in the reporting standards) and they are a tax resident in New Zealand, or
- if they do not have a residence for tax purposes, they have a place of management (including effective management) in New Zealand or are incorporated in New Zealand.

The reporting standards include special rules that apply in circumstances where there is more than one reporting platform operator. These rules prevent the need for multiple reporting platform operators to provide the same information about the same seller to different tax authorities.

The Bill does not give legislative effect to the optional provision in the model reporting rules for digital platforms in relation to “excluded reporting platform operators”. An excluded reporting platform operator is relieved from the reporting requirements contained in the model reporting rules. This exclusion is targeted at smaller-scale digital platforms to reduce their compliance costs. Including this exclusion in New Zealand’s implementation of the reporting standards could have resulted in Inland Revenue not receiving information from tax authorities in Europe because New Zealand would not have had rules of equivalence (as the European rules do not include an option for excluding smaller-scale reporting platform operators).

The reporting standards also define a “seller”. The definition of “seller” broadly refers to a person who receives consideration for their activities provided through a digital platform. Certain sellers are excluded from the reporting requirements, such as:

- large providers of hotel accommodation that provide accommodation at a high frequency (at least 2,000 services per year in respect of a “Property Listing”)
- government entities, and
- entities (including related entities) whose stock is regularly traded on an established securities market.

Due diligence procedures

The reporting standards contain due diligence procedures that reporting platform operators must conduct in relation to sellers that are active on a digital platform for a “reportable period” (a calendar year). This involves collecting identifying information about sellers, such as their name, date of birth, address, and tax file number (including the jurisdiction that issued the tax file number). Reporting platform operators are also required to consider the seller’s tax residence based on address information provided by the seller. Further information on the due diligence procedures is included in the reporting standards themselves.

The reporting standards require reporting platform operators to complete the due diligence procedures set out in the standards by 31 December (the end of the reportable period).

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

The Bill proposes that reporting platform operators based in New Zealand would be able to choose to apply only the model reporting standard for digital platforms (that covers the rental of immovable property and personal services) and not the extended

model reporting standard (that covers the sale of goods and vehicle rentals), provided that the sellers operating on the digital platform are tax resident in New Zealand and are not tax resident in a country or territory other than New Zealand. This decision would be enabled under proposed new section 185S(3) of the TAA.

Example 2: New Zealand-based digital platform with a New Zealand tax resident seller receiving consideration for the sale of goods

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

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

Under the proposed amendments, the operator of "Kraymond's List" could choose:

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

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

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

Form, due date, and use of information under the reporting standards

The Bill does not prescribe the form, use, and due date of information under the reporting standards directly. These requirements are contained in the reporting standards.

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

The reporting standards also require that information be provided by 31 January following the completion of the calendar year. This timeframe is necessary to enable foreign tax authorities to use the information in the tax assessment process for sellers.

Inland Revenue would use the information it received under the reporting standards (and from foreign tax authorities) for tax administration purposes. This would include cross-checking of sellers' income tax returns against information to ensure that sellers were declaring income from their activities conducted through digital platforms. The Bill does not propose using the information to pre-populate sellers' income tax returns.

Pre-population of income tax returns will be considered in the future and would require legislation to achieve.

Enforcement and penalties

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

- platform operators with reporting obligations, and
- sellers who must provide platform operators with information about themselves.

The Bill therefore proposes to introduce new civil penalties to the TAA that could apply to platform operators and sellers that fail to comply with their obligations under the reporting standards. The penalties in the Bill are based on penalties introduced to the TAA when the Common Reporting Standard (CRS) (an OECD information exchange relating to financial account information) was implemented in New Zealand.

The penalties are contained in proposed new sections 142J (for platform operators) and 142K (for sellers) of the TAA. If the Commissioner assessed a penalty under either of these new sections, the penalty would become payable on the later of:

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

Penalties would not apply to the extent that a platform operator or seller, as applicable, establishes in proceedings challenging the assessment of the penalty that the penalty is excessive, or that the operator or the seller is not chargeable with the penalty.

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

It is anticipated that the Commissioner would exercise discretion in applying penalties during the first years of operation of the reporting standards. This is provided platform operators and sellers had demonstrated a willingness to comply with their obligations under the reporting standards. This is also consistent with the approach taken by the Commissioner when the CRS was implemented in New Zealand.

Penalties when platform operators fail to comply with their obligations

Reporting platform operators could be liable for penalties under proposed section 142J of the TAA where they have an obligation to comply with the requirements set out in the model reporting standard for digital platforms and/or the extended model reporting standard for digital platforms and they do not meet the requirements for sellers operating on their platform.

The Bill proposes that the penalty be \$300 for each occasion that the reporting platform operator does not meet their requirements. This is capped at a maximum of \$10,000 per "reportable period" (a calendar year).

Reporting platform operators would not be liable to pay these penalties if the failure to meet the requirements under the applicable model reporting standard is shown to be due to circumstances outside of their control.

The Bill also proposes increased penalties for reporting platform operators that do not take reasonable care to meet the requirements of the reporting standards. The amount of the penalty would be \$20,000 for the first occasion and \$40,000 for

subsequent occasions. This would be capped at a maximum of \$100,000 for a reportable period.

Penalties when sellers fail to comply with their obligations

A person who is a seller on a digital platform could be liable for a penalty under proposed section 142K of the TAA where they have an obligation to provide information to a reporting platform operator under the reporting standards and they fail to comply with their obligations.

The Commissioner would be able to assess a penalty of \$1,000 in circumstances where the seller:

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

Example 3: Seller fails to provide platform operator with required information

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

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

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

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

Absolute liability and strict liability offences would not apply

The TAA includes criminal penalties that apply on conviction of absolute liability or strict liability offences. Proposed section 143(2E) would ensure that neither platform operators nor sellers could be convicted of an absolute liability or strict liability offence if they fail to comply with a requirement under the reporting standards. Instead, the civil penalties noted above could apply.

Regulations related to the model reporting standards for digital platforms

The Bill includes a regulation-making power that would enable the Governor-General to provide for the effect of future changes to the reporting standards by way of Order in Council. This regulation-making power is included in proposed section 226F of the TAA.

Not all changes would need to be implemented through an Order in Council. For example, minor changes to the reporting standards, or the commentary for the standards, should automatically flow through into New Zealand. Minor changes may reduce compliance costs for reporting platform operators by clarifying how the rules are intended to apply.

Orders in Council would not have retrospective effect and would generally be expressed as applying from the calendar year following the Order in Council coming into force. If it is necessary for an Order in Council to come into force during the calendar year in which it is made, the changes effected by the Order would only need to be applied on a prospective basis from when it came into force.

The OECD would coordinate and consult on changes to the reporting standards before New Zealand needed to consider the effect of an Order in Council for these purposes. If changes were made (through automatic inclusion or through an Order in Council), these changes would be communicated by Inland Revenue.

This approach is consistent with how changes to the CRS would be implemented in New Zealand.

Detailed guidance on the model reporting standards for digital platforms

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

For further information and detailed guidance, the OECD has published:

- the model reporting standard for digital platforms
- the extended model reporting standard for digital platforms
- the User Guide
- the XML Schema, and
- the Code of Conduct.

This information is accessible on the OECD's website at <https://www.oecd.org/ctp/exchange-of-tax-information/model-rules-for-reporting-by-platform-operators-with-respect-to-sellers-in-the-sharing-and-gig-economy.htm>

GST – MARKETPLACE RULES FOR ACCOMMODATION AND TRANSPORTATION SERVICES

Clauses 103(2), (5) and (11), 107(1) and (3), 110, 112(1) and (3), 130(1), (3), (5) and (6)

Summary of proposed amendments

The Bill proposes that the current GST rules for electronic marketplaces that apply to remote services and certain imported goods be extended to apply to “listed services”. Listed services would include taxable supplies of accommodation, ride-sharing, beverage and food delivery services, and other services that are closely connected with these services. This extension would require marketplace operators to collect and return GST on these services provided through electronic marketplaces.

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

GST is a consumption tax that applies to the supply of goods and services in New Zealand. It applies to a broad range of goods and services, which keeps it simple, fair, and efficient.

Since its introduction in 1985, the Goods and Services Tax Act 1985 (GST Act) has been amended in response to new business models and technologies, including those that facilitate cross-border transactions. More recently:

- in 2016, GST started applying to imported digital services (remote services) that are provided through electronic marketplaces such as websites and mobile phone app stores, and
- in 2019, GST also started applying to supplies of low value imported goods (including goods purchased and imported through electronic marketplaces).

These changes were consistent with New Zealand’s broad-based GST system and helped support the sustainability and fairness of the GST system overall. These changes also followed a consultation process undertaken by the Organisation for Economic Co-operation and Development (OECD), and similar changes have been implemented in many other countries with value-added tax (VAT) systems.

In 2020, the OECD began to consider the VAT/GST policy and administration issues that arose in the context of the “gig and sharing economy” or, as described in this Bill, the “platform economy”. This led to a report, “The Impact of the Growth of the Sharing and Gig Economy on VAT/GST Policy and Administration”, which is intended to support jurisdictions to design and implement effective VAT/GST policy responses to the growth and popularity of the gig and sharing economy. The report contains a range of different options that jurisdictions with VAT systems could consider implementing, including requiring platform operators to collect and return GST on behalf of the sellers on the platforms.

The Government consulted on potential changes to the GST system in New Zealand following the OECD’s report in a discussion document, “The role of digital platforms in the taxation of the gig and sharing economy”, published in March 2022. The discussion document observed that services provided through electronic marketplaces (such as accommodation and personal services) are often not subject to GST. This is because the providers of these services through electronic marketplaces operate below the GST

registration threshold of \$60,000 per 12-month period. Where the providers of these services are registered for GST and have no control or influence over the pricing of the services (which are set by the marketplace operators), it is the providers (instead of consumers) that bear the GST costs. This is inconsistent with the principle that GST is intended to be a tax on final consumption by consumers and not generally a cost to businesses.

Electronic marketplaces have become a popular means of enabling buyers to purchase services such as accommodation and transportation. These kinds of services, when provided through other means, are normally subject to GST under New Zealand's broad-based GST framework. When provided through electronic marketplaces, the services are often not subject to GST. If this were to continue, it could have adverse consequences for the long-term sustainability of the GST system. It places traditional suppliers of these services who are charging and returning GST at a comparative disadvantage, and it could undermine New Zealand's broad-based GST system.

The Bill includes proposed amendments that would extend the current rules for electronic marketplaces to apply to a new category of "listed services". These services would include taxable accommodation and certain transportation services, including ride-sharing, and beverage and food delivery services. The OECD identified these activities as among the most significant in the platform economy currently. The amendments have been designed in such a way that further activities or services could be included in "listed services" if appropriate.

The proposed amendments in the Bill build on existing rules in the GST Act that apply to marketplace operators that supply remote services or imported goods in New Zealand. This is intended to reduce compliance costs on marketplace operators by leveraging rules that have been in place since 2016 and that marketplace operators are familiar with.

Detailed analysis

An electronic marketplace is a marketplace that is operated by electronic means through which a person (an underlying supplier) makes a supply of goods, remote services or, as proposed by the Bill, "listed services".² The supply itself is made by electronic means through another person (the operator of the electronic marketplace) to a third person (the recipient). This definition includes a website, internet portal, gateway, store, distribution platform, or other similar marketplace. It does not include a marketplace that solely processes payments.

The operator of an electronic marketplace is treated, for GST purposes, as the supplier of the relevant goods or services when certain criteria are met. The rules for electronic marketplaces also include a priority rule that applies where there are multiple electronic marketplaces that could be liable for GST on a single supply of goods or services. Under this rule, it is the first operator that authorises the charge or receives payment for the supply that is treated as the supplier.

The Bill proposes amendments to the rules for electronic marketplaces that would extend the circumstances when the operator of an electronic marketplace would be treated as the supplier of services that are made through the marketplace. These amendments would supplement the existing rules for remote services and imported goods made through electronic marketplaces to also include a new category of "listed services".

² For "listed services", an underlying supplier would be a host that provides the accommodation or a driver that provides the transportation services.

The Bill includes "listed services" in proposed section 8C of the GST Act. It sets out that the following services would be included in the definition:

- **Taxable accommodation services.** This would include all forms of accommodation (such as commercial, short-stay, and visitor accommodation) other than exempt residential accommodation (see the heading "Taxable accommodation" below).
- **Transportation services.** The relevant transportation services would be ride-sharing, and beverage and food delivery. Other transportation services would not be included in this definition (see the heading "Transportation services" below).

"Listed services" would also include services that are closely connected with the above services where these services are also available through the electronic marketplace. This includes, for example, cleaning services that may be charged by the operator of the electronic marketplace to consumers.

The Bill proposes to extend the existing electronic marketplace rules so that they would apply to determine whether the operator of the electronic marketplace is the supplier of the listed services. Under these rules, the marketplace operator of an electronic marketplace through which listed services are supplied would be treated as the supplier where they:

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

The existing rules in the GST Act that apply when there is more than one operator of the electronic marketplace would also apply in the context of the proposed amendments for listed services.

When the operator of an electronic marketplace is treated as the supplier of listed services, the following would apply:

- The person who provides the services (the underlying supplier) would be treated as having made a supply of the listed services to the operator of the electronic marketplace. This supply would be zero-rated under existing GST legislation and the underlying supplier would therefore not pay GST on this supply.
- The operator of the electronic marketplace supplying listed services would be treated as the supplier of the listed services that would be subject to GST at the standard rate of 15%.

The underlying supplier would have incurred GST on costs associated with making supplies of listed services. The GST treatment of these costs would depend on whether the underlying supplier is registered for GST. If the underlying supplier is registered for GST, they would be able to deduct input tax on their expenses in the usual way (see the heading "GST-registered underlying suppliers" below). If the underlying supplier is not a registered person, they would be subject to the proposed flat-rate scheme (see the item "Flat-rate credit scheme" later in this Commentary).

When GST would apply to listed services

The proposed rules for listed services differ slightly from the existing rules for electronic marketplaces that supply remote services or goods. Those existing rules require:

- the recipient of remote services to be a New Zealand tax resident, and
- the address for the delivery of goods to be at a place in New Zealand.

Further, where the recipient of remote services is a registered person themselves, the operator of the electronic marketplace can treat the services as being supplied outside New Zealand, or the services can be zero-rated.

The Bill proposes that where a marketplace operator is treated as supplying listed services, these services would be subject to GST when they are performed, provided, or received in New Zealand. Amendments are proposed to the place of supply rules in section 8 of the GST Act to achieve this outcome.

Example 4: Listed services performed, provided, or received in New Zealand

Charlotte is based overseas and is looking for accommodation in New Zealand for an upcoming holiday.

She uses an electronic marketplace to book accommodation in a bach in Queenstown.

Under the proposed amendments, as the accommodation provided through the electronic marketplace is in New Zealand, the marketplace operator would be treated as the supplier of the accommodation and would need to account for GST.

The Bill also proposes that listed services would always be subject to GST at the standard rate. This means the current rules that allow marketplace operators to treat supplies of remote services or low-value goods made to GST-registered persons as zero-rated supplies (or supplies made outside New Zealand) would not apply to listed services.

Marketplace operators would be required to collect and return GST on supplies of listed services from 1 April 2024. The effect of this is that the purchase of taxable accommodation or transportation services (as described in proposed section 8C(2)) through an electronic marketplace before this date would not be subject to GST.

Example 5: Listed services purchased before 1 April 2024

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

Under the proposed amendments, the operator of the electronic marketplace would not collect GST on the accommodation, even though it is provided after 1 April 2024.

Taxable accommodation

The Bill proposes that all accommodation (other than exempt accommodation) provided through an electronic marketplace would be subject to GST. For a supply of accommodation to be exempt under New Zealand's GST Act, the recipient of the accommodation must use the property as their principal place of residence, and they will usually have rights of quiet enjoyment. Accommodation provided through electronic marketplaces will generally not meet these criteria and therefore will not be exempt. This means that, under the proposals in the Bill, marketplace operators would need to return GST on accommodation services provided by underlying suppliers through the electronic marketplace at the standard rate of 15%. The Bill proposes that large commercial providers of accommodation can opt-out of this treatment – see the item "Opt-out agreements" later in this Commentary.

The GST Act includes a special valuation rule for domestic goods and services provided in a commercial dwelling. This rule discounts the rate of GST from 15% to 9% in limited circumstances, provided certain criteria are met. New section 10(6B) proposes

that where the accommodation is provided through an electronic marketplace, this special valuation rule would not apply. This is because it would be impractical for the operator of an electronic marketplace to determine whether the underlying supplier is providing domestic goods and services that are subject to the discounted GST rate or other accommodation services that are subject to the standard GST rate.

Transportation services

The Bill proposes to define “transportation services” in the context of listed services as:

- ride-sharing services, and
- beverage and food delivery services.

Ride-sharing services refers to the use of a mobile app or website (electronic marketplace) to engage a personal driver to collect and transport a fare-paying consumer to a chosen destination.

Courier services for the delivery of beverages and/or food provided through an electronic marketplace are also included in listed services. This does not include the cost of the beverage or food itself.

Closely connected services

The Bill proposes to include in listed services all closely connected services that are advertised, listed, or otherwise available through the electronic marketplace.

This means that services that are closely connected with the supply of taxable accommodation or the transportation services included in proposed section 8C(2)(b) of the GST Act would also be treated as listed services and would therefore be subject to GST.

Services would be considered closely connected where they were incidental to the taxable accommodation or transportation services included in proposed section 8C(2).

Example 6: Closely connected services

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

Geoff provides accommodation in his property to Jenny through the electronic marketplace. The electronic marketplace also charges Jenny a cleaning fee of \$50 that is payable to the electronic marketplace.

Under the proposed amendments, the cleaning fee would be subject to GST as the fee corresponds to a service that is closely connected with taxable accommodation (a listed service).

A service would not be considered closely connected with a listed service if the service did not arise because of the listed service itself. This means that, for example, if cleaning services were provided through an electronic marketplace but were not connected to taxable accommodation or the transportation services included in proposed section 8C(2), those cleaning services would not be “listed services” that a marketplace operator would need to collect and return GST on.

GST-registered underlying suppliers

The proposed amendments would require marketplace operators to collect and return GST on behalf of underlying suppliers of listed services. This would apply regardless of the GST registration status of the underlying supplier.

An underlying supplier of listed services will purchase goods and services for use in making supplies of listed services through electronic marketplaces. If the underlying supplier is registered for GST, they would be able to recover GST on these costs in the normal way, by claiming a deduction for input tax in their GST return.

Under the proposed amendments in the Bill, an underlying supplier of listed services that is registered for GST would:

- no longer account for GST on supplies of listed services sold through electronic marketplaces (as GST would be accounted for by the marketplace operator)
- be treated as making supplies of listed services to the marketplace operator (section 60(1C)(a)), and these supplies would be zero-rated (section 11A(1)(jc))
- need to include these zero-rated supplies in their GST return that they provide to Inland Revenue, and
- be able to claim input tax deductions on the costs they incur in making supplies of listed services through electronic marketplaces in their GST return.

Example 7: Recovery of GST on costs incurred by a GST-registered underlying supplier

Wiremu provides ride-sharing services through an electronic marketplace. Wiremu has chosen to be registered for GST, and he has notified the operator of the electronic marketplace of his GST registration status.

In making supplies of ride-sharing services, Wiremu purchases fuel and pays to have his vehicle registered and insured. These costs include GST, which Wiremu can recover as an input tax deduction when he completes his GST return.

Under the proposed amendments, in this situation:

- The operator of the electronic marketplace collects GST on the supply of ride-sharing services Wiremu provides through the electronic marketplace.
- Wiremu recovers GST on his expenses in the normal way in his GST return. He includes the income he receives from the operator of the electronic marketplace in the zero-rated supplies box of his GST return to avoid having a GST obligation on these sales (as GST has already been collected by the operator of the electronic marketplace).

OPT-OUT AGREEMENTS

Clauses 130(4) and (6), and 135

Summary of proposed amendments

The proposed amendments would allow large commercial enterprises providing taxable accommodation services to enter into agreements with marketplace operators that enable them to continue being responsible for their own GST obligations.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

The proposal to extend the electronic marketplace rules to apply to listed services, including taxable accommodation services, would mean that operators of electronic marketplaces are treated as the suppliers of services that are supplied by another person. This is appropriate in circumstances where the underlying supplier of the services does not have a large commercial operation of providing accommodation services, such as a person who supplies short-stay accommodation in their own home or in an investment property.

Many commercial enterprises that provide taxable accommodation (and who will already be collecting and returning GST to Inland Revenue on their supplies of accommodation) will list their services on electronic marketplaces. Under the proposals in the Bill, where taxable accommodation services are supplied through an electronic marketplace, the operator of the electronic marketplace (and not the accommodation provider itself) is treated as the supplier and would therefore have the obligation to return GST on those supplies to Inland Revenue. This could result in increased compliance costs for commercial accommodation providers who would need to make changes to their accounting systems and practices.

To avoid this, the Bill proposes that large commercial providers of accommodation would be able to enter into agreements with operators of electronic marketplaces that enable them to retain responsibility for collecting and returning GST on their supplies of taxable accommodation. These "opt-out" agreements are intended to be available only to large commercial enterprises that provide accommodation services and not smaller-scale operations. In the case of the latter, the Government considers it appropriate that operators of electronic marketplaces should be responsible for collecting and returning GST.

If an opt-out agreement were entered into, this would mean that:

- the accommodation providers themselves would remain responsible for collecting and returning GST on the fees received for the accommodation services they provide, and
- the operator of the electronic marketplace would not be treated as the supplier of the accommodation services and consequently would not need to collect and return GST to Inland Revenue on these supplies.

This would enable large accommodation providers to maintain their existing accounting practices. It would also mitigate the risk of double taxation that might arise if the operator of the electronic marketplace collected and returned GST on supplies of

accommodation that large accommodation providers might also include as standard-rated sales in their own GST returns.

Key features

The proposed amendments would:

- enable large commercial enterprises to enter into opt-out agreements from the electronic marketplace rules, allowing them to agree with marketplace operators to continue being responsible for collecting and returning GST on accommodation services they supply themselves, and
- provide the Commissioner with a determination-making power that enables the Commissioner to determine the circumstances where other categories of taxpayers in the accommodation sector can enter into an opt-out agreement.

Detailed analysis

With marketplace rules, the operator of an electronic marketplace is treated as the supplier of goods or remote services that are provided by another person through the electronic marketplace (the underlying supplier).

The rules that apply to electronic marketplaces are included in section 60C of the GST Act. The Bill proposes amendments to section 60C that would enable opt-out agreements between the operator of an electronic marketplace and a person who meets the criteria to be a "large commercial enterprise".

Proposed section 60C(2BB) would enable a person who meets the criteria to be a "large commercial enterprise" to enter into an agreement with the operator of an electronic marketplace that would treat the person, and not the operator of the electronic marketplace, as the supplier of the accommodation services made through the electronic marketplace (an "opt-out agreement") where:

- the documentation provided to the recipient of the services shows the supply as being made by the large commercial enterprise and not the operator of the electronic marketplace, and
- a documented agreement between the operator of the electronic marketplace and the large commercial enterprise provides that the large commercial enterprise is liable for the payment of GST, and not the operator of the electronic marketplace.

The Bill proposes to define a "large commercial enterprise" as a person who provides accommodation services through an electronic marketplace (an underlying supplier) and lists more than 2,000 nights of accommodation available through the electronic marketplace in a 12-month period. This threshold is similar to the threshold of 2,000 listings per year that is applied in the OECD model reporting standards for determining when a seller on a digital platform should be subject to the reporting requirements. The underlying supplier would also need to have a reasonable expectation that they can meet this threshold for any 12-month period.

Proposed section 60C(2BC) would also allow the Commissioner to determine alternative criteria that can be satisfied for an underlying supplier to be a "large commercial enterprise".

In making such a determination, the Commissioner would have to have regard to:

- the compliance costs that would arise for underlying suppliers in making changes to their accounting systems and practices, and
- the size, scale, and nature of the accommodation services and activities undertaken by underlying suppliers (and it would not be determinative that the underlying supplier exceeded the GST registration threshold alone).

The Commissioner would undertake public consultation before making a determination.

The Bill proposes that electronic marketplace rules for listed services would apply from 1 April 2024. However, the Bill also proposes a special transitional rule that would make the amendments relating to listed services and opt-out agreements effective on the date the Bill is enacted. This would enable large commercial enterprises to enter into agreements with the operators of electronic marketplaces well before 1 April 2024. It would also enable the Commissioner to make a determination that defines the class of taxpayers who can meet the criteria to be a “large commercial enterprise” that can enter into an opt-out agreement. This transitional rule is included in proposed section 85D.

FLAT-RATE CREDIT SCHEME

Clauses 103(3) and (11), 110, 117(3), (16), (22), (25) to (27), 131 and 185(1)

Summary of proposed amendments

The proposed amendments would implement a flat-rate credit scheme that marketplace operators would have to apply for underlying suppliers of listed services that were not registered for GST.

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

The Bill proposes that operators of electronic marketplaces that supply listed services (taxable accommodation and certain transportation services) would be required to collect and return GST on these supplies to Inland Revenue.

For underlying suppliers that are registered for GST, they would be able to continue claiming input tax deductions for goods and services they purchase to make supplies of listed services through electronic marketplaces (see the heading "GST-registered underlying suppliers" in the item "GST – Marketplace rules for accommodation and transportation services" earlier in this Commentary).

For underlying suppliers that are not registered, or required to be registered, for GST, the Bill proposes a flat-rate credit scheme. The flat-rate credit scheme would require marketplace operators to pass on, as a credit, a proportion of the consideration charged for the listed services to the underlying supplier. The flat-rate credit approximates the amount of GST that the underlying supplier would be able to recover as a GST deduction if they were registered for GST.

Flat-rate schemes are used in other jurisdictions with value-added tax systems as a way of reducing the compliance and administration costs associated with GST registration.

Key features

The proposed amendments would:

- require marketplace operators to apply a flat-rate credit scheme for underlying suppliers of listed services who have not notified them that they are registered for GST
- provide an input tax deduction equal to the amount of the flat-rate credit for listed services, which marketplace operators would account for in completing their GST return
- require sellers to provide marketplace operators with sufficient information about themselves and their GST registration status to enable marketplace operators to apply the flat-rate credit scheme
- include rules to reverse the benefit of the flat-rate credit where it is received by underlying suppliers who are registered for GST, and

- include an ability for the Commissioner to disclose a person's GST registration status to marketplace operators to ensure the effective operation of the flat-rate credit scheme.

Detailed analysis

The purpose of the flat-rate credit scheme is to reduce compliance costs for underlying suppliers who are not required to be registered for GST and who would be able to take an input tax deduction for GST on costs they incur in making supplies of listed services. It would achieve this by providing these underlying suppliers with a flat-rate credit that approximates the amount of GST deductions they would be able to claim on their costs if they were registered for GST.

Underlying suppliers could choose not to apply the flat-rate credit scheme and instead claim input tax deductions as a GST-registered person would in the usual way. The flat-rate credit scheme would not be available to GST-registered underlying suppliers, including underlying suppliers who are required to be registered for GST (because they make more than \$60,000 of taxable supplies in a 12-month period).

The proposed flat-rate credit scheme would require:

- underlying suppliers to provide their name, tax file number, and GST registration status to the operators of electronic marketplaces that they operate on (and to update this information as soon as practicable in the event of changes, for example, a person becomes registered for GST)
- operators of electronic marketplaces to take an input tax deduction equal to the flat-rate credit, which is prescribed in proposed section 20(3N) of the GST Act, where the services provided are listed services, and the underlying supplier has not notified the operator of the electronic marketplace that they are registered for GST at the time of supply, and
- operators of electronic marketplaces to pass on the flat-rate credit to underlying suppliers of listed services, and to also provide details of the passed-on flat-rate credit amount as part of their usual reporting practices at least once a month.

Proposed new subsection 20(3N) provides that the amount of the input tax deduction to be taken by operators of electronic marketplaces that corresponds to the flat-rate credit passed on to relevant underlying suppliers (that is, underlying suppliers of listed services who have not notified the operator of the electronic marketplace that they are registered for GST) would be 8.5% of the value of the listed services. The deduction for input tax is taken under proposed section 20(3)(de). The flat-rate credit is required to be passed on to relevant underlying suppliers under proposed section 8C(3)(b)(ii). The flat-rate percentage was determined through analysis of GST return information from suppliers who had identified themselves as suppliers of accommodation in holiday homes and from taxi drivers.

Example 8: Basic operation of the flat-rate credit scheme for marketplace operators

Henry provides taxable accommodation through an electronic marketplace where the marketplace operator is responsible for collecting and returning GST on these supplies.

Henry notifies the operator of the electronic marketplace that he is not a registered person for the purposes of the GST Act.

Josie books accommodation that Henry provides through the electronic marketplace for \$200 plus GST for the stay. The marketplace operator collects

GST of \$30 on the supply of the taxable accommodation that they are treated as making to Josie.

Knowing that Henry is not a registered person, under the proposed amendments, the marketplace operator applies the flat-rate credit scheme and calculates:

- GST of \$30 at 15% of the value of the supply, and
- the input tax deduction of \$17 for the flat-rate credit at 8.5% of the value of the supply.

The marketplace operator would be required to deduct input tax of \$17 from the \$30 of GST payable to Inland Revenue and pass on the \$17 to the underlying supplier as a flat-rate credit.

The marketplace operator would pay the remaining \$13 to Inland Revenue, and this would be the net GST collected on the supply of the accommodation.

The flat-rate credit scheme would not apply where the underlying supplier is registered for GST and has notified the operator of the electronic marketplace of their GST registration status. This is because underlying suppliers that are registered for GST would recover GST on the costs of goods and services they use in making supplies of listed services in the normal way through their own GST return (see the heading "GST-registered underlying suppliers" in the item "GST – Marketplace rules for accommodation and transportation services" earlier in the Commentary).

Receiving flat-rate credit when registered for GST

The Bill also contains amendments that would maintain the integrity of the flat-rate credit scheme. These proposed amendments are to ensure that the benefit of the flat-rate credit is only available to underlying suppliers of listed services who are not registered, or required to be registered, for GST.

If an underlying supplier of listed services were registered for GST and received the flat-rate credit, under proposed section 8C(3) of the GST Act, they would:

- **Have a tax shortfall equal to the amount of the flat-rate credit they received.** This tax shortfall could be liable for shortfall penalties under the Tax Administration Act 1994 of up to 150% of the flat-rate credit taken for a taxable period that the underlying supplier should not have received.
- **Be required to account for output tax for the amount equal to the flat-rate credit they received in a taxable period.** This output tax obligation, and the timing of the output tax adjustment, is provided for in proposed sections 20(3JD) and 20(4E) of the GST Act.

Example 9: Underlying supplier of listed services is registered for GST and receives flat-rate credit – tax shortfall

Bradd is a registered person and provides taxable accommodation services through an electronic marketplace. He has notified the operator of the electronic marketplace that he is not a registered person for the purposes of the GST Act.

Bradd's only sales are through an electronic marketplace. He is registered for GST on a six-monthly basis. Between April 2024 and September 2024, Bradd makes sales through the electronic marketplace equal to \$46,000 including GST.

Bradd has incurred expenses of \$5,000 including GST. Bradd has claimed GST on these expenses in his GST return.

Under the proposed amendments, as Bradd notified the operator of the electronic marketplace that he was not a registered person, Bradd also received flat-rate credits from the operator of the electronic marketplace equal to \$3,910. Bradd therefore has a tax shortfall equal to this amount and could be liable for a shortfall penalty of up to 150% of the tax shortfall.

Example 10: Underlying supplier of listed services is registered for GST and receives flat-rate credit – output tax adjustment

In completing her GST return for the period ending 31 March 2025, Poppy realises she has received flat-rate credits from the operator of the electronic marketplace she operates through. Poppy identifies this from the statement the operator of the electronic marketplace has provided her showing the amount of the flat-rate credits she received in March 2025.

Poppy became a registered person in February 2025 but forgot to notify the operator of the electronic marketplace of the change in her GST registration status. Poppy is keen to correct this error. The amount of the flat-rate credits Poppy received in February and March totalled \$6,000.

Poppy includes \$6,000 as an output tax adjustment in her GST return for the period ending March 2025. This output tax will be offset by the amount of GST on the expenses Poppy is claiming an input tax deduction for in the GST return.

If an underlying supplier of listed services who is registered for GST receives flat-rate credits that span multiple taxable periods (and therefore multiple GST returns), an output tax adjustment would need to be made in the GST return for each taxable period that the underlying supplier received the flat-rate credit. The timing rules for the adjustment are included in proposed section 20(4E) of the GST Act.

Example 11: Timing of output tax adjustment for the flat-rate credit spanning multiple taxable periods

Marley is registered for GST and provides listed services through an electronic marketplace. He incorrectly receives the flat-rate credit as he had not notified the operator of the electronic marketplace that he is registered for GST.

Marley has a six-monthly taxable period, providing GST returns for the periods covering 1 April 2025 to 31 October 2025 and 1 November 2025 to 31 March 2026.

Marley receives the following amounts of flat-rate credits:

- \$600 in February 2025
- \$400 in March 2025
- \$800 in April 2025.

Marley is required to make an output tax rate adjustment of:

- \$1,000 in his GST return for the taxable period ending 31 March 2025, and
- \$800 in his GST return for the period ending 31 October 2025.

Requirement for underlying suppliers to provide marketplace operators with information

To enable the effective operation of the flat-rate credit scheme, underlying suppliers would have to provide marketplace operators with their name, tax file number, and GST registration status under proposed section 60H(1). If this information changed (for example if the underlying supplier registered for GST), the underlying supplier would be required to inform the marketplace operator of this change as soon as practicable in accordance with proposed section 60H(2).

An underlying supplier is also a "seller" for the purposes of the OECD's model reporting standards for digital platforms and would be required to provide information about themselves to a reporting platform operator for those purposes.

The Bill also proposes that the Commissioner would be able to disclose a person's GST registration status to marketplace operators for the effective operation of the flat-rate credit scheme. The marketplace operator would be required to act on this information from the Commissioner as soon as practicable (see proposed section 8C(5) of the GST Act and the proposed permitted disclosure in clause 3B of schedule 7, Part A, of the Tax Administration Act 1994).

GST returns for marketplace operators

The Bill proposes that the operators of electronic marketplaces that supply listed services would be required to take a deduction of input tax equal to the flat-rate credit in circumstances where the underlying supplier had not notified them that they were registered for GST. The marketplace operator would then be required to pass on this flat-rate credit to these underlying suppliers.

The deduction for input tax would be taken under proposed section 20(3)(de) in the marketplace operator's own GST return, and this would reduce the amount of GST payable to Inland Revenue on the listed services the marketplace operator is treated as supplying.

Proposed section 60H(3) would enable marketplace operators to rely on the information they receive from underlying suppliers about their GST registration status. If the GST registration status of an underlying supplier is later found to be incorrect (and the operator of the electronic marketplace took a deduction for the flat-rate credit), the operator of the electronic marketplace would not be liable for the tax shortfall. This is intended to recognise the compliance costs associated with the flat-rate credit scheme on operators of electronic marketplaces, who should be protected from any tax shortfalls that relate to underlying suppliers.

Where the operator of an electronic marketplace is a non-resident for GST purposes, GST returns and payments would be provided to Inland Revenue on a quarterly basis. If the operator of an electronic marketplace is a New Zealand resident, the filing and payment frequency would depend on the value of marketplace operator's total supplies.

Marketplace operators would continue applying the existing GST rules to determine whether their facilitation services were standard rated, zero-rated, or non-taxable. The Bill does not contain amendments to these rules.

The Bill does not contain amendments requiring marketplace operators to provide Inland Revenue with periodic information about underlying suppliers that have received the flat-rate credit. This is because Inland Revenue would seek to use the information under the OECD's model reporting standards for digital platforms to determine whether underlying suppliers had correctly received the flat-rate credit. Inland Revenue could also request information from marketplace operators if necessary to ensure the integrity of the flat-rate scheme.

CONSEQUENTIAL AMENDMENTS

Clauses 106(4) and (12), 110, 111, 112(2) and (3), 115, 116, 126, 127, 129, 132 and 133

Summary of proposed amendments

Several consequential amendments are required to the Goods and Services Tax Act 1985 (GST Act) to ensure that the proposed extension of the existing rules for electronic marketplaces to supplies of listed services work as intended.

Effective date

The proposed amendments would have effect for taxable periods starting on or after 1 April 2024.

Background

The GST rules for electronic marketplaces treat the marketplace operator as the supplier of the goods or services that are provided through the electronic marketplace by someone else (the underlying supplier).

The GST Act contains special rules for electronic marketplaces and the Bill proposes to extend these rules to also apply where the services supplied through the electronic marketplaces are listed services. These include amendments to the rules for:

- vouchers, discounts, and loyalty programmes
- taxable periods
- taxable supply information
- bad debt deductions for marketplace operators
- GST registration
- agents
- the keeping of records in a place outside of New Zealand, and
- foreign currencies and currency conversion.

These proposed amendments would be consequential in nature and are intended to ensure that the existing rules for operators of electronic marketplaces apply in the context of listed services.

Detailed analysis

Vouchers, discounts, and loyalty programmes

The GST Act contains special rules for vouchers, discounts, and loyalty programmes. When the rules for remote services and imported goods were enacted, amendments were made to these rules to ensure they applied appropriately when remote services and imported goods were supplied through electronic marketplaces.

The Bill proposes amendments to these rules for listed services supplied through electronic marketplaces: for vouchers (section 5(11G)), discounts (section 10(7D)), and loyalty programmes (section 9(9)). These rules would apply to listed services in the same way that they apply to remote services and imported goods.

Taxable periods

Non-resident marketplace operators have a quarterly taxable period, with the first taxable period beginning on 1 January and ending on 31 March. This means that their GST returns and payments are due four times a year.

The Bill proposes an amendment to the rules for taxable periods in section 15 of the GST Act that would incorporate a reference to "listed services". This would ensure that non-resident operators of electronic marketplaces that make supplies of listed services would be able to maintain a quarterly taxable period.

Taxable supply information

A GST-registered person who makes supplies of goods and services is generally required to provide the recipient of the supply with taxable supply information. The Bill proposes amendments to this general rule in circumstances where:

- **There is a deemed supply of listed services from the underlying supplier to an electronic marketplace.** There would be no requirement for the underlying supplier of listed services to provide taxable supply information to the operator of the electronic marketplace in these circumstances. This is included in proposed section 8C(3)(a)(i) of the GST Act.
- **The operator of an electronic marketplace is treated as making a supply of listed services to a person.** The Bill proposes that the operator of an electronic marketplace would be required to provide the recipient of listed services with taxable supply information. There is no need for the recipient of the supply to request the taxable supply information, and the GST registration status of the recipient is also not relevant. This is included in the proposed amendment to section 19K of the GST Act.

Bad debt deductions for operators of electronic marketplaces

The GST Act includes special rules that enable marketplace operators to claim a bad debt deduction for GST they would be liable to pay to Inland Revenue on supplies of remote services or imported goods made through electronic marketplaces.

The Bill contains an amendment to section 26AA of the GST Act that would enable marketplace operators that are treated as the supplier of listed services to apply these rules. This would enable them to claim a bad debt deduction for the GST component of the listed services that they have written off as a bad debt. Under these rules, the bad debt deduction would be reversed to the extent that the GST was recovered by the marketplace operator.

GST registration

The proposed new rules would require non-resident operators of electronic marketplaces that supply listed services to register for, and return, GST on these supplies where they are performed, provided, or received in New Zealand if these supplies exceed, or are expected to exceed, NZ\$60,000 in a 12-month period.

The Bill proposes to amend the registration rules in section 51 of the GST Act to enable non-resident operators of electronic marketplaces to use a fair and reasonable method of converting foreign currency amounts to New Zealand currency to determine whether the registration threshold has been exceeded.

The Commissioner is not able to allocate a tax file number (IRD number) to an offshore person unless they have provided the Commissioner with evidence of their New Zealand bank account number. An exception to this exists where the offshore person needs an IRD number solely because they are a non-resident supplier of goods and services under the GST Act. This exception would continue to apply in

circumstances where a non-resident marketplace operator would need to register for GST in New Zealand.

Agents

The Bill proposes an amendment to the agency rules in section 60 of the GST Act to allow non-resident marketplace operators to enter into agency agreements with New Zealand resident agents. The New Zealand resident agent would be treated as the supplier of listed services instead of the marketplace operator.

Record keeping

GST-registered persons can apply to the Commissioner for authorisation to keep records at a place outside New Zealand or in a language other than English. The Bill proposes an amendment to the record-keeping rules in section 75 that would provide an automatic exception from this requirement where a marketplace operator treated as a supplier of listed services is a non-resident. This is intended to reduce compliance costs for non-resident operators of electronic marketplaces as they would not need to obtain authorisation from Inland Revenue to maintain records outside New Zealand.

Currency conversion

The Bill proposes to amend the rules for New Zealand and foreign currency in section 77 of the GST Act to provide non-resident marketplace operators with the option of expressing amounts in a foreign currency at the time of supply. This would override the general principle in the GST Act that all amounts be expressed in New Zealand currency at the time of supply.

Cross-border workers

CROSS-BORDER WORKERS REFORM

Overview

The Income Tax Act 2007 and the Tax Administration Act 1994 impose obligations on persons who make payments subject to pay as you earn (PAYE) withholding tax – including non-resident contractors' tax (NRCT), fringe benefit tax (FBT) or employer's superannuation contribution tax (ESCT).

Concerns were raised with Inland Revenue that current policy settings do not adequately reflect the complexities of cross-border work or the ways in which work is changing. In light of those concerns, an officials' issues paper³ was published containing potential policy options for addressing issues faced by employers and payers of non-resident contractors with a view to improving certainty, efficiency and fairness in the tax system.

Following consultation, measures contained in this Bill were developed to respond to the issues raised with Inland Revenue. The measures seek to balance competing considerations—in particular, whether:

- an ultimate tax liability exists for the payee in New Zealand,
- withholding taxes enable the risk of non-compliance to be managed, and
- better provision, and use, of information can play a role in promoting tax compliance.

The proposed amendments are part of a wider package of reform to the tax treatment of employers, payers and cross-border workers, including administrative and operational changes. In addition to the key legislative amendments described below, three remedial legislative changes are included in the reform package.

Amendments to the PAYE, FBT and ESCT rules

The PAYE, FBT and ESCT rules are strictly applied. PAYE streamlines the collection of taxes on employees' salaries and wages and ensures the amounts collected are broadly accurate. PAYE collection and reporting also enables better administration of the tax and transfers system. FBT and ESCT ensure all elements of remuneration are taxed on an equivalent basis. These taxes are quantified and collected under subpart RD (Employment-related taxes) of the Income Tax Act 2007.

The proposed amendments would acknowledge that employees working in New Zealand for a non-resident employer (whether as a remote worker, a business traveller or on assignment to a New Zealand business) are in different compliance circumstances to employees of resident employers. These different circumstances may mean a different administrative approach is justified that reduces the cost of compliance with the rules.

The proposed key amendments seek to:

- enable more flexible application of the PAYE, FBT and ESCT rules in specific circumstances, including:
 - introducing a grace period that will apply in certain circumstances,
 - enabling the Commissioner of Inland Revenue to agree with an employer of cross-border employees to pay PAYE annually in special circumstances, and

³ [Cross-border workers: issues and options for reform : an officials' issues paper \(October 2021\)](https://www.ird.govt.nz/cross-border-workers-issues-and-options-for-reform) ([ird.govt.nz](https://www.ird.govt.nz))

- repealing the PAYE bond provision, which is rarely used and is anticipated will no longer be required, and
- improve the clarity and integrity of the PAYE, FBT and ESCT rules.

Amendments to the non-resident contractor rules

NRCT applies to contract payments for the performance of services by a non-resident contractor and the supply of personal property or services by other persons. NRCT was introduced and expanded in response to specific concerns about the integrity of the New Zealand tax base. The purpose of NRCT is to manage 'flight risk' – contractors who departed New Zealand having completed their work and collected payment but having not paid the New Zealand tax due. It is intended to be a robust withholding obligation.

Unless a contract payment is exempt, the payer is required to withhold NRCT, generally at 15%, from each contract payment. While NRCT is included in the PAYE system, it can apply to contracts in which both payer and contractor are non-resident and only the activity takes place in New Zealand. Further, NRCT is an interim, not minimum or final, tax – the non-resident contractor has its own tax filing requirement that gives effect to the final tax position.

The proposals in the Bill aim to modernise the NRCT rules and introduce more flexibility for payers of NRCT. The proposed amendments are:

- simplifying the approach to the schedular payment thresholds
- introducing a reporting requirement for payers of NRCT
- improving the flexibility of NRCT payments and exemptions by:
 - introducing a grace period that will apply in certain circumstances,
 - modifying NRCT exemptions, and
 - introducing a nominated taxpayer approach, and
- repealing the NRCT bond provision, which is rarely used and is anticipated will no longer be required.

FLEXIBLE PAYE, FBT AND ESCT ARRANGEMENTS

Clauses 16, 17, 18, 86, 91 and 98(5)

Summary of proposed amendments

The proposed amendments would enable more flexible pay as you earn (PAYE) withholding tax, fringe benefit tax (FBT), and employer's superannuation contribution tax (ESCT) arrangements for employers of cross-border employees.

Effective date

The proposed amendments would generally take effect on 1 April 2023. Provisions that introduce flexible PAYE measures, including the introduction of the 60-day grace period and the repeal of the PAYE bond provision, would take effect on 1 April 2024.

Background

The Income Tax Act 2007 (ITA) and the Tax Administration Act 1994 (TAA) impose obligations on persons who make payments subject to PAYE, FBT, ESCT (collectively referred to in this discussion as "the rules") as applicable.

As the rules are strictly applied, in some circumstances the cost of compliance can be disproportionately high. The strictness of the rules is appropriate for domestic employees, but the tax arrangements for cross-border employees can be unduly complicated, and it is not always easy for an employer to meet their New Zealand tax obligations on a timely basis. The proposed amendments seek to reduce the cost of compliance with the rules.

Key features

The proposed amendments would establish a more flexible framework for PAYE, FBT and ESCT where these rules are applied to cross-border employees. The key features are:

- A definition of a "cross-border employee" for the purpose of the rules.
- A 60-day grace period that applies where a cross-border employee has breached the conditions of an exemption from the rules or receives an extra pay.
- An ability for the employer to apply to the Commissioner of Inland Revenue for a bespoke PAYE arrangement in special circumstances.
- Repeal of the PAYE bond provision.

Detailed analysis

Cross-border employment arrangements take a variety of forms, including secondments, short-term business travel and remote working (where a person works in a different location to the employer's place of business). As the arrangements can be complicated, an employer may not correctly understand, or be able to meet, their New Zealand payment and tax obligations even though they are trying to comply.

Examples that demonstrate the problem include the following situations:

- An employer may expect an employee to benefit from an exemption from New Zealand tax under the terms of a double taxation agreement, but a project delay means that the conditions for exemption are not met, and this results in the need to pay New Zealand tax.

- The employee is paid elements of their remuneration package from one or more global locations. It is not always possible to gather and process compensation data in time to meet New Zealand's reporting and payment due dates.

Strictly, breaches of the rules require a voluntary disclosure to report underpaid tax to Inland Revenue and correct the tax position for each affected employer and/or employee. Voluntary disclosures are time-consuming and costly to prepare, and from an administrative perspective, they are also time-consuming to process and resolve.

Definition of a "cross-border employee"

The flexibility enabled by the proposed amendments would apply to cross-border employees only. Proposed new section CE 1F(4) of the ITA would define a "cross-border employee" as:

- an employee of a non-resident employer who provides services in New Zealand, or
- a New Zealand resident employee who provides services outside New Zealand.

The purpose of the definition is to ensure that flexibility is appropriately targeted and to enable Inland Revenue to police the application of the rules.

The definition is intended to apply to cross-border secondees, short-term business travellers and remote workers (persons whose employer does not provide a workplace in New Zealand). The definition would extend to persons who may work abroad but who are resident in New Zealand and who pay tax in New Zealand on the worldwide basis.

60-day grace period

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

- breached a threshold for exemption under section CW 19 of the ITA
- breached a threshold for exemption under a relevant double taxation agreement, or
- received an extra pay.

The grace period would run from the earliest of the date of the breach or payment and the date on which the employer could reasonably foresee that the breach or payment will occur.

The grace period would be available to employers of cross-border employees and to cross-border employees who are responsible for paying PAYE, FBT and ESCT themselves. At present, these persons may choose to make a voluntary disclosure of underpaid tax to Inland Revenue. Under the proposed amendments, a voluntary disclosure would be unnecessary where an employer or relevant cross-border employee meets or corrects the tax due within the grace period. Penalties and interest would not be imposed in respect of underpaid tax if the underpayment is corrected within the grace period.

Application for a bespoke PAYE arrangement

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

The proposed amendment to section RA 15 would enable an employer of a class of cross-border employees to apply to the Commissioner for an agreement that the tax due for a PAYE income payment may be made by 31 May following the end of the tax year. The agreement would only be made where 'special circumstances' exist. Applicants would need to establish the basis for seeking an annual arrangement for payment. Inland Revenue will develop guidance to clarify the types of scenarios that would qualify for annual payments of tax.

Repeal of the PAYE bond

Under current law, section RD 23 of the ITA allows an employer or PAYE intermediary to apply to the Commissioner to be released from a withholding obligation for a PAYE income payment by providing a bond or other security for the amount that would otherwise be required to be withheld. The section applies where it could not be reasonably determined at the time of withholding whether the payment will be exempt income of an employee under section CW 19 (Amounts derived during short-term visits) or a relevant double tax agreement. If the employee's PAYE income payment does not ultimately qualify for exemption, the payment of the bond is credited against the amount of tax payable. Regardless of whether the total amount of tax due is satisfied by the bond or security, use of money interest accrues on the total amount of tax due.

This provision has been little used in practice. A more flexible approach to the rules is expected to mean that section RD 23 is no longer required, and it is therefore proposed to repeal the section.

PAYE, FBT AND ESCT INTEGRITY MEASURES

Clauses 16, 17, 93, 94, 98(5), 144, 166, 171 and 183(1)

Summary of proposed amendments

The proposed amendments would clarify the application of the pay as you earn (PAYE) withholding tax, fringe benefit tax (FBT), and employer's superannuation contribution tax (ESCT) rules (collectively referred to in this discussion as "the rules") by introducing a safe harbour and clarifying that obligations pass to the employee in the absence of other arrangements.

Effective date

The proposed amendments would take effect on 1 April 2023.

Background

The obligations imposed by the rules have been interpreted differently by employers, tax advisors and Inland Revenue. A recent operational statement "Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations"⁴ has clarified that the obligations arise for an employer with a sufficient presence in New Zealand. The sufficient presence test is a fact-based determination of whether the employer has made themselves subject to New Zealand law. This can range from trading from a permanent office or site to a single employee who performs contracts in New Zealand on behalf of the non-resident employer. If an employer wrongly assesses itself as not having a sufficient presence in New Zealand and on that basis does not perform its obligations under the rules, it will need to pay the underpaid tax, penalties and interest to Inland Revenue.

Under the current rules, if there is no sufficient presence in New Zealand, an employee should pay PAYE directly to Inland Revenue. However, no equivalent rule exists for FBT and ESCT. It is necessary to provide rules that ensure the payment of FBT and ESCT so that all elements of remuneration are taxed equally, as they are for domestic employees.

Key features

The proposed amendments would:

- make a safe harbour available to non-resident employers who wrongly assess their liability to the rules, where the conditions of the safe harbour are met, and
- provide that where a non-resident employer does not have an obligation under the rules, the employment-related tax obligations pass to the employee in the absence of other arrangements.

Detailed analysis

The application of the PAYE, FBT and ESCT rules lack clarity. Further, there is a need to ensure that non-cash benefits and employer's superannuation contributions are taxed. The proposed amendments to the rules would clarify and support the integrity of the sufficient presence test.

⁴ [os-21-04.pdf \(ird.govt.nz\)](#)

Safe-harbour arrangements for non-resident employers

Proposed amendments to sections 120B and 141ED of the Tax Administration Act 1994 would provide a safe harbour for non-resident employers who have incorrectly determined that they do not have New Zealand PAYE, FBT and ESCT obligations. The rules propose that a safe harbour would be available where the non-resident employer has:

- either two or fewer employees present in New Zealand at any point in the income year, or pays \$500,000 or less of gross employment-related taxes in New Zealand for the income year, and
- arranged for their employment-related tax obligations to be met by another person or has communicated to the affected employee(s) that they must meet those obligations directly.

Where the conditions of the safe harbour are met, a non-resident employer who has incorrectly determined that they do not have a sufficient presence in New Zealand would be protected from penalties and interest on the unpaid tax.

The safe-harbour arrangement would confirm that the persons who may discharge a non-resident employer's obligations under the rules are varied: it may be an agent or PAYE intermediary, or it may be a related company that agrees to take on the obligation, in accordance with existing rules and operational practice.

Transfer of obligations to an employee

Where a non-resident employer does not have a PAYE obligation, proposed new section CE 1F(3) of the Income Tax Act 2007 would clarify that the obligation to pay and report PAYE, FBT and ESCT transfers to the employee.

Section RD 21 provides that if some, or all, of the amount of tax for a PAYE income payment is not withheld at the time it is paid to an employee, the employee must provide the relevant income information and pay the amount of the deficiency. As noted above, there is currently no equivalent provision for FBT and ESCT.

Proposed new sections RD 62B and RD 71B would therefore provide the rules corresponding to section RD 21 for FBT and ESCT respectively. This would ensure that employees are taxed equally on fringe benefits and superannuation contributions, regardless of their employer's New Zealand tax residence or presence.

FLEXIBLE NRCT PAYMENT ARRANGEMENTS

Clauses 147 and 172

Summary of proposed amendments

The proposed amendments would enable more flexible arrangements for paying non-resident contractors tax (NRCT) by providing for a 60-day grace period and introducing a nominated person approach.

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

The Income Tax Act 2007 (ITA) and the Tax Administration Act 1994 (TAA) impose obligations on persons who make contract payments (payers) to non-resident contractors to withhold NRCT, a tax on certain schedular payments.

The NRCT rules are strict and inflexible. In practice, unforeseen factors may impact the performance of the contract and mean that NRCT should have been withheld. This could occur where a non-resident contractor is called in at short notice to handle an emergency. In other cases, weather, or other factors outside the payer or non-resident contractor's control, cause project times to overrun. In these circumstances, correction is required. Under current law, the correction is made by a voluntary disclosure. This process can be complex, costly and time-consuming.

The strict nature of the rules also may not work well for certain types of business models that commonly use non-resident contractors, for example, large projects where multiple different businesses are working together. This process could be streamlined by allowing one entity to be accountable for the NRCT on the project as a whole.

The proposed amendments would modernise the application of the rules to support a more flexible approach.

Key features

Proposed new section 141GC of the TAA would introduce flexibility into the NRCT rules by allowing a 60-day grace period for correcting NRCT payments.

Proposed new section 24HB would enable a payer to nominate a related New Zealand person to take on their NRCT obligations and form the basis of a good compliance history for exemption purposes.

Detailed analysis

Introducing a grace period for NRCT

Proposed new section 141GC would introduce a 60-day grace period for a payer to meet or correct their NRCT obligations where:

- the payer makes a schedular payment to a non-resident contractor, and
- at the time the payment was made it was not clear that withholding would be required (for example, where the payer intended to rely on the 92-day threshold),

- some, or all, of the tax is underpaid at the tax due date, and
- the payer can demonstrate they have taken reasonable steps in relation to the tax obligations for the schedular payment.

The grace period would run from the earliest of the date of the breach and the date on which the employer could reasonably foresee a breach will occur.

Introducing this flexibility is intended to allow underpayments of NRCT to be remedied without attracting penalties or interest, provided the payer can demonstrate they have made reasonable enquiries or took reasonable steps to confirm the thresholds would not be exceeded.

If this correction is not made within the 60 days, normal procedures would apply.

Introducing a nominated taxpayer approach to NRCT

A non-resident contractor may be liable to pay income tax relating to its contract activities in New Zealand, or be obliged to undertake certain tax obligations, such as withholding pay as you earn from employee earnings. Some business models would benefit from streamlining the management of their tax obligations, for example, where a non-resident contractor creates separate project entities for each contract undertaken.

Proposed new section 24HB would confirm that a 'nominated taxpayer' may meet a non-resident contractor's New Zealand tax obligations.

The intention is to simplify the process of meeting NRCT obligations, particularly where delivery of a project involves multiple parties, or where a non-resident contractor uses different businesses for separate contracts. The proposed new section would clarify that the nominated taxpayer would:

- be permitted to discharge the non-resident contractor's obligations on its behalf, and
- provide a compliance history for the purposes of obtaining an NRCT exemption under section RD 24 of the ITA (see the item "Exemptions for withholding NRCT" later in this Commentary).

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

SCHEDULAR PAYMENTS TO NON-RESIDENT CONTRACTORS: WITHHOLDING THRESHOLDS

Clause 90

Summary of proposed amendments

The proposed amendments would change the interpretation of the schedular payment withholding thresholds as they apply to payments made to non-resident contractors from an 'all circumstances' view (considering all the non-resident contractor's activity in New Zealand) to a 'single payer' view (considering matters only related to the contract with the payer).

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

Payers are not required to withhold non-resident contractor's tax (NRCT) if the payment is exempt under either of two schedular payment thresholds: the 92 days of presence rule (section RD 8(1)(b)(v) of the Income Tax Act 2007 (ITA)) or the \$15,000 de minimis rule (section RD 8(1)(b)(vi)).

Under the current 'all circumstances' view, the payer is required to consider matters unrelated to the contract payment, including:

- days of presence unrelated to the contract (for example, holidays), or
- contract payments made to the contractor for all contract activities or services in New Zealand by other payers, that may be completely unrelated to that payer.

This imposes an excessive compliance burden on the payer and may be difficult to apply in practice.

Key features

The proposed amendments would modify how a payer considers the thresholds from an 'all circumstances' view to a 'single payer' view. This would mean the payer only had to consider the thresholds relating to their contract or contracts with the non-resident contractor.

Detailed analysis

The proposed amendments to section RD 8 would modify the threshold tests to require the payer to consider the tests in relation to their contract (or contracts if more than one in a 12-month period), with the non-resident contractor only. This means, when applying the NRCT thresholds, the payer would be required to consider:

- *For the 92-day test:* the days on which the non-resident contractor is in New Zealand to perform the duties for the contract (from their arrival to their departure after completion of the contract). This would include weekends and holidays during the period of the contract but exclude days on which the contractor is present in New Zealand for purposes unrelated to the contract.
- *For the \$15,000 test:* the payments made to the contractor or another person on their behalf that are related to the contract.

For these thresholds, the payer's assessment of the relevant threshold in relation to their contract with a non-resident contractor may include a payment made to that contractor by an associated person or, for a consolidated group, a payment made to a member of the group of companies.

These proposed changes would be supported by a new reporting requirement that would enable monitoring of the thresholds by Inland Revenue (see the item "Reporting requirements for payers of NRCT" later in this Commentary).

REPORTING REQUIREMENTS FOR PAYERS OF NRCT

Clauses 145 and 184

Summary of proposed amendments

The proposed amendments would introduce a reporting requirement for payers of non-resident contractor's tax (NRCT).

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

Payers of NRCT are not currently required to provide information to Inland Revenue about payments to non-resident contractors. This puts the burden of correct assessment and policing of the NRCT thresholds on the payer and creates an information imbalance between payers of NRCT, non-resident contractors and Inland Revenue.

The Bill proposes modifying the schedular payment thresholds to a 'single payer' view (see the item "Schedular payments to non-resident contractors: withholding thresholds" earlier in this Commentary). This would introduce an integrity risk. Without reporting, Inland Revenue would be unable to police the rules and would be unaware of whether NRCT had been correctly withheld from contract payments.

Reporting will assist Inland Revenue to identify the non-resident contractor and monitor the thresholds and exemptions. Currently, where tax has not been withheld, the Commissioner of Inland Revenue may seek the tax due from the payer or the non-resident contractor.⁵ Reporting will better enable Inland Revenue to seek New Zealand tax due from the non-resident contractor.

Key features

Proposed new section 23R of the Tax Administration Act 1994 would introduce a reporting requirement for persons who make a schedular payment to or on behalf of a non-resident contractor.

Payers of NRCT would have to provide the information set out in proposed new schedule 6B, which is as follows:

- The names of the payer and payee
- The date on which the schedular payment is made
- Whether the schedular payment is paid during a grace period
- The contact addresses⁶ of the payer and payee, whether in NZ or otherwise
- The tax file number of the payee, or their foreign tax identification number
- The gross amount of the schedular payment
- The amount of tax withheld from the schedular payment

⁵ [Interpretation Statement \(IS 10/04\) Non-Resident Contractor Schedular Payments](#)

⁶ Under section 14G of the Tax Administration Act 1994, contact addresses include postal, email and electronic addresses.

- Whether an exemption applies in relation to the schedular payment
- Whether a threshold applies in relation to the schedular payment
- The start and end dates of the contract under which the schedular payment is made.

Payers would be required to provide this information monthly, on the 15th day following the end of each calendar month.

EXEMPTIONS FOR WITHHOLDING NRCT

Clauses 92, 146 and 147

Summary of proposed amendments

The proposed amendments would improve the flexibility of non-resident contractor's tax (NRCT) exemptions by

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

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

An exemption from withholding NRCT can be obtained under section RD 24 of the Income Tax Act 2007 (ITA) if the NRCT thresholds do not apply. Exemptions are available if one or more of the following conditions are met:

- the amount of the payment is not assessable income,
- the contractor provides a bond or other security for the income tax payable on the amount, or
- the contractor has a 'good compliance history' in the previous 24 months that is expected to continue.

If an exemption is granted, this is notified by the Commissioner of Inland Revenue under section 24H of the Tax Administration Act 1994 (TAA).

Detailed analysis

Enabling NRCT exemptions to have retroactive effect

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

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

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

Using the nominated taxpayer approach (see the item "Flexible NRCT payment arrangements" earlier in this Commentary), proposed new section 24HB of the TAA would enable an associated New Zealand entity to establish a good compliance history

for the purpose of obtaining exemption certificates for associated non-resident contractors.

Repeal of the NRCT employee bond provision

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

This provision is rarely used in practice. A more flexible approach to the NRCT rules means that this exemption would no longer be required, and it is therefore proposed to repeal section RD 24(1)(b) of the ITA.

EMPLOYER CONTRIBUTIONS TO FOREIGN SUPERANNUATION SCHEMES

Clauses 25, 26, 89, 183(2) and (3)

Summary of proposed amendments

The proposed amendments would make employer contributions to foreign superannuation schemes subject to tax under PAYE, rather than fringe benefit tax (FBT).

Effective date

The proposed amendments would take effect on 1 April 2024.

Background

Currently, under section CX 13 of the Income Tax Act 2007 (ITA), a fringe benefit arises when an employer contributes to a superannuation scheme for the benefit of an employee. The contribution is generally taxed under FBT rules unless it qualifies as an 'employer's superannuation cash contribution'.⁷ A fringe benefit also arises under section CX 14 when an employer contributes to a sickness, accident, or death benefit fund for an employee.

It is common for cross-border employees and their employers to contribute to a superannuation scheme established in the country of origin. The employee may not receive any other benefits that would be subject to FBT. As such, FBT treatment creates compliance costs in filing FBT returns that might not otherwise be required.

Key features

The proposed amendments would ensure employer contributions to a foreign superannuation scheme would be subject to PAYE as salary or wages, rather than FBT. This would include contributions to sickness, accident, or death benefit funds within the foreign superannuation scheme.

⁷ Employer's superannuation cash contributions are contributions paid in money either to a superannuation fund or under the KiwiSaver Act 2006. These contributions are taxed under ESCT as per section RD 65 of the Income Tax Act 2007.

FBT OBLIGATIONS AND 'TRAILING PAYMENTS'

Clause 28

Summary of proposed amendment

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

Effective date

The proposed amendment would take effect on 1 April 2024.

Background

Fringe benefits, such as health insurance or a vehicle, may be provided by an employer to their employees. Currently, section CX 26 of the Income Tax Act 2007 ensures any fringe benefits provided to an employee in a quarter or income year are subject to FBT if the employee receives a taxable PAYE income payment in that quarter or income year. If no taxable PAYE income payment is derived, the benefits received by the employee are not fringe benefits and no FBT is payable by the employer.

Some employees will receive a payment, such as a cash bonus relating to their time working in New Zealand, after they have ceased to work here or to be a New Zealand tax resident. These are known as trailing payments and are, correctly, taxable PAYE income payments in New Zealand. However, trailing payments can pose a problem where employees receive fringe benefits abroad. This is because New Zealand tax obligations can be triggered on any fringe benefits provided at the time the trailing payment arises. This can include fringe benefits provided abroad and unrelated to time spent working in New Zealand. Such an outcome is contrary to the policy intent.

Detailed analysis

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

CLARIFYING THE STATUS OF NON-RESIDENT ENTERTAINERS

Clause 98(11)

Summary of proposed amendment

The proposed amendment would change the definition of “non-resident contractor” in section YA 1 of the Income Tax Act 2007 (ITA) to exclude a “non-resident entertainer” and thereby clarify the provisions that apply to non-resident entertainers.

Effective date

The proposed amendment would take effect on 1 April 2024.

Background

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

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

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

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

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

The proposed amendment would remove this confusion and clarify the position of non-resident entertainers.

Dual resident companies

DUAL RESIDENT COMPANIES - LOSS GROUPING, CONSOLIDATION, AND IMPUTATION CREDIT RULES

Clauses 63, 64, 77, 78, 79, 81, 83, 98(2) and (9)

Summary of proposed amendment

The proposed amendments would allow dual resident companies to be eligible to offset income tax losses against the profits of other group companies, be a member of a consolidated group and retain their imputation credit account (ICA) balance.

Effective date

The proposed amendments would take effect on 15 March 2017. This would ensure New Zealand companies affected by the change to Australia's corporate tax residence rules have uninterrupted access to certain New Zealand tax regimes.

Background

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

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

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

Under New Zealand's tax rules, there are several beneficial tax regimes that do not ordinarily apply to dual resident companies. There is an opportunity to amend the eligibility requirements of certain beneficial tax regimes to include dual resident companies, while maintaining the integrity of the underlying rules.

Key features

The proposed amendments would allow companies that are dual resident to offset their tax losses against the profits of another company in the same group. The amendments would also allow a dual resident company to be a member of a consolidated group of companies for income tax purposes. This includes where the company's residence tie-breaks to another country under a double tax agreement (a DTA non-resident company).

The proposed amendments would also allow companies that change their tax residence from New Zealand to Australia, or vice versa, to automatically retain their accumulated ICA balance.

Detailed analysis

Three New Zealand tax regimes have been identified where changes should be made to resolve concerns with the application of Australia's residence rules while maintaining the integrity of the underlying regimes.

Loss grouping rules

The proposed amendments would amend the residence requirements of the loss grouping rules so that a dual resident company can use the loss grouping rules. These requirements were originally implemented to prevent "double dipping" of expenditure (that is, claiming a deduction in more than one country for the same expense). This integrity issue is now addressed by the hybrids and branch mismatch rules, which means the residence requirement in the loss grouping rules is no longer required.

The proposed amendments would repeal section IC 7(2) of the Income Tax Act 2007. This section requires that a New Zealand resident company must not be either a DTA non-resident company or liable for tax in another jurisdiction for the duration of the commonality period.

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

Commonality periods starting before 15 March 2017

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

The Bill proposes introducing new sections IC 5(8) and IZ 7B to ensure that the existing residence requirements are applied to commonality periods that begin before 15 March 2017 where the tax losses arose in a tax year after the 1990–91 tax year. This would mean that for calculating a commonality period that began before 15 March 2017 and continued after 15 March 2017 (for losses incurred after the 1990–91 tax year), the existing residence requirements in section IC 7(2) would only apply up to 15 March 2017 and cease thereafter. Consequently, to offset a tax loss that arose before 15 March 2017, either of the two companies may still be dual resident, provided that the period of dual residence started after 15 March 2017.

Example 12: Loss grouping rules after 15 March 2017

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

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

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

Example 13: Commonality period that began before 15 March 2017

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

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

In 2019, Zoë's Pots Limited has net income of \$50,000 and Rose's Flowers Limited has net income of \$0. Rose's Flowers Limited wishes to make available its accumulated tax loss of \$50,000 to Zoë's Pots Limited. While Rose's Flowers Limited is a dual resident company, under the proposed amendments the residence requirements would not apply after 15 March 2017.

For the purposes of the commonality period, as long as the residence requirements were maintained up to 15 March 2017, then Rose's Flowers Limited (as the "loss" company) would be able to be a dual resident company after 15 March 2017, even if the tax loss arose before 15 March 2017. Therefore, Rose's Flowers Limited could offset its \$50,000 tax loss against Zoë's Pots Limited's net income. However, if Rose's Flowers Limited had become dual resident in 2016 instead, then it would not be able to offset that loss.

Consequential amendments

Consequential amendments to sections IC 5(1)(b) and LK 1 are required because section IC 7 no longer includes a residence requirement.

Consolidation rules

The proposed amendments would amend the tax residence requirements for the consolidation rules to enable a dual resident company to be a member of a consolidated group of companies. Similar to the residence requirements in the loss offset rules, these requirements were implemented to prevent "double dipping" of expenditure. This integrity issue is now addressed by the hybrids and branch mismatch rules, which means the residence requirement in the consolidation rules is no longer required.

The proposed amendments would repeal the residence requirements in sections FM 31(1)(b) and (e) that currently require that a company is not a foreign company or liable for income tax in another jurisdiction through domicile, residence, or place of incorporation.

This would mean a company that is both a New Zealand tax resident and tax resident in another jurisdiction would be able to be a member of a consolidated group of companies.

Example 14: Consolidation rules after 15 March 2017

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

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

ICAs

A New Zealand resident company is required to maintain an ICA. An Australian resident company can also choose to maintain an ICA, but it cannot do so until it makes an election to the Commissioner of Inland Revenue. This requirement can result in a New Zealand resident company losing its ICA credit balance if it becomes Australian tax resident before making the relevant election.

The proposed amendments would automatically make a New Zealand resident company an Australian ICA company when its residence tie-breaks to Australia under the Australia/New Zealand double tax agreement (the DTA). That is, in these circumstances, the DTA non-resident company would not be required to follow the election process currently set out in section OB 2.

At the time when the company becomes an Australian ICA company because of the residence tie-break test under the DTA, the company would continue to be required to maintain an ICA. Proposed section OB 2(3B) would ensure that the company's ICA balance, at the point of becoming an Australian ICA company, is preserved and consequently any accumulated imputation credits up until the point of becoming an Australian ICA company are retained.

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

The proposed amendments would also allow an Australian ICA company to preserve its ICA balance if the company's residence was to revert to New Zealand.

These amendments would not apply where a New Zealand resident company becomes tax resident in any country other than Australia.

Definitions in YA 1

The relevant definitions in section YA 1 would be amended as follows:

- "Australian ICA company" would include where a New Zealand resident company becomes an Australian ICA company because it has become Australian tax resident under the DTA.
- "ICA company" would no longer refer to an election being made for an Australian ICA company to be an ICA company.

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

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

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

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

Imputation groups

The proposed amendments include a consequential change to the eligibility rules for imputation groups in section FN 4(1)(d). This change would retain the eligibility of an Australian ICA company to be a member of an imputation group but remove the requirement for the company to have elected to be an Australian ICA company.

DUAL RESIDENT COMPANIES – INTEGRITY ISSUES WITH DIVIDENDS AND CORPORATE MIGRATION RULES

Clauses 10, 11, 13, 15, 22, 47, 60 to 62, 84, 85, 87, 95 to 97, 98(7), (8) and (19), 141(2) and 148 to 150

Summary of proposed amendments

The proposed amendments seek to address integrity issues involving New Zealand resident companies where the residence tie-breaks to another country under a double tax agreement. In particular, the proposed amendments would:

- remove the exemption in section CW 10 of the Income Tax Act 2007 (the ITA) (the domestic dividend exemption) for certain dividends paid to New Zealand resident companies whose residence tie-breaks to another country under a double tax agreement (DTA), and
- extend the rules in subpart FL of the ITA (the corporate migration rules) to certain companies whose residence tie-breaks from New Zealand to another country under a DTA.

Effective date

The proposed amendments would take effect on the date of introduction of the Bill.

Background

Integrity issues have been identified regarding the domestic dividend exemption and the corporate migration rules. These issues give rise to situations where companies may derive income or pay dividends without the anticipated New Zealand income taxation by changing their tax residence and obtaining tax relief under a DTA.

Domestic dividend exemption

In general, a dividend paid between members of a wholly owned group of New Zealand resident companies is exempt income under section CW 10 of the ITA. This domestic dividend exemption currently applies to dividends paid to a New Zealand resident company that is also resident overseas under the tax laws of another country (referred to as a “dual resident company”), including where the company’s residence tie-breaks to another country under a DTA (a DTA non-resident company).

In some cases, a DTA may prevent the application of non-resident withholding tax (NRWT) when a dividend is paid by a DTA non-resident company to a non-resident. This is because the dividend is treated as being paid between two non-New Zealand residents under the DTA.

Corporate migration rules

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

However, the corporate migration rules do not apply when a New Zealand resident company becomes a DTA non-resident company. This can result in New Zealand losing taxing rights on income and distributions made to non-residents due to the application of a DTA, even though there has not been a change in the company’s tax residence

under domestic law. This significantly undermines the effect of the corporate migration rules.

The combination of the domestic dividend exemption and the corporate migration rules, with the tax relief provided by DTAs to DTA non-resident companies, creates potential opportunities for foreign-sourced income to go untaxed in New Zealand and for dividends to be paid to non-residents without the application of NRWT.

Detailed analysis

Dividends paid to DTA non-resident companies

The proposed amendments would remove the domestic dividend exemption for certain dividends paid to a DTA non-resident company and would require NRWT to be withheld. A two-year period is provided for the dividend payer to meet this NRWT obligation. However, if the DTA non-resident company becomes New Zealand tax resident for the purposes of applying the relevant DTA during this period, and the company does not pay a dividend, the dividend would again be treated as exempt and there would be no NRWT obligation.

Changes to the domestic dividend exemption

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

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

- Where all shareholders of the dividend recipient would be entitled to a full exemption from NRWT under an applicable DTA if they received a dividend from the dividend recipient (that is, if a dividend was on-paid to the shareholders) and the recipient was treated as a company that was not a foreign company (as defined in section YA 1 of the ITA).
- Where the total dividends received by the recipient from the payer is less than \$1 million in each 12-month period that includes the date the recipient derives the dividend.
- If, within a two-year period of the dividend recipient receiving the dividend, the company's tax residence changes so that it is no longer a "foreign company" and it has not paid a dividend while it was a foreign company.

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

The second bullet point is a *de minimis* rule and will reduce the impact of the changes on smaller businesses.

The third bullet point seeks to address a situation where the dividend recipient's residence only temporarily tie-breaks to another jurisdiction under a DTA (for example, due to a change in application of another country's tax laws). This is achieved by providing a two-year period for the tax residence of the dividend recipient to be changed back to New Zealand. However, it is only applicable if the dividend recipient does not pay a dividend while being a DTA non-resident company, as a

dividend paid during that time to the DTA non-resident company and on-paid could be completely relieved from NRWT due to the application of a DTA.

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

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

Example 16: DTA relief

NZ Limited is a New Zealand tax resident company and is wholly owned by DR Limited. DR Limited is resident in New Zealand and Australia under their respective tax laws. DR Limited's residence tie-breaks to Australia under the Australia/New Zealand DTA.

DR Limited is wholly owned by AUS Limited, an Australian tax resident company listed on the Australian Stock Exchange. AUS Limited has held the shares in DR Limited for more than 10 years.

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

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

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

Example 17: Fully imputed dividend

Bob's Books Limited is a New Zealand tax resident company. It is wholly owned by Pete's Publishing Limited, which is tax resident in both New Zealand and Australia. Under the Australia/New Zealand DTA, Pete's Publishing Limited is treated as being tax resident in Australia.

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

Because the dividend is fully imputed, as calculated under section RF 9 of the ITA, the dividend would meet the requirements of proposed new section CW 10(1B) of the ITA. Assuming the other relevant criteria are satisfied, the dividend would be exempt under the proposed amendments to section CW 10 of the ITA.

Example 18: Partially imputed dividend

Assume the same facts as in example 17.

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

Applying the formula in section RF 9 of the ITA, \$720,000 of the net dividend would be treated as being fully imputed for the purposes of proposed new section CW 10(1B) of the ITA.

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

Dividend rules

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

Proposed new section CD 1(3) of the ITA would modify the income year that a dividend is allocated to if it is derived by a New Zealand resident company that is treated as not being resident in New Zealand under a DTA, and the requirements of sections CW 10(1)(b) to (d), (5), and (6) of the ITA are met.

This income is deferred to the "DRCD⁸ deferral date", which is defined in proposed new section RA 6(2) of the ITA as the second anniversary of the date on which the dividend was paid.

NRWT obligations for dividends

A dividend paid to a DTA non-resident company is equivalent in some respects to a dividend being paid to a non-resident company. This is because, once a dividend is paid to a DTA non-resident company, New Zealand may lose its right to tax the on-payment of that dividend to another company. For this reason, it is considered appropriate for the NRWT rules to apply to a dividend paid to a DTA non-resident company. The NRWT obligation would apply on the DRCD deferral date under proposed new section RA 6(5) of the ITA.

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

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

⁸ Dual Resident Company Dividend.

Example 19: No NRWT obligation due to a change in tax residence

Jolly Jandals Limited is a New Zealand resident company. It is wholly owned by Aussie Thongs Limited, which is tax resident in both New Zealand and Australia. Aussie Thongs Limited's tax residence tie-breaks to Australia under the Australia/New Zealand DTA.

On 1 July 2023, Jolly Jandals Limited pays an unimputed dividend of \$3 million to Aussie Thongs Limited.

From 1 May 2025, there is a change in the way that control of Aussie Thongs Limited is exercised, resulting in the company becoming New Zealand tax resident under the Australia/New Zealand DTA. Aussie Thongs Limited has not paid a dividend since it received the dividend from Jolly Jandals Limited on 1 July 2023.

In this situation, the dividend paid by Jolly Jandals Limited would qualify for the revised domestic dividend exemption in proposed new section CW 10 of the ITA. This is due to Aussie Thongs Limited becoming New Zealand resident under the Australia/New Zealand DTA within two years of receiving the dividend from Jolly Jandals Limited and not having paid a dividend itself since the receipt of the dividend. As a result, the dividend from Jolly Jandals Limited would not be subject to NRWT.

Consequential amendments

The Bill also proposes a number of consequential amendments that would:

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

Corporate migration rules

New Zealand's corporate migration tax rules ensure that companies that migrate their tax residence from New Zealand (and therefore cease being tax resident under New Zealand's domestic law) pay tax on all their worldwide income earned while tax resident in New Zealand. These rules reflect the inability for New Zealand to tax companies in certain situations once they become a DTA non-resident company.

However, similar issues arise for New Zealand tax resident companies if they become non-resident for the purposes of applying a DTA. For example, where a DTA non-resident company pays a dividend to a non-resident, that dividend may be relieved from New Zealand taxation in some instances due to the application of a DTA. Similarly, a DTA can relieve a DTA non-resident company from taxation on certain types of income (such as income from sources outside New Zealand).

As the economic effects are very similar to a company ceasing being tax resident under New Zealand's domestic law, it is proposed that the corporate migration rules would be triggered immediately before a New Zealand tax resident company becomes a DTA non-resident company in the situation where it pays a dividend or obtains relief from taxation of income under a DTA.

It is therefore proposed to amend the corporate migration rules in certain situations where a New Zealand resident company becomes a DTA non-resident company.

New section FL 3

The Bill proposes inserting new section FL 3 of the ITA into the corporate migration rules. The purpose of proposed new section FL 3 is to bring into scope those companies that are still tax resident under domestic law but to which New Zealand loses taxing rights because of a residence tie-break test in a DTA.

Proposed new section FL 3 would apply to treat a New Zealand tax resident company as migrating from New Zealand immediately before it becomes a DTA non-resident company after the introduction of the Bill where one of the following events (known as a “triggering event”) occurs:

- the company derives income that is eligible for relief under a DTA while it is a DTA non-resident company
- the company pays a dividend that is not fully imputed while it is a DTA non-resident company
- the company becomes non-resident, or
- the company has been treated as a DTA non-resident company for the previous two years.

Deferring the application of the corporate migration rules for up to two years would provide an opportunity for taxpayers to remedy any inadvertent residence changes. If a DTA non-resident company’s residence reverts to being New Zealand resident for the purposes of applying the relevant DTA and none of the triggering events listed in proposed section FL 3(1) have occurred, then proposed new section FL 3 would not apply to the company.

Under proposed section FL 3(2), when one of the triggering events occurs, the DTA non-resident company would be treated as disposing its assets and making a distribution to its shareholders immediately before it became a DTA non-resident company. Proposed section FL 3(3) would treat each shareholder of the DTA non-resident company as being paid a dividend equivalent to the amount they would be entitled to if the company was treated as going into liquidation.

These proposed provisions would ensure that New Zealand can tax the accumulated income and gains of the company before it becomes a DTA non-resident company and a DTA restricts or removes those taxing rights.

Example 20: Company continues to be non-resident under a DTA after two years

Cloudy Cloud Limited is a New Zealand resident company that provides IT cloud storage services.

On 1 October 2023, several directors of Cloudy Cloud Limited relocated to the United Kingdom to investigate potential new markets and commercial partners. It was anticipated that this project would take up to nine months.

On 1 May 2025, as part of the general tax residence compliance checks, tax advisors of Cloudy Cloud Limited discovered the directors had continued to reside in the UK and continued to exercise control of the company while in the UK. The directors made the decision to remain in the UK for the foreseeable future.

The directors exercising control of Cloudy Cloud Limited while in the UK resulted in the company becoming UK resident under UK domestic law from 1 October 2023. Application of the residence tie-breaker test in the New Zealand/UK DTA results in Cloudy Cloud Limited being treated as UK resident for DTA purposes from 1 October 2023.

On 1 October 2025, the directors were still residing in the UK and exercising control of Cloudy Cloud Limited from the UK.

Therefore, on 1 October 2025, Cloudy Cloud Limited would have been treated under a DTA as not being New Zealand resident for a continuous period of two years. Under the proposed amendments, assuming no other triggering event in proposed section FL 3(1) has occurred, section FL 3(1)(d) would apply, and Cloudy Cloud Limited would be treated as migrating immediately before becoming a DTA non-resident company.

Example 21: Company pays a dividend

Valleys Limited is a company that is tax resident in both New Zealand and Japan.

On 1 May 2023, Valleys Limited becomes treated as Japanese resident under the Japan/New Zealand DTA.

On 1 August 2023, Valleys Limited pays a \$5 million unimputed dividend to its shareholder, Japan Holdco. Japan Holdco is tax resident in Japan.

Due to a change in the location from which control of the company is exercised, Valleys Limited is treated as being resident in New Zealand under the Japan/New Zealand DTA from 1 April 2025.

Although the tax residence of Valleys Limited has reverted to New Zealand within two years of becoming non-resident under a DTA, Valleys Limited paid a dividend while it was a DTA non-resident company. The payment of a dividend on 1 August 2023 by Valleys Limited would be a triggering event for the purposes of proposed section FL 3(1), and Valleys Limited would be treated as migrating immediately before it became a DTA non-resident company under the proposed amendments.

Example 22: Company derives income that is subject to relief under a DTA

Trash Limited is a New Zealand tax resident company. It undertakes operations in the waste and recycling industry in both New Zealand and Austria.

On 28 January 2024, Trash Limited ceases its activities in New Zealand.

On 15 October 2024, due to a change in the place from where the central management and control takes place, Trash Limited becomes tax resident in Austria. Under the Austria/New Zealand DTA, Trash Limited is treated as being resident in Austria from 15 October 2024.

On 18 December 2024, Trash Limited sells its New Zealand and Austrian assets to a third party.

Some of the assets disposed of by Trash Limited are not connected with a New Zealand permanent establishment for the purposes of the Austria/New Zealand DTA. As a result of Trash Limited not being New Zealand resident for the purposes of the Austria/New Zealand DTA, some of the income derived from disposing of the assets is relieved from New Zealand tax under the Austria/New Zealand DTA.

The derivation of income on 18 December 2024 that is relieved from tax due to a DTA would be a triggering event for the purposes of proposed section FL 3(1)(a), and Trash Limited would be treated as migrating immediately before it became a DTA non-resident company under the proposed amendments.

The proposed rules would include an income allocation rule for both the company and shareholders. The income derived from a deemed disposal, liquidation and distribution would be allocated to the income year in which the relevant triggering event occurred. The income would still be treated as arising immediately before the change in residence for the purpose of the DTA and New Zealand's domestic tax law. This would ensure New Zealand can still tax that income under the DTA on the basis that the company was New Zealand resident.

Amendments to sections FL 1 and FL 2

Section FL 1(1) of the ITA would be amended to provide that the subpart also applies where a company is treated under a DTA as not being a New Zealand tax resident. Section FL 1(2) would also be amended to include a reference to a triggering event occurring.

Section FL 2 of the ITA would also be redrafted, but the substance of the section would remain unchanged.

Change in definition of time of emigration

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

Consequential amendments

The Bill proposes updating references in sections CD 14, CD 26, CD 43, EE 31, OB 62 and RA 18 of the ITA to include proposed new section FL 3.

The Bill also proposes updating sections 25E and 29 of the TAA to include proposed new section FL 3.

GST apportionment

GST APPORTIONMENT AND ADJUSTMENT RULES

Clauses 103(8) to (10), 106(5) to (8), (13), (14), 114, 117(4), (6), (9) to (15), (17), (21), (23), (24), (27) to (29), 118 to 125, 137 and 158

Summary of proposed amendments

The Bill proposes a package of changes to the GST apportionment and adjustment rules that would reduce the compliance costs they impose on businesses and better align them with current taxpayer practices. These changes would include:

- introducing a principal purpose test for goods and services acquired for \$10,000 or less (GST exclusive) that would allow a registered person to claim a full GST input tax deduction, and
- allowing GST-registered persons to elect to treat certain assets that have mainly private or exempt use, such as dwellings, as if they only had private or exempt use.

Effective date

Most of the proposed amendments would have effect for goods and services supplied, or adjustment periods beginning, on or after 1 April 2023. The exceptions to this are noted below and explained in more detail in the Detailed analysis:

- The proposed amendments to allow GST-registered businesses to elect to treat the supply of certain goods, with mainly private or exempt use, as an exempt supply would generally have effect for supplies made on or after 1 April 2011.
- The proposed amendments to the asset value thresholds determining the number of years that post-acquisition adjustments are required would take effect on the day after the date the Bill receives the Royal assent.
- The proposed amendments to the definition of "actual deduction" in the wash-up calculation in section 21FB of the Goods and Services Tax Act 1985 (GST Act) and the definition of "percentage actual use" in section 21G would take effect on 30 June 2014.
- The proposed amendments to sections 20(3E), (3EB), 21(4) and (4B) of the GST Act to allow Inland Revenue to approve a wider range of apportionment methods would take effect on the day after the date the Bill receives the Royal assent.
- The proposed repeal of the mixed-use asset rules in sections 20(3JB) and 20G of the GST Act would have effect for a registered person's first adjustment period beginning on or after 1 April 2024.

Background

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

Once a business has claimed an input tax deduction based on their estimated business use, they are generally required to monitor their actual use of the asset over time. If

the estimate is inaccurate, they must account for this difference in their GST return at the end of each year.⁹ This is known as an adjustment or change in use.

The current GST apportionment and adjustment rules are complex and impose high compliance costs.

For example, the apportionment rules apply to all goods and services acquired by registered persons. This imposes undue compliance costs for low-value assets, such as computers, phones and tools, which often only have a very small or incidental amount of private or exempt use.

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

The proposed changes in the Bill are designed to reduce business compliance costs, better align the rules with current taxpayer practices, and improve fairness between different types of ownership structures.

Key features

The proposed amendments would make the following changes to the GST apportionment and adjustment rules:

- A principal purpose test would be introduced in proposed new sections 20(3CB) and (3CC) of the GST Act for goods and services acquired for \$10,000 or less (GST exclusive) such that a registered person would be able to claim a full GST input tax deduction for such goods or services (rather than applying the apportionment or adjustment rules) provided they were acquired for the principal purpose of making taxable supplies. No input tax deduction would be able to be claimed for goods and services acquired for \$10,000 or less that were not acquired principally to make taxable supplies.
- Under proposed new section 14(4), GST-registered persons would be able to elect to treat the supply of certain goods as an exempt supply. This would apply to goods not acquired or used for the principal purpose of making taxable supplies.
- The number of adjustment years that GST-registered persons need to monitor their percentage actual use of assets and make post-acquisition adjustments would be amended to limit the number of adjustments to ten for land and to increase the other asset value thresholds.
- The disposal of an asset for which a registered person has previously claimed taxable use would be deemed to be a taxable supply under proposed new sections 5(16) and (16C). In addition, where the Commissioner of Inland Revenue considers a registered person has increased their non-taxable use of goods or services and then applied the wash-up rule in section 21FB in contemplation of the sale of the goods or services or ceasing their taxable activity, proposed new section 5(16B) would ensure the disposal of the relevant asset would also be deemed by proposed new section 5(16C) to be a taxable supply.

⁹ Adjustments are not made in certain cases, mainly for assets valued below \$5,000. The Bill proposes increasing this to \$10,000.

- The ability to use the wash-up rule in section 21FB would be expanded to enable it to apply when there has been any permanent change in use and to allow it to be applied in the adjustment period in which the change of use occurred.
- Remedial amendments would be made to the definition of “percentage actual use” in section 21G and the definition of “actual deduction” in section 21FB.
- Amendments to sections 20(3E), (3EB), 21(4) and (4B) would enable Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply.
- The mixed-use asset rules in sections 20(3JB) and 20G of the GST Act would be repealed, and GST input tax deductions and adjustments would instead be calculated using the same general GST apportionment rules that apply to other assets.
- A new information disclosure would be introduced to the Tax Administration Act 1994 to improve Inland Revenue’s ability to monitor and collect GST owing on the sale of assets by a GST-registered business that claimed the taxable use of an asset when they originally acquired the asset.

Detailed analysis

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

The Bill proposes the introduction of new rules in sections 20(3CB) to (3CF) of the GST Act that would allow a registered person to claim a full input tax deduction for a supply of goods and services acquired for \$10,000 or less (excluding GST) for the principal purpose of making taxable supplies.

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

Example 23: Goods acquired for \$10,000 or less with a principal purpose of making taxable supplies

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

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

If a supply of goods or services is acquired for \$10,000 or less (excluding GST) but **not** for a principal purpose of making taxable supplies, a registered person would not be able to either claim an input tax deduction for the acquisition of the good or service or apportion input tax for an adjustment period between their taxable and non-taxable use of the good or service.

Example 24: Goods acquired for \$10,000 or less with mostly private use

Amy acquires a car for \$9,000 (plus \$1,350 GST) that has a principal purpose of private use, but which she may also use occasionally in her business to make taxable supplies (estimated to have 20% taxable use by mileage).

Because the car was acquired for \$10,000 or less (GST exclusive) and not for a principal purpose of making taxable supplies, under the proposed amendments Amy would not be able to claim an input tax deduction on acquisition or make any subsequent adjustment for the 20% taxable use.

The proposed principal purpose test is intended to apply instead of the general apportionment rules. Proposed amendments to sections 20(3C), (3L) and (3LB) would ensure that those sections do not apply if the proposed new sections 20(3CB) and (3CC) apply. Thus, if the good or service was acquired for \$10,000 or less (excluding GST), sections 20(3C), (3L) and (3LB), which provide a deduction to the extent that the goods or services are used to make taxable supplies, would no longer apply.

If the goods or services are acquired for more than \$10,000, then the registered person would continue to apportion input tax on acquisition using sections 20(3C), (3L), (3LB) and (3G) to (3M). This will be based on their intended percentage use for making taxable supplies, with adjustments being made at the end of their adjustment period (balance date) under sections 21 to 21H.

If the registered person has agreed an alternative apportionment method with the Commissioner of Inland Revenue under sections 20(3E), 20(3EB), 21(4) or 21(4B), they would continue to apply this agreed apportionment method rather than the new principal purpose test. This is because such persons often agree a global apportionment ratio based on their mix of taxable and exempt supplies and this ratio is used for both inputs acquired for less than \$10,000 and higher value inputs. In such cases, it would increase compliance costs and change the agreed ratio if they were required to account for inputs below \$10,000 using a different method to the method agreed with the Commissioner.

The proposed new principal purpose test would be applied at the time a registered person acquired the goods or services. The proposed amendment to section 21(2)(b) would ensure that the registered person would no longer need to monitor the actual use after acquisition, nor make any annual adjustments for goods or services valued at less than \$10,000 at the end of their adjustment period (for example, their balance date). The amendment would increase the threshold in section 21(2)(b) from "\$5,000 or less" to "\$10,000 or less", ensuring no adjustments would be made for goods or services valued at \$10,000 or less.

The proposed amendment to section 21(2)(b) would apply to all goods and services valued at \$10,000 or less, including those that are **not** principally used to make taxable supplies.

The proposed amendments to sections 20(3C), (3L), (3LB), and 21(2)(b) and inserting sections 20(3CB) to (3CF) to introduce the principal purpose test would have effect for goods and services acquired on or after 1 April 2023.

GST-registered persons may elect to treat the supply of certain goods as an exempt supply

The Bill proposes inserting new section 14(4) to add to the list of exempt supplies in section 14 of the GST Act. This new provision would allow registered persons to elect to treat the supply of goods that were not acquired or used for the principal purpose of making taxable supplies as exempt. This proposal is intended to align the GST rules with current practices for GST-registered persons who may have some minor use of

their goods, such as private dwellings, in the course and furtherance of their taxable activity (that is, their GST-registered business).

The proposed exemption would be limited to goods (as opposed to services) as it is intended to be used for tangible assets, such as land, dwellings or vehicles, which are likely to have a minor amount of use in making taxable supplies, rather than intangibles, such as brands or intellectual property, which are likely to have an exclusive or mainly taxable use when acquired by registered persons. Limiting the exemption to goods also clarifies that the goods need to be sold or disposed of for the exemption to apply. Where land or dwellings are provided by way of a lease, the service of providing the lease should be subject to the usual GST rules, rather than affected by the proposed exemption.

To qualify as an exempt supply under the proposed rule, the goods would have to satisfy the following requirements outlined in proposed new section 14(4)(a) to (d):

- No previous deductions claimed for the goods under section 20(3).
- The goods were not acquired for the principal purpose of making taxable supplies.
- The goods were not used for the principal purpose of making taxable supplies.
- The goods were not acquired as zero-rated supplies under sections 11(1)(m) or (mb).

No deductions under section 20(3)

Proposed section 14(4)(a) would require the registered person making the supply of goods not to have previously claimed a deduction under section 20(3) for the goods they are now supplying. If they have claimed any deductions under section 20(3), the exemption would not apply.

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

- an input tax deduction under section 20(3)(a) or (b) at the time the goods were acquired
- a subsequent deduction under section 20(3)(e) after applying the adjustment rules to the goods at the end of the person's adjustment period, or
- deductions under 20(3) for other goods and services that were acquired to make substantial improvements to the goods being supplied under section 14(4). The policy intention is to only consider deductions taken for substantial improvements that have become an integral part of the goods being supplied.

The registered person would still be able to satisfy section 14(4)(a) if they claim input tax deductions for overheads or operating costs that do not become an integral part of those goods.

Example 25: Dwelling with a minor use in a registered person's taxable activity

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

Under the proposed amendments, when Rebecca sells the dwelling, she would be able to elect to treat the sale as an exempt supply of goods as it meets the requirements of the proposed new section 14(4).

Example 26: Dwelling where deductions are claimed for taxable use

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

The dwelling would not qualify for the exemption in proposed new section 14(4) because relevant deductions were taken for the goods under section 20(3). A deduction was claimed on acquisition, and deductions were also claimed for substantial improvements that became an integral part of the dwelling.

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

Not acquired for principal purpose of making taxable supplies

Proposed section 14(4)(b) provides that the goods cannot have been acquired for the principal purpose of making taxable supplies. Principal purpose is intended to have the same meaning here as the reference to principal purpose used in the pre-2011 GST Act definition of "input tax". The principal purpose is the main, primary or fundamental purpose. This does not necessarily equate with a more than 50% test.

Not used for principal purpose of making taxable supplies

Proposed section 14(4)(c) provides that during the time the registered person owned the goods, they cannot have been used by the person for the principal purpose of making taxable supplies. To satisfy section 14(4)(c), the primary use of the goods, from the time the person acquired them until their disposal, would need to be a non-taxable use, that is, a private or exempt use.

It also means the goods cannot be goods whose principal purpose involved the registered person selling the goods in the course or furtherance of their taxable activity, such as trading stock.

Not acquired as a zero-rated supply

Proposed section 14(4)(d) requires that the goods cannot have been acquired as a zero-rated going concern under section 11(1)(m) or as a zero-rated supply of land

under section 11(1)(mb).¹⁰ For section 11(1)(m) to apply, the registered person who acquires the goods must acquire a taxable activity, or part of a taxable activity, that is a going concern at the time of supply and capable of continuing as a going concern. For section 11(1)(mb) to apply, the registered person must acquire land with the intention of using it to make taxable supplies.

Output tax adjustment to satisfy section 14(4)(d)

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

However, in some cases the purchaser's taxable use of the goods, while sufficient for the supply of the goods to qualify as a zero-rated supply under section 11(1)(m) or (mb), may be minor and secondary to their non-taxable (exempt or private) use of the goods. Therefore, the supply of the goods would satisfy the requirements of proposed new section 14(4) other than paragraph (d).

To accommodate these cases, an additional amendment is proposed to sections 14(4)(d) and 20(3J) that would allow the registered person to return an amount of output tax under section 20(3J)(a)(iv) equal to the full nominal GST amount as calculated by section 20(3J)(a)(i).

If the registered person made this output tax adjustment, the exclusion under proposed new section 14(4)(d) for goods acquired as zero-rated goods would no longer apply. Although the person acquired the goods as a zero-rated supply, making the output tax adjustment would put them in the same position as a person who acquired standard-rated or secondhand goods and did not claim an input tax deduction on acquisition.

This proposed amendment would have effect for taxable periods beginning on or after 1 April 2023 (see the heading "Effective date of section 14(4)" below).

Example 27: Acquiring a holiday home as a zero-rated supply of land

Gavin is a registered person who acquires a holiday home from another registered person. Gavin's principal purpose for acquiring the holiday home is to use it for his own private recreation (and not as his principal place of residence). However, because Gavin also intends to use the holiday home for a secondary and more minor purpose of making taxable supplies of guest accommodation, he acquires the holiday home as a zero-rated supply under section 11(1)(mb) for \$1m (rather than a standard-rated supply of \$1m plus \$150,000 of GST, which would have been the price had section 11(1)(mb) not applied to the supply).

Under proposed new section 20(3J), if Gavin intended to use section 14(4) to make his future disposal of the holiday home an exempt supply, he could choose to return output tax of \$150,000, being the full amount of the nominal GST component. If he did this, section 14(4)(d) could then be satisfied for a future disposal of the holiday home.

¹⁰ Note that to qualify as a zero-rated supply, land cannot be intended to be used as a principal place of residence of the recipient of the supply or a close relative. Furthermore, supplies of dwellings (such as farmhouses) will often be separate supplies to supplies of the surrounding land (such as a farm) due to the operation of section 5(15), which splits the supply into a supply of a principal place of residence and a supply of land. This means a principal place of residence may be acquired as a separate supply to the supply of zero-rated land, and therefore such a residence may still qualify as not being acquired as a zero-rated supply.

Alternatively, Gavin can choose to return the smaller amount of \$105,000 output tax under section 20(3J) based on his 70% expected non-taxable use of the holiday home at the time he acquires the holiday home. However, if he does this, a future disposal of the holiday home would not qualify for the exempt supply rule in section 14(4)(d) as he would not have returned the full amount of the nominal GST component on acquisition of the zero-rated supply of land.

Electing to use new section 14(4)

The registered person would not generally have to disclose to, or notify, the Commissioner that they have made the election to treat the supply of the qualifying goods as an exempt supply. Instead, they would simply not account for GST on the asset (by not claiming deductions for the secondary taxable use and not returning output tax on disposal). The only exception to this would be for assets acquired before 1 April 2023 and subject to the transitional rule, explained below.

Effective date of section 14(4)

The proposed new exempt supply rule in section 14(4) would generally have effect for taxable supplies made on or after 1 April 2011. This retrospective application date would mean that if a registered person had previously taken a tax position consistent with the requirements of proposed new section 14(4), this tax position would become correct once the Bill is enacted. This could include a person treating their dwelling as not being part of their taxable activity even though it may have been partly used to make taxable supplies.

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

For goods that a registered person sells or disposes of between the date of introduction of the Bill and 1 April 2023 that would qualify as exempt supplies under the proposed new section 14(4), the registered person would be able to amend their GST position to make the relevant disposal an exempt supply.

The proposed amendments to sections 14(4)(d) and 20(3J) to allow a registered person to make an output tax adjustment for the full nominal GST component of goods acquired as zero-rated land or a zero-rated going concern, so that the acquisition is no longer treated as a zero-rated supply, would have effect for taxable periods beginning on or after 1 April 2023.

Transitional rule for certain goods acquired before 1 April 2023

Proposed new section 91 would insert a transitional rule to allow a registered person to return an amount of output tax for certain goods that would otherwise not satisfy proposed new section 14(4) so that those goods may qualify as an exempt supply on disposal. This transitional rule would apply for the 24-month period between 1 April 2023 and 1 April 2025.

Proposed new section 91 would apply when a registered person has acquired goods before 1 April 2023 and previously claimed a deduction under section 20(3) for the goods or acquired them as zero-rated supplies.

Provided the relevant goods were not acquired or used for the principal purpose of making taxable supplies, the registered person could elect to notify the Commissioner before 1 April 2025 and return output tax based either on the previous taxable use that was claimed for the goods (where deductions have been claimed under section

20(3)) or the taxable use percentage of the nominal GST component (as defined in section 20(3J)) (where the goods were acquired as a zero-rated supply).

If a registered person applied section 91 and returned the relevant output tax amount, a future disposal of the relevant goods would be an exempt supply. This would be unless the registered person later chose to claim a deduction under section 20(3) for any taxable use of the goods since applying section 91.

Consequential amendments to sections 5(15) and 21(2)

A consequential amendment is proposed to section 21(2) to ensure that the registered person would not have to monitor their actual taxable use and make adjustments at the end of their adjustment period for any goods for which they apply the proposed new rules in proposed sections 14(4) or 91. This reflects the fact that to apply these new rules the person would have to have either not claimed input tax deductions or returned an amount of output tax, meaning they end up with the same net GST position as a person who has no taxable use of the goods. No adjustments are necessary when a person has no taxable use of their goods.

The proposed amendment to section 21(2) would have effect for supplies made on or after 1 April 2011, but not to supplies for which an assessment has been made before the introduction of the Bill.

Consequential amendments are also proposed to section 5(15). Section 5(15) currently applies if a person makes a supply of real property (land) that includes a principal place of residence (such as the person's home). It provides that the principal place of residence is treated as a separate (and usually non-taxable) supply to other parts of the real property, such as farmland or a business premises, which may be a taxable supply. The proposed amendments would expand the scope of section 5(15) so it would also apply to a supply of real property that has goods the registered person has elected to treat as an exempt supply under proposed new sections 14(4) or 91. The exempt supply of these goods would be treated as a separate supply to the supply of any other real property.

It is anticipated the relevant exempt goods will usually be a dwelling. For example, a second house that is not any person's main home, a holiday house or a dwelling used to provide temporary worker accommodation. As these types of dwellings would not be a principal place of residence, they would not currently be treated as a separate supply under the current section 5(15). The proposed amendments would ensure such dwellings (or other exempt goods) are treated the same as dwellings that are a person's principal place of residence.

The proposed insertion of section 5(15)(c), relating to proposed new section 14(4), would have the same retrospective effective date as proposed new section 14(4) itself, that is, generally supplies made on or after 1 April 2011 (see the heading "Effective date of section 14(4)" above). The proposed insertion of section 5(15)(d), relating to proposed new section 91, would have the same effective date as proposed new section 91, that is, 1 April 2023.

Reducing the number of required adjustment periods

The current GST adjustment rules require unlimited adjustment periods for land and two, five or ten adjustment periods for other types of goods or services, depending on their value. A higher number of required adjustment periods imposes higher compliance costs as the registered person needs to monitor their taxable use of the asset and make adjustments for a longer period.

The Bill proposes amendments that would require only ten adjustment periods for land and would reduce the number of adjustments required for certain other assets by increasing the relevant asset value thresholds: see table 1 below.

Table 1: Changes to adjustment periods

Required number of adjustment periods (Balance dates since acquisition)	Current asset values	Proposed new asset values (Differences to current asset values shown in bold)
Zero (No adjustments to deduction taken on acquisition)	\$5,000 or less Apportionment on acquisition	\$10,000 or less Full input tax deduction on acquisition if acquired for a principal purpose of making taxable supplies, otherwise no deduction
Two	\$5,001 to \$10,001	\$10,001 to \$20,000
Five	\$10,001 to \$500,000	\$20,001 to \$500,000
Ten	\$500,000+	\$500,000+ and land (regardless of the value of the land)
Unlimited	Land (regardless of the value of the land)	Not applicable

Proposed amendments to section 21G(4) would replace the reference to “\$5,000” with “\$10,000” and the two references to “\$10,000” with “\$20,000”.

Section 21G(4)(a)(iii), which provides for 10 adjustment periods, would be amended so that it also applies to land, and section 21G(5), which currently requires an unlimited number of adjustment periods for land, would be repealed. The requirement for ten adjustment periods for land would apply regardless of the value of the land. Thus, even if land was acquired for less than \$500,000, it would still be adjusted for ten adjustment periods.

These proposed amendments would take effect from the day after the date the Bill receives the Royal assent.

Deeming the disposal of an asset to be a taxable supply

An asset for which a registered person has previously claimed a taxable use

Under the current GST Act, supplies of goods or services by a registered person in the course or furtherance of their taxable activity are taxable supplies. This includes selling or otherwise disposing of assets used by the registered person in their taxable activity.

A person’s taxable activity includes all activities in the course or furtherance of that taxable activity, which includes anything done in connection with the beginning or ending of that activity, including a premature ending. However, even with this broad definition, it may be unclear whether a disposal of a valuable asset, such as land, is a taxable supply when the registered person is no longer using the asset to make taxable supplies, or when they previously claimed they had a taxable use of the asset but did not in fact use the asset to make any taxable supplies.

To clarify that the disposal of such goods and services is a taxable supply, the Bill proposes replacing section 5(16) and inserting new section 5(16C). These provisions would deem such a disposal to be made in the course and furtherance of a taxable activity carried on by the person (a taxable supply). The disposal could be the sale of the relevant goods or services, or it could be a deemed disposal because another

deeming rule applies, such as section 5(3), which deems the disposal at market value of any assets held by a person who ceases to be a registered person.

The proposed deeming rule would apply to goods and services that a person has previously claimed a taxable use for, even though the person is not using the goods or services in the course or furtherance of their taxable activity at the time the goods or services are disposed of. It would effectively broaden the scope of the existing deeming rule in section 5(16), which applies to dwellings for which a registered person has claimed a deduction under section 20(3).

The definition of "registered person" includes a person who is liable to register for GST. This means that the proposed deeming rule in section 5(16C) would also apply to a person who had previously deregistered from GST but becomes liable to register for GST because of the application of the section and the fact they are making taxable supplies of more than \$60,000 in a 12-month period (including the consideration received for the section 5(16C) taxable supply).

There are three ways that a person may have previously claimed a taxable use for the relevant goods or services:

- by claiming an input tax deduction for taxable use under section 20(3)
- by acquiring the supply from another registered person as a zero-rated supply of land under section 11(1)(mb), or
- by acquiring the supply as a zero-rated going concern under section 11(1)(m).

The proposed deeming rule would not apply in situations where the registered person had previously returned an amount of output tax on the goods or services equal to or greater than either the deductions taken for the relevant goods or services under section 20(3), or the nominal GST component under section 20(3J) in the case of a supply that was acquired by them as a zero-rated supply of land or a going concern.

The person could have previously returned this amount of output tax because of one or more of the following circumstances:

- The person had deregistered for GST and returned output tax on the market value of the asset (which was higher than the acquisition cost) under section 5(3).
- Section 20(3J) applied, and the registered person's percentage intended use for making taxable supplies was nil at the time they acquired the supply, which had initially been treated as a zero-rated supply of land or a going concern. For example, at the time of supply the person had initially planned to use the land to make taxable supplies, but once they acquired the land their plans changed so that they would only have private or exempt use of the land.
- The wash-up rule in section 21FB had been applied by a registered person who had total non-taxable use, and therefore they had repaid an amount of output tax equal to their earlier deductions or nominal GST component for their earlier taxable use.
- The registered person had applied the proposed new transitional rule in section 91 for qualifying goods they had acquired before 1 April 2023 and had notified the Commissioner and returned output tax equal to the previous deductions (or nominal GST component) claimed in respect of their taxable use of the goods.

Section 5(19) of the GST Act would also be repealed as it would become superseded by the proposed new section 5(16). Section 5(19) provided an election that a registered person could use before 1 August 1996 to pay output tax on a dwelling for which the person had previously claimed deductions under 20(3) to ensure a future disposal of the dwelling would not be subject to the deeming rule in section 5(16). The proposed new section 5(16) would mean that, provided the registered person who applied the section 5(19) election had not claimed a subsequent deduction under section 20(3) for a taxable use of the dwelling since returning the output tax in 1996,

a disposal of the dwelling would not be deemed by the new section 5(16) to be a taxable supply.

Assets sold after a non-taxable wash-up is performed

Section 21FB of the GST Act currently applies when a person changes their use of an asset to either a fully taxable or a fully non-taxable use. If a person's use becomes fully non-taxable, the asset may no longer be used in the course and furtherance of the person's taxable activity and therefore not a taxable supply if it is subsequently sold or disposed of.

This provides a potential opportunity for tax avoidance. For example, registered persons could try to minimise their output tax liability on assets, such as land, that are used to make taxable supplies but which they plan to sell soon. The output tax that needs to be returned under section 21FB on a change to non-taxable use is based on the full input tax deduction that could have been claimed for the GST charged on the asset *at the time it was originally acquired*. This means that for appreciating assets, such as land, the output tax liability from claiming a change of use and applying section 21FB may be significantly less than the output tax that would be charged *at the time of disposal* if the asset was sold as a taxable supply.

To address this risk, proposed new section 5(16B) provides that the new deeming rule in section 5(16C) would also apply in circumstances where the Commissioner of Inland Revenue considers the registered person has increased their non-taxable use of the goods or services and then applied section 21FB in contemplation of the sale of the goods or services or ceasing their taxable activity.

If proposed new section 5(16B) applied, the disposal of the relevant asset would be deemed by proposed new section 5(16C) to be made in the course and furtherance of a taxable activity carried on by the person (that is, it would be a taxable supply). The disposal could be the sale of the relevant goods or services, or a deemed disposal under another deeming rule (such as section 5(3), which deems the disposal at market value of any assets held by a person who ceases to be a registered person).

The proposed amendments to sections 5(16), (16B) and (16C) would have effect for goods and services supplied on or after 1 April 2023.

Expanding the ability to use the wash-up rule

Allowing the calculation in the current adjustment period

Section 21FB of the GST Act contains a wash-up calculation that applies when a registered person has experienced a change to either 100 percent taxable use or 100 percent non-taxable use of an asset during the current adjustment period and for all the following adjustment periods. This is measured at two consecutive annual balance dates. If their use of the asset has changed to 100 percent taxable use, the wash-up rule requires the registered person to claim a full input tax deduction for the input tax they incurred at the time they acquired the asset. If, instead, their use has changed to 100 percent non-taxable use, they are required to make an output tax adjustment to repay input tax previously deducted.

Some taxpayers may purchase business assets before they are GST registered that they subsequently use to make taxable supplies after they register for GST. If they had been registered for GST at the time they purchased the business asset, they would have been able to claim an input tax deduction in their next GST return to the extent to which they used the asset to make taxable supplies. The apportionment and adjustment rules allow such taxpayers to gradually claim input tax deductions on such assets after they have registered for GST. They may also be able to claim a full input tax deduction if the wash-up rule in section 21FB applies. This is because they would have had two adjustment periods where they had 100 percent taxable use of the

asset. However, this delays their ability to claim a full input tax deduction for assets used to make taxable supplies.

To address this issue and reduce the compliance costs associated with requiring a taxpayer to measure their actual use and make two periods of adjustments for a permanent change of use, the Bill proposes an amendment so the wash-up calculation in section 21FB is applied at the end of the adjustment period in which the permanent change in use occurred.

Allowing the calculation for any permanent change in use

Another issue is the wash-up rule can only be used if there has been a change to either 100 percent taxable or 100 percent non-taxable use. This means the wash-up rule cannot be used by registered persons whose use has permanently changed but to a percentage less than 100 percent, for example, a registered person whose taxable use of an asset has permanently changed from 90 percent to 20 percent. Such registered persons are required to continue to gradually change their percentage actual use each adjustment period. This imposes compliance costs.

To reduce these compliance costs, the Bill proposes amending the wash-up rule to allow it to be used for any permanent change to a particular fixed percentage use. For example, if a registered person's use of a particular good or service permanently changed to 50 percent taxable use and they expected this percentage to remain stable for the foreseeable future, they would be able to perform the wash-up calculation.

Example 28: Permanent change in use

Tōtara is a registered person that acquires an apartment building for \$23m from an unregistered person. Tōtara will use 80 percent of the building to make exempt supplies of accommodation in a dwelling and lease 20 percent of the building as a commercial lease to Rimu, a registered person who uses these apartments to supply commercial accommodation of hotel units and serviced apartments. Tōtara claims a deduction for 20 percent of the \$3m input tax on acquisition, or \$0.6m.

After 24 months, Tōtara negotiates a long-term commercial lease to supply 50 percent of the building to Rimu for Rimu to make taxable supplies of commercial accommodation. This will result in a permanent change to 50 percent of the apartment building being supplied by Tōtara for making taxable supplies for the foreseeable future.

The new permanent percentage use is 50 percent and the actual use in the previous adjustment period was 20 percent, a difference of 30 percent additional taxable use. Under the proposed new section 21FB, Tōtara would be able to make an adjustment at the end of their adjustment period (on their next annual balance date) to deduct \$0.9m, which is equal to 30 percent of the \$3m of input tax on acquisition. They would include this adjustment in their first GST return filed after the end of their adjustment period.

After applying section 21FB, the registered person would not make any further adjustments in future adjustment periods unless their actual use changed from their new percentage taxable use of the goods or services. This outcome is already provided for by section 21(2)(ac) of the GST Act.

The proposed amendments to section 21FB would have effect for a registered person's adjustment period beginning on or after 1 April 2023.

Remedial amendment to definition of “percentage actual use”

A remedial amendment is proposed to the definition of “percentage actual use” in section 21G to clarify that after the wash-up rule in section 21FB has been applied, the registered person should only measure their percentage actual use from the date that the wash-up calculation was performed, rather than the date they acquired the asset.

The proposed amendment ensures the earlier adjustment taken under section 21FB is properly accounted for when the person makes a final adjustment either on disposal under section 21F or because they had to make a subsequent annual adjustment because their percentage use had changed since they applied the wash-up calculation. The proposed remedial amendment would take effect on 30 June 2014, which is the date the wash-up calculation in section 21FB was originally introduced.

Remedial amendment to wash-up rule for assets that were zero-rated when they were acquired

For the purposes of the wash-up calculation in section 21FB of the GST Act, “actual deduction” is defined in section 21FB(3)(b) as the “amount of deduction already claimed, taking into account adjustments made up to the end of the adjustment period referred to in subsection 1(c)(ii)”. This definition does not take into account any nominal deduction that the person has benefited from by paying a reduced amount of consideration when acquiring a zero-rated supply of land.

This means that if a registered person acquires land as a zero-rated supply, and then changes their use of the land to a 0 percent taxable use, they could perform the wash-up calculation in section 21FB and have no output tax to return as their “actual deduction” would be nil. This is not the intended policy outcome. In other cases, where the land was acquired as a secondhand good or a standard-rated supply, the “actual deduction” would be the amount of input tax deducted on the land and the registered person would be required to return output tax equal to this amount.

The other adjustment rules (including the definition of “full input tax deduction” in section 21FB) already take into account nominal deductions on acquisition under section 20(3J). It appears to be an oversight that this was not included in the definition of “actual deduction” in section 21FB. The Bill proposes a retrospective remedial amendment to take effect on 30 June 2014, the date the wash-up calculation was first introduced, to ensure the definition of “actual deduction” in section 21FB correctly accounts for land acquired as a zero-rated supply.

Allowing Inland Revenue to approve a wider range of apportionment methods

The apportionment and adjustment rules allow registered persons to apply to the Commissioner of Inland Revenue to agree an alternative apportionment method. This is intended to reduce compliance costs, as an alternative apportionment method could produce similar GST outcomes to the default apportionment rules but with lower compliance costs.

Currently, any alternative apportionment method is required to “have regard to the tenor” of the default apportionment rules and formula. The default apportionment and adjustment rules require a person to apportion deductions based on their intended taxable percentage use or actual use in the current adjustment period, even though their current use may be temporary and incidental to their ultimate use of the goods or services.

This requirement can prevent the Commissioner from agreeing to some methods that may simplify the apportionment and adjustments required but use a different approach to the default apportionment and adjustment rules.

For example, a registered person may purchase land to conduct a large-scale development that will make substantial taxable supplies. However, the land contains

some existing houses for which they will receive residential rental income for a limited time as they prepare the planning and consents for the large-scale development. These supplies of accommodation in a dwelling are temporary and incidental to their much larger taxable use of the land. In such cases, it could be more practical for the registered person to return (but not charge to their tenants) output tax on consideration received for an exempt supply of accommodation in a dwelling. They could then be treated as though they made only taxable supplies and claim full input tax deductions for associated expenses, rather than apportioning their deductions and making annual adjustments under the default apportionment rules and formula.

To accommodate a wider range of methods, the Bill proposes to remove the requirements in sections 20(3E), (3EB), 21(4) and (4B) that the alternative method "have regard to the tenor of" the default apportionment rules and formula. The proposed amendments would retain the more general requirement that the alternative method provides "a fair and reasonable method" of apportionment or calculating adjustments.

These proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Repealing the mixed-use asset rules in sections 20(3JB) and 20G

The mixed-use asset rules in sections 20(3JB) and 20G add the complexity of another potential formula but have limited application. The rules only apply to certain assets, such as holiday homes, aircraft, and boats, and only when their use is a mixture of private days, taxable days and at least 62 unused days.

In addition, many of the holiday homes that would otherwise become subject to these mixed-use asset rules could become excluded from a registered person's taxable activity due to the new exempt supply rules proposed in sections 14(4) and 91 (discussed above), which would allow registered persons to elect for mainly private or exempt assets to be treated as if they only had non-taxable use.

The Bill therefore proposes to repeal the current mixed-use asset rules in sections 20(3JB) and 20G. In cases where GST apportionment continued to apply to a registered person's mixed-use assets, their GST input tax deductions and adjustments would instead be calculated using the same general GST apportionment rules that apply to other assets.

These general rules would allow an apportionment percentage to be calculated based on days of taxable use. This is a similar method to the current formula in section 20G, but the calculation would be less prescriptive, and it would not be limited to the set of "mixed-use assets" described in section DG 3 of the Income Tax Act.

The proposed repeal of sections 20(3JB) and 20G would have effect for the registered person's first adjustment period beginning on or after 1 April 2024. This would mean that if, on 31 March 2024, a registered person had begun an adjustment period for a mixed-use asset to which section 20G applied, they would continue to use section 20G until the end of that adjustment period. At their first adjustment period beginning on or after 1 April 2024, they would then begin to use the ordinary adjustment rules in sections 21 and 21A.

Prescribing an information disclosure requirement for GST persons claiming a taxable use on purchases of land, aircraft or pleasure craft

The Bill proposes introducing new section 61B to the Tax Administration Act 1994, which would provide the Commissioner of Inland Revenue with the ability to prescribe a new type of information disclosure requirement that would apply when a registered person acquires land, a pleasure craft, or an aircraft with the intention of using it to make taxable supplies.

For this new rule, "land" would have the meaning set out in section 2 of the GST Act 1985, "aircraft" would have the meaning set out in section 2 of the Civil Aviation Act 1990, and "pleasure craft" would have the meaning set out in section 2 of the Maritime Transport Act 1994. These definitions of land, aircraft and pleasure craft are currently used in the GST Act for determining if certain goods and services are zero-rated supplies.

The proposed information disclosure requirement is intended to assist Inland Revenue to better monitor and promote compliance by registered persons who have previously claimed large input tax deductions (or acquired zero-rated land) but no longer appear to be proceeding with, or carrying on, a taxable activity (for example, they have been continuously filing GST returns with no or low sales).

Proposed section 61B(1) would enable the Commissioner to prescribe and adjust the specific requirements to ensure the rules are practical and effective. It would allow the Commissioner to set (and adjust) what information would be reported and the form and deadlines for the disclosure, including the start date for the first disclosure period.

The information required to be disclosed could include the amount of consideration paid for the asset, the initial amount of GST input tax deducted on purchase (or the nominal GST amount that would otherwise have been charged if the asset was purchased from another registered person as a zero-rated supply of land or a going concern), and a statement of how the asset will be used to make taxable supplies.

Proposed new section 61B(2) would allow the Commissioner to exempt certain types of registered persons from being required to disclose the information if they are considered by the Commissioner to represent a low risk of using the relevant asset for a private or exempt use. For example, the exemption could be designed to define certain categories of registered persons who have a well-established business of making taxable supplies of land development, commercial leasing, or dealing in aircraft or pleasure craft, whether by themselves or through associated persons.

Before implementing an information disclosure requirement, Inland Revenue would work with GST practitioners and software developers to test the proposed design (including the specific information that would be disclosed, the timing and format of the disclosure and which groups or assets should be exempt as they represent a low risk) to ensure it is well-targeted and practical. Although the proposed amendments would take effect on the day after the date the Bill receives the Royal assent, because of the further design and testing required and the need to provide sufficient time for affected businesses and accounting software providers to update their systems, it is expected that the earliest possible implementation date to apply the new disclosure rules would be for land, pleasure craft or aircraft acquired on or after 1 April 2024.

GST on managed funds

GST ON MANAGEMENT SERVICES SUPPLIED TO MANAGED FUNDS

Clauses 103(4), (6) and (7), 105 and 138

Summary of proposed amendment

The proposed amendments would make manager and investment manager services supplied to managed funds subject to GST at the standard rate of 15%.

The proposed amendments would also make manager and investment manager services supplied to retirement schemes, including KiwiSaver schemes, subject to GST at the standard rate of 15%. Currently these services are exempt supplies of financial services.

Effective date

The proposed amendments to the definition of "financial services" would be effective for taxable periods beginning on or after 1 April 2026.

The proposed transitional rules would be effective for taxable periods beginning on or after 1 April 2018, until the proposed amendments above take effect on 1 April 2026.

Background

Management services supplied to managed funds and retirement schemes

Managed funds and retirement schemes purchase three main types of services from third parties.

- **Fund manager services.** A fund manager has overall responsibility for managing the fund. This can include offering and issuing units in the fund to investors, managing the fund's investments, reporting to investors, procuring services from an investment manager, and various administration services.
- **Investment manager services.** An investment manager recommends which assets (such as shares, bonds, cash) or other managed funds the fund should invest into.
- **Various administrative services.** These services can include legal, accounting, information and communications technology services, or reporting services.

Currently, there are three common types of GST positions taken for manager and investment manager services supplied to managed funds and retirement schemes.

The first of these GST positions is for management services directly provided to retirement schemes funds. In this case, the services are treated as exempt supplies. However, this exemption does not apply to the common investment structures where a retirement scheme invests into an underlying wholesale managed fund, as in that case the relevant managers and investment managers are providing services to the wholesale fund (rather than a retirement scheme).

The other two GST positions taken relate to non-retirement scheme funds. The first of these two GST positions taken by the affected managers and investment managers is to treat 90 percent of the relevant fees as being for exempt supplies of financial services and 10 percent as being for taxable supplies. This is because these managers consider their services mostly qualify for the exemption under section 3(1)(l) of the Goods and Services Tax Act 1985 (GST Act) for "agreeing to do, or arranging," the financial services described in section 3(1)(a) to (ka), and therefore most of their

services should qualify for the GST exemption for financial services. Only 10 percent of their fee is treated as being for taxable supplies, such as advice. This means their services are effectively only subject to 1.5% GST.

The final GST position is to treat all the fees as being taxable supplies. This is because these managers consider their services are providing investment advice or other types of services that are excluded from being a financial service under section 3(1)(l) and are typically subject to 15% GST. This approach means these managers can claim full GST deductions on their purchases.

The practice of treating 90 percent of the relevant fee as consideration for an exempt supply was first accepted by Inland Revenue in 2001, as part of an operational agreement with certain members of the industry. This agreement established that it was acceptable to treat 10 percent of a unit trust manager's fees as being for taxable supplies with the remaining 90 percent being for exempt supplies. This agreement expired in 2014. Many investment managers have also been treating their fees as 10 percent standard rated and 90 percent exempt.

The inconsistency in the GST treatment of manager and investment manager services, both between manager services supplied to retirement schemes and general (non-retirement) managed funds, and between funds within these groups, has inadvertently led to a distorted marketplace. The complexity and uncertainty of the existing rules has also resulted in additional compliance costs for managers and investment managers.

A subsequent technical review of the existing rules by Inland Revenue found that the current GST laws are likely to provide different tax outcomes than the current industry practices. Furthermore, enforcing the current law is complex and has proven difficult. Inland Revenue therefore considered what the policy settings for fund manager and investment manager services should be. Following consultation on a range of potential policy reform options, the proposed legislative reforms in this Bill were developed.

Key features

The proposed amendments in the Bill would:

- exclude manager and investment manager services from the GST Act definition of "financial services", meaning these services would become taxable supplies
- remove "management of a retirement scheme" from the definition of "financial services", meaning these services would become taxable supplies and have the same GST treatment as manager and investment manager services provided to managed investment schemes that are not retirement schemes, and
- provide a transitional period until April 2026 to allow time for the managed funds industry to prepare for the proposed policy changes. The proposed transitional rules for manager and investment manager services would provide certainty that GST positions taken between 1 April 2018 until the new rules take effect on 1 April 2026 would be preserved. The rules would also allow a manager or investment manager to adopt the new GST rules earlier than 1 April 2026, if they wanted to.

Detailed analysis

Exclusion from the definition of "financial services"

The proposed amendments would add exclusions to the definition of "financial services" in section 3(4) of the GST Act so that services supplied by a manager or investment manager to a managed investment scheme, another manager or another investment manager would not qualify as financial services. Accordingly, these services would be taxable supplies.

The terms “manager”¹¹, “investment manager”¹² and “managed investment scheme”¹³ are as defined in sections 6 and 9 of the Financial Markets Conduct Act 2013 (FMCA).

To be excluded under the proposed new rules in section 3(4), the relevant services provided by the manager, or the investment manager would be able to be provided either directly or indirectly to either another manager, another investment manager, or a managed investment scheme. The reference to “indirectly” is intended to look beyond the formal contractual relationship to consider the ultimate recipient of the service. This will ensure the proposed rules cover situations where a manager or investment manager, as defined under the FMCA, may be supplying services via an intermediary to a managed investment scheme, manager, or investment manager.

The exclusion to the definition of “financial services” applies only for the section 3(1)(l) definition of “financial services”, that is, agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka) of the definition, other than advising thereon. The amendments do not seek to change the financial services exemption that applies to the financial services that managed investment schemes provide to their investors/members. This means that providing an interest in a managed investment scheme remains an exempt supply of financial services.

Example 29: Manager and investment manager supplying services to a managed fund

On 30 June 2026, ABC Limited supplies \$50,000 plus GST of manager services to the XYZ fund – a managed fund. DEF Limited supplies \$30,000 plus GST of investment manager services to the XYZ fund.

The services supplied by ABC Limited and DEF Limited are excluded from the GST Act definition of financial services. Therefore, these supplies are taxable supplies and subject to GST.

ABC Limited would return \$7,500 of GST in its relevant GST return, and DEF Limited would return \$4,500 of GST.

¹¹ **Manager** means,—

(a) in relation to a registered scheme (other than a restricted scheme), the person designated or appointed as the manager of the scheme:

(b) in relation to a restricted scheme, the persons designated or appointed as trustees of the scheme or, if only 1 person is designated or appointed as a trustee of the scheme, that person:

(c) in relation to a managed investment scheme if there is no person to whom paragraph (a) or (b) applies or if it is not a registered scheme, a person occupying the position of, and carrying out any of the functions of, the manager set out in section 142.

¹² **Investment manager** means, in relation to a managed investment scheme, a person to whom a manager of the scheme has contracted the investment of some or all of the scheme property.

¹³ **Managed investment scheme** means a scheme to which each of the following applies:

(a) the purpose or effect of the scheme is to enable persons taking part in the scheme to contribute money, or to have money contributed on their behalf, to the scheme as consideration to acquire interests in the scheme; and

(b) those interests are rights to participate in, or receive, financial benefits produced principally by the efforts of another person under the scheme (whether those rights are actual, prospective, or contingent, and whether they are enforceable or not); and

(c) the holders of those interests do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

Example 30: Investment manager supplying services to a manager

On 30 October 2026, DEF Limited supplies \$30,000 plus GST of investment manager services to Mike Managers Limited, who manages the Gekko managed fund. These services are for investment recommendations DEF Limited has provided for the assets and investments in the Gekko managed fund.

The investment manager services supplied by DEF Limited are excluded from the GST Act definition of "financial services" and are therefore a taxable supply. GST of \$4,500 would be charged and returned by DEF Limited.

Mike Managers Limited has been invoiced by DEF Limited for \$30,000 plus \$4,500 GST for investment manager services that Mike Managers Limited uses to make its own taxable supplies of manager services. Mike Managers Limited can therefore claim an input tax deduction of \$4,500.

Mike Managers Limited then charges \$92,000, including \$12,000 GST, for their own taxable supplies to the Gekko managed fund. This cost includes the investment manager services Mike Managers Limited acquired from DEF Limited. Mike Managers Limited will return \$12,000 of GST output tax on this supply.

Example 31: Investment manager raising capital to expand their business

DEF Limited is doing very well and the company decides to take the opportunity to grow the business and to undertake a capital raise by issuing new shares in DEF Limited.

DEF Limited's supply of issuing shares is an exempt financial service under section 3(1)(d) of the definition of "financial services". The supply of issuing these shares would not be the investment manager services described in proposed new section 3(4)(d) of the GST Act.

Because DEF Limited is a registered person principally making supplies that are taxable supplies, the company can claim input tax deductions under the capital raising rules in section 20H for input tax it incurs on legal fees and other relevant inputs it acquires to make its exempt supply of issuing the shares in DEF limited.

Removal of "management of a retirement scheme"

The Bill proposes removing "management of a retirement scheme" from the definition of "financial services" in section 3(1)(j) of the GST Act. This would mean manager and investment manager services supplied to a retirement scheme would no longer qualify as financial services. The proposed amendments to section 3(4), discussed above, would instead apply to ensure manager and investment manager services that are supplied to managed investment schemes (including retirement schemes) are deemed not to be financial services. These services would become taxable supplies from the first taxable period beginning on or after 1 April 2026.

The provision, or transfer of ownership, of an interest in a retirement scheme will remain an exempt supply of financial services.

Transitional rule

The proposed amendments would introduce a transitional rule for managers and investment managers of managed investment schemes in proposed new section 92 of the GST Act.

As discussed in Background above, managers and investment managers are currently treating their services based on their historical interpretation of section 3(1)(l) of the GST Act. These interpretations, once permitted under the industry agreement and currently accepted by Inland Revenue, have formed the basis for the GST positions taken by managers and investment managers in taxable periods up until now.

The purpose of the transitional rule is:

- to provide certainty to managers and investment managers of their historically applied interpretation of section 3(1)(l), and
- to require managers and investment managers to continue to apply their particular interpretation for all subsequent taxable periods, until the new rules in section 3(4) come into effect.

Specifically, the transitional rule requires a manager or investment manager that directly or indirectly supplies services to a managed investment scheme, another manager, or another investment manager to apply their particular historical GST treatment consistently in each taxable period that began on or after 1 April 2018 until the proposed new rules in section 3(4) apply.

For the purposes of the transitional rule, the definitions of “manager”, “investment manager” and “managed investment scheme” are the same as those applied in new section 3(4)(c) and (d), that is, they are as defined in sections 6 and 9 of the FMCA.

The purpose of the transitional rule is to provide certainty to managers and investment managers that have taken varying GST positions to their services before 1 April 2026. The rule would not apply to services that qualify as an exempt supply of financial services as the management of a retirement scheme under section 3(1)(j). A transitional rule is not required for these services because an explicit exemption for the management of a retirement scheme would continue to apply until 1 April 2026.

Example 32: Transitional rule for existing managed fund

Since 1 April 2018, Cheap and Cheerful (CAC) has supplied manager services to Ben’s Economic Fund (BEF), a managed fund based in New Zealand. CAC has been treating 90 percent of the consideration received as being for exempt supplies of financial services and 10 percent as being for taxable supplies. In their monthly GST return ending 30 April 2023, CAC can continue to treat 90 percent of the consideration received as being for exempt supplies of financial services and 10 percent as being for taxable supplies.

CAC continues to apply this ratio to their manager services until their taxable period beginning on 1 April 2026. From this taxable period onwards, the transitional rule no longer applies, and the new rule in section 3(4)(c) applies instead. This rule requires CAC’s manager services to be taxable supplies (as they no longer qualify as financial services).

As BEF is a managed fund and is only making exempt supplies, the managed fund cannot claim any GST input tax deductions on the services supplied to them by CAC.

New managers and investment managers

A newly formed manager or investment manager may wish to supply services to a managed investment scheme, another manager or investment manager before 1 April 2026.

In these circumstances, the transitional rule would apply, and in the first taxable period, the manager or investment manager would take a GST position based on the

interpretation of section 3(1)(l) and whether the services they are providing are advising services only or a mix of advising and arranging services. The GST treatment they apply in this first taxable period must be the treatment they consistently apply for all subsequent taxable periods until the new rules become compulsory on 1 April 2026.

As with existing managers and investment managers, new managers and investment managers are expected to apply an interpretation and GST treatment that accurately reflects their circumstances. This includes being prepared to explain the technical basis for adopting their particular treatment at the time they take their GST position in their first taxable period.

Example 33: Transition rule for new investment manager

In April 2024, Willy Stock Selectors (WSS) is established as a new provider of investment manager services. They did not previously exist or provide investment manager services before this date.

From June 2024 WSS begins providing investment management services to a range of different managers and managed investment schemes. WSS chooses to treat their supply of services as being 90 percent for exempt supplies of financial services and 10 percent for taxable supplies.

Since WSS will be including these services in the taxable period ending 30 June 2024, the transitional period rule would apply from this taxable period and for each subsequent taxable period, including the taxable period before the taxable period beginning on or after 1 April 2026. From the first taxable period beginning on or after 1 April 2026, the new rule in section 3(4)(d) would apply and the investment manager services would become taxable supplies.

Early adoption of the new rules

While the proposed new rules in section 3(4) do not become compulsory until taxable periods beginning on or after 1 April 2026, a manager or investment manager that supplies services to a managed investment scheme, another manager, or another investment manager may choose to adopt the new rules early in a taxable period that begins before 1 April 2026, thus shortening the transition period.

The proposed amendments provide that in a taxable period beginning on or after 1 April 2023, a manager or investment manager would be able to irrevocably elect to adopt the proposed rules in section 3(4)(c) and (d) early by taking the relevant GST position in that taxable period. No further notification to the Commissioner of Inland Revenue is required.

If the manager or investment manager elects to adopt the proposed new rules in section 3(4)(c) and (d) in a taxable period before 1 April 2026, then they would have to continue to do so for all subsequent taxable periods.

Example 34: Early adoption of the new rules

Lucy's Consolidated Capital Experts (LCCE) supplies manager services to Ben's Diversified Funds (BDF), a managed fund. LCCE treats the supplies as 90 percent exempt supplies of financial services and 10 percent taxable supplies. In anticipation of the new GST rules coming into effect in April 2026, LCCE decides to adopt the new rules early and charge full GST on its manager services. The new GST treatment is reflected in LCCE's 30 June 2025 GST return.

Because LCCE has elected to apply proposed new section 3(4)(c) to its manager services to treat them as a taxable supply in a taxable period beginning after 1 April 2023 and before 1 April 2026, LCCE must now continue to apply the new section 3(4)(c) to its manager services for all subsequent taxable periods.

Other policy items

GST STATUS OF LEGISLATIVE CHARGES

Clauses 106(1), (3) and (11), 134, 136 and 139

Summary of proposed amendment

The proposed amendments would introduce a rule that provides for the GST treatment of charges payable under legislation (including Acts and regulations) in New Zealand. The proposed amendments also include exceptions to this rule and a transitional regulation-making power for the Minister of Revenue to add charges to the proposed schedule of non-taxable legislative charges.

Effective date

The proposed amendments would be effective for:

- any legislative charges that come into force on or after 1 July 2023 (which includes new and amended legislative charges), and
- all other legislative charges on 1 July 2026.

The proposed amendments that prevent amendments to historic assessments would take effect from the date of introduction of the Bill.

Background

The term “charge” is used to describe a liability to pay money and is intended to be broad-ranging, including fees and levies. A legislative charge is a charge that is payable under legislation (including secondary legislation such as Orders in Council). Common examples of legislative charges include fees paid to government agencies or bodies for the renewal of a licence or for registration. Other types of legislative charges may be payable by certain persons in specific industries, where the revenue from those charges is used to fund the activities of a representative body or of a regulator. These charges are generally subject to GST as there is an obvious nexus between the supply and the consideration for that supply.

The GST treatment of some legislative charges can, however, sometimes be unclear. To date, the approach to resolve these uncertainties has been for piecemeal amendments to be made to the Goods and Services Tax Act 1985 (the GST Act) to treat specific charges as consideration for the supply of goods and services and therefore subject to GST. This approach lacks transparency, creates uncertainty, and has resulted in an inconsistent and incoherent application of GST to legislative charges.

The lack of a broad rule for legislative charges in the GST Act can be contrasted against the rules for government grants and subsidies. Under the framework for government grants and subsidies, the GST Act generally requires GST-registered recipients of government grants and subsidies to return GST on the amounts received if they relate to the recipient’s taxable activity. The GST Act also enables the Governor-General to declare government grants and subsidies not subject to these rules by Order in Council.

Key features

The key features of the proposals include:

- A new rule that would provide that charges payable under legislation are treated as consideration for a supply of goods and services (the legislative charges rule).

- Exceptions to the legislative charges rule that would provide that fines, penalties, interest, and general taxes are not treated as consideration for a supply of goods and services under the legislative charges rule.
- A new schedule of non-taxable legislative charges, and a transitional regulation-making power that would enable the schedule to be updated by Order in Council on the recommendation of the Minister of Revenue until 30 June 2026.
- GST-registered persons and the Commissioner of Inland Revenue would be prevented from amending historic GST returns in a way that is inconsistent with the amendments.
- The removal of a number of existing deeming provisions from the GST Act that would be superseded by the proposed amendments.

Detailed analysis

The Bill proposes amendments to section 5 (Meaning of the term supply) with the addition of new subsections (6EC) to (6EF). These proposed amendments would:

- treat any charges, including fees and levies, payable under legislation as consideration for a supply of goods and services (new section 5(6EC))
- exclude legislative charges that have been added to the proposed schedule of non-taxable legislative charges from the proposed deeming rule (new section 5(6ED)(a))
- exclude legislative charges that are, or are in the nature of, fines, penalties, interest, and general taxes from the proposed rule (new section 5(6ED)(b)), and
- define a “general tax” for these purposes as being a charge in the nature of a tax imposed by a tax law that is not earmarked in legislation for a specific purpose (new section 5(6EE)).

The proposed amendments would be phased in over a three-year period. They would apply immediately to legislative charges that come into force on or after 1 July 2023. For all other charges, the rule would apply from 1 July 2026. This three-year transitional period provides government agencies time to make any necessary changes to legislative charges for which they have administrative responsibility.

The proposed legislative charges rule and the exceptions

Proposed section 5(6EC) would treat any charge payable under legislation as consideration for the supply of goods and services. The usual rules for determining whether a supply of goods or services is standard rated, zero-rated, or exempt would continue to apply.¹⁴

References to “legislation” are to be taken as a reference to the whole or part of any Act or secondary legislation.¹⁵ This means that charges payable pursuant to any Act or any secondary legislation would be subject to the proposed rule and exceptions.

Proposed section 5(6ED) provides that a legislative charge would not be treated as consideration for a supply of goods and services to the extent that the charge is, or is in the nature of, a fine, a penalty, interest, or a general tax.

¹⁴ A supply of goods and services could still be zero-rated or exempt depending on whether the conditions in sections 11, 11A, or 14 of the GST Act are satisfied. For example, a legislative charge for the supply of financial services (as defined in the GST Act) would still be exempt.

¹⁵ According to section 13 of the Legislation Act 2019.

Proposed section 5(6EE) defines a “general tax” for the purposes of the proposed amendments. For a charge to be a general tax, it would have to:

- be a charge in the nature of a tax
- be imposed by a tax law, and
- not be earmarked in legislation for a particular purpose or function.

Under the proposed definition, a levy that is paid to fund the activities of a regulator would not be a general tax because the legislation enabling the levy would earmark the revenue for a particular purpose or function (that is, to enable the regulator to perform its functions). In contrast, income tax and GST itself would be general taxes, as these charges are in the nature of a tax, are payable under a tax law, and the revenue from these charges is not earmarked in legislation for a particular purpose or function.

The proposed schedule of non-taxable legislative charges

The Bill proposes a schedule to the GST Act that would contain a list of non-taxable legislative charges. This is similar to an Order in Council that exists, and which is amended from time to time, for government grants and subsidies: the Goods and Services Tax (Grants and Subsidies) Order 1992.

The proposed schedule of non-taxable legislative charges could be amended through either:

- amendments contained in primary legislation – for example, an amendment Act, or
- the proposed transitional regulation-making power, which expires on 30 June 2026.

The proposed transitional regulation-making power would enable the Minister of Revenue to recommend an Order in Council be made where the Minister is satisfied that adding a charge (which includes either a specifically named charge, or a class of charge) to the schedule is desirable, having regard to whether adding the charge, or class of charges, to the schedule would be consistent with the approach taken for similar charges in the past.

The Bill proposes that the transitional regulation-making power would expire on 30 June 2026. This is the day before it is proposed the new rules would apply to all legislative charges. This three-year transitional period is intended to provide sufficient time for government agencies to make any necessary changes to legislative charges for which they have administrative responsibility or to seek an addition to the proposed schedule.

The proposed schedule and regulation-making power are intended to recognise that there may be circumstances in the future where a specific charge should not be affected by the proposed rules. No charges have been included on the proposed schedule on the Bill’s introduction.

The proposed schedule and regulation-making power would come into force on the day after the Bill receives the Royal assent.

Limitation on amending assessments

The Bill proposes the introduction of new section 81A of the GST Act. The new section would prevent taxpayers and the Commissioner of Inland Revenue from amending historic GST assessments in a way that would be inconsistent with proposed new sections 5(6EC) to 5(6EE). This limitation would apply retrospectively to the date of the Bill’s introduction.

The reason for this limitation is that persons who have paid GST on legislative charges would have done so with a reasonable expectation that GST would have been

applicable. To unwind GST assessments would result in compliance and administration costs for both those that collected legislative charges and Inland Revenue.

Amendments to historic GST assessments to remove GST on legislative charges would:

- provide a windfall gain for the persons responsible for the legislative charges equal to the amount of GST collected and returned to Inland Revenue (as there would be no corresponding obligation on the collector of the charge to forward this GST on to the payers of the legislative charges), and
- require amendments to GST assessments for persons that have paid legislative charges and who have taken a deduction for input tax of the GST included in the legislative charges.

Allowing amendments in these circumstances could also pose a significant fiscal risk for the Crown.

Repealing specific deeming rules that have been superseded

The GST Act has been amended over time to include specific provisions that deem amounts paid to be consideration for a supply of goods and services made by the recipient of the payment in the course or furtherance of a taxable activity that they carry on.

The Bill proposes to repeal the specific provisions set out in table 2 below that would be superseded by the proposed rule for legislative charges. This is to avoid duplication and confusion.

Table 2: Specific provisions to be repealed

Section reference	Description
Section 5(6AA)	Levies payable to the New Zealand Transport Agency and the Environmental Protection Authority under the Climate Change Response Act 2002
Section 5(6AAB)	Fees and charges payable pursuant to regulations made under the Land Transport Act 1998
Section 5(6A)	Registration and licence fees payable under the Land Transport Act 1998
Section 5(6AB)	The levy payable to Fire and Emergency New Zealand under the Fire and Emergency New Zealand Act 2017
Section 5(6AC)	Various payments and levies payable under the Waste Minimisation Act 2008
Section 5(6B)	Road user charges payable under the Road User Charges Act 2012
Section 5(6BB)	Regional Fuel Tax and rebates paid under the Land Transport Management Act 2003 (or associated regulations)
Section 5(7F)	The levy payable under the Infrastructure Funding and Financing Act 2020

The Bill proposes these provisions would be repealed on 30 June 2026. This is the day before the proposed rule for legislative charges would come into force.

The repeal of these provisions is not intended to affect the existing GST treatment of the charges or the status of the recipient of the charges as a registered person for the purposes of the GST Act.

BUILD-TO-RENT EXEMPTION FROM INTEREST LIMITATION

Clauses 98(3) and 100

Summary of proposed amendments

The proposed amendments provide an in-perpetuity exemption from the interest limitation rules for build-to-rent dwellings that meet the asset class definition.

Effective date

The proposed amendments would take effect on 1 October 2021 to align with the introduction of the interest limitation rules.

Background

The interest limitation rules took effect on 1 October 2021 and are aimed at tilting the playing field for existing residential property away from investors and towards first home buyers and owner-occupiers. Exemptions, such as the new build exemption, were included to ensure the interest limitation rules do not have a negative impact on new housing supply. An additional exemption for build-to-rent assets is considered necessary to ensure the rules do not negatively impact the supply of rental property specifically.

Key features

The Bill proposes to insert a new definition of “build-to-rent land” in section YA 1 of the Income Tax Act 2007 (ITA). The interest limitation rules would not apply to interest incurred in relation to property that meets the definition of “build-to-rent land”. However, if the land fails to meet the definition at any point, the interest limitation rules would apply, and interest would no longer be able to be deducted in relation to that residential rental property.

“Build-to-rent land” would mean land to the extent to which, together with any other contiguous land owned by the same person:

- it has 20 or more dwellings
- each dwelling is used, available for use, or being prepared or restored for use, as a dwelling occupied under a residential tenancy to which the Residential Tenancies Act 1986 (RTA) applies
- every residential tenancy has the option of a 10-year term, with the ability to give 56 days’ notice of termination
- every tenancy agreement includes a personalisation policy, and
- at no time it after it first meets the above requirements does it fail to meet those requirements.

Exemption would apply to existing dwellings that meet the definition by 1 July 2023

The policy is intended to apply to new and existing build-to-rent developments. However, it is highly unlikely any existing developments would have offered 10-year tenancies to all tenants. Existing build-to-rent assets would therefore have until 1 July 2023 to comply with the tenure and personalisation policy requirements included in the definition of “build-to-rent land”.

Detailed analysis

Configuration of development

A build-to-rent development would have to have no less than 20 dwellings at all times that satisfy the requirements to qualify as “build-to-rent land”. The proposed definition would mean that dwellings could be held in one or more titles and could be on adjoining parcels of land.

The development could also include commercial premises or other dwellings that do not meet the build-to-rent requirements and do not form part of the “build-to-rent land”. This would enable community amenities to be provided, allow for mixed tenure types, and provide alternative revenue streams for the development. In these instances, apportionment would be required. It is proposed that existing tax apportionment principles would apply.

“To the extent” test

A dwelling would qualify for the exemption “to the extent” to which it meets the definition requirements. This means each individual dwelling, as well as the overall development, would have to meet the definition for interest to be deductible. Only interest relating to the portion of the development that meets the definition of “build-to-rent land” can be deducted.

Example 35: A development qualifies “to the extent” it meets definition

Te Awhi Co completed an apartment block development in 2021 that is made up of 35 apartments along with a block of commercial shops on the ground floor. Of the 35 apartments, 10 were sold to owner-occupiers and 25 were retained by Te Awhi Co to rent out under the build-to-rent model.

Assuming the 25 apartments meet the other requirements of the “build-to-rent land” definition (for example, they are rented out under the RTA, tenants have been offered a 10-year tenancy agreement, and personalisation policies have been offered), these 25 units would qualify as build-to-rent land. Any interest relating to these 25 apartments would therefore be deductible.

Having commercial premises and dwellings that do not meet the “build-to-rent” definition in the same development does not stop the build-to-rent units from qualifying for the exemption. Any interest relating to those non-build-to-rent parts of the development would not be deductible under the build-to-rent exemption. However, other exemptions may apply, such as the new build exemption.

“Same person”

A development must be owned by the same person to qualify for the exemption. The “same person” can include any natural person or legal entity (for example, a company).

Continuous use requirement

Land would have to continually meet the requirements of the “build-to-rent land” definition to qualify for the exemption.

Even if land met the requirements in the future, it would never be able to qualify again as “build-to-rent land” if at any point it had failed to meet the definition.

Existing build-to-rent developments would have to meet all the requirements by 1 July 2023 and continue to meet the requirements at all times after this date. All new developments would have to comply at all times after 1 July 2023.

Used, available for use, or being prepared or restored for use

A dwelling would have to be used, available for use or being prepared or restored for use as a build-to-rent dwelling to qualify for the proposed exemption. The wording "available for use" would cover situations where dwellings are not currently occupied but are being advertised on the market as available for rent. "Being prepared or restored for use" would cover scenarios where a dwelling is not currently available for use but is undergoing work to be suitable for use as a rental property. For example, a unit may be renovated between tenancies to replace an outdated kitchen. The dwelling would still qualify during this period even though it is not occupied.

Tenure length requirement

Tenants of a build-to-rent dwelling would have to be offered a fixed-term tenancy of at least 10 years and be given the ability to give 56 days' notice of termination. This does not mean the tenant has to accept this offer. They may agree to, or request, a different tenancy offer.

Existing build-to-rent developments would have until 1 July 2023 to offer all existing tenants a 10-year contract, and they would have to offer all new tenants from 1 July 2023 a 10-year contract. Any build-to-rent development completed after 1 July 2023 would have to meet this requirement immediately.

Personalisation policies

Build-to-rent providers would have to supply tenants with explicit personalisation policies, beyond what is already allowed under the RTA, that outline any personalisation options available for tenants, for example, the ability to make certain renovations, or the allowance of pets.

Requiring explicit personalisation policies would make lifestyle issues like pets and home-making more transparent to prospective tenants and would allow build-to-rent providers to offer different personalisation options for different developments. For example, not all build-to-rent locations and typologies will be suitable for pets, and some build-to-rent providers may wish to promote exclusion of pets as a point of difference to benefit some tenants.

Existing build-to-rent developments would have until 1 July 2023 to agree to personalisation policies with all current tenants. Any build-to-rent developments completed after 1 July 2023 would have to comply with this requirement immediately.

When the exemption applies

Taxpayers would be eligible for the exemption from the date the development meets the definition requirements. The exemption would take effect on 1 October 2021 to align with the introduction of the interest limitation rules.

Existing build-to-rent developments completed before 1 July 2023 would have until this date to meet the definition requirements. If the development does not do so by 1 July 2023, they would never be able to qualify for the exemption. If an existing development qualified for the exemption, it would apply retrospectively; that is, they would be able to deduct interest incurred for the period between 1 October 2021 and the date they qualified. If the 2021–22 return has already been filed, taxpayers would be able to amend their return via the process under section 113 of the Tax Administration Act 1994.

New build-to-rent developments would need to comply with the requirements immediately and would be eligible for the exemption from the date they meet the requirements.

To qualify for the exemption, the Chief Executive of Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development would have to be satisfied that the development meets the definition of “build-to-rent land”. The asset would then be recorded on a register of assets that would be shared with Inland Revenue. Inland Revenue would then exempt the listed taxpayers. The exemption would continue for as long as the development meets the definition requirements.

Exemption applies to interest incurred in relation to build-to-rent land

The effect of the build-to-rent exemption would be that the interest limitation rules in subpart DH would not apply to deny interest deductions. However, interest would still have to be deductible under existing tax rules.

The interest deductible under the exemption would include interest on loans to:

- acquire the land for a build-to-rent development
- construct or install a build-to-rent development on the land
- pay expenses such as insurance and rates, and
- renovate, maintain, or repair a build-to-rent dwelling.

When the exemption ceases

A dwelling would cease to qualify immediately if it fails to meet the definition of “build-to-rent land”. If a dwelling in a development no longer meets the requirements, for example, if it is not rented out under the RTA, interest relating to that dwelling would no longer be deductible. If that dwelling ceased to qualify, and this resulted in there being less than 20 qualifying dwellings in a development, the exemption would cease to apply to the entire development.

Example 36: When a unit ceases to qualify

Assume the same facts as in example 35 above. Te Awhi Co currently deducts interest relating to the 25 qualifying units in its development. Four of these units are sold in February 2022, so interest is only deductible for the remaining 21 units.

In May 2022, two units are rented out to new tenants who are only offered three-year contracts. This does not meet the requirement of offering a fixed-term tenancy of at least 10 years. As such, the two units no longer qualify for the exemption. There are now only 19 units that meet the requirements, so the exemption would cease to apply for the entire development.

Interaction with the new build exemption

The new build exemption currently applies to exempt new builds from the interest limitation rules for a period of 20 years. A new build is a self-contained dwelling that has received its CCC on or after 27 March 2020.

A build-to-rent development is not barred from accessing the new build exemption. However, a development would still have to meet the build-to-rent exemption requirements from 1 July 2023 to access that exemption at any time in the future (for example, once the 20-year new build exemption ceases).

FRINGE BENEFIT TAX EXEMPTION FOR CERTAIN PUBLIC TRANSPORT FARES SUBSIDISED BY EMPLOYER

Clauses 23 and 27

Summary of proposed amendments

The proposed amendments would exempt from fringe benefit tax (FBT) public transport fares that are subsidised by an employer mainly for the purpose of their employees travelling between their home and place of work.

Effective date

The proposed amendments would have effect for fringe benefits provided on and after 1 April 2023.

Background

Currently, contributions an employer makes to their employee's public transport costs for travel between home and the workplace, for example, in the form of a voucher or a loaded electronic ticketing card, are generally an unclassified fringe benefit (see sections CX 2(1)(b)(ii), CX 37, and RA 5(1)(b) of the Income Tax Act 2007 (ITA)). FBT applies unless the benefit falls below certain de minima.¹⁶

On the other hand, employer-provided on-premises car parks are largely exempt from FBT under the general exemption for on-premises benefits. This gap in the FBT rules can be a sizeable benefit given the rental cost of car parks in major urban areas.

Broadening the coverage of FBT to include more of these car parks (the ideal tax policy outcome) has proved to be problematic in the past mainly due to concern about the potential compliance costs and safety issues for some CBD employees.¹⁷ Acknowledging this issue, the Tax Working Group recommended aligning the FBT treatment by also exempting public transport subsidies from FBT. The proposal in the Bill reflects this recommendation.

Specifically, this alignment would produce a more neutral FBT outcome between the options of travelling to and from work by car and travelling by the more environmentally friendly mode of public transport.

Key features

Proposed new section CX 19C provides that FBT would not apply to certain public transport fares that an employer subsidises.

Detailed analysis

Proposed new section CX 19C provides that public transport fares that an employer has subsidised mainly for the purpose of the employee travelling between their home

¹⁶ FBT does not currently apply if the value of all unclassified benefits provided falls below the standard de minima. Unclassified benefits are exempt from FBT when the taxable value of the benefit provided to each employee is \$300 or less per quarter per employee and the total taxable value of all unclassified benefits provided by the employer over the past four quarters is \$22,500 or less.

¹⁷ See, for example, various commentaries in 2012-13 when this was last attempted.

and place of work would not be a fringe benefit provided the public transport is via a bus, train, ferry, tram or cable car. This means that the employer would not have to pay FBT on such benefits.

Air transport, taxis, shuttles and other services that people share access to that are provided by service providers with a physical and/or digital infrastructure network, (such as bike-sharing, ridesharing, and e-scooter hire) are not covered by the exemption.

Interaction with section CX 9 (Subsidised Transport)

The current concessionary provisions for certain subsidised transport (see sections CX 9, RD 33 and YA 1 "subsidised transport") would continue to apply to situations that fall outside the application of the proposed public transport exemption in new section CX 19C, for example, where employees of an airline company are provided with free or discounted air travel. In such cases, the benefit to the employee will continue to be valued at 25% of the highest fare the employer charges the public for the equivalent transport. A consequential amendment to section CX 9 is proposed to clarify its relationship with the proposed new section CX 19C.

Interaction with section CE 1

Some employer subsidised use of public transport may fall under the employment income rules in section CE 1 of the ITA rather than the FBT rules.

For example, if an employer were to directly reimburse an employee in cash for their bus fare costs, that reimbursement would be employment income. The proposed amendment does not extend to those situations. From a policy perspective, there is no relative bias between car and public transport options in that situation as reimbursement of carparking costs would also be employment income.

This contrasts with the example of an employer providing a bus/train pass, which would be a fringe benefit and qualify for the proposed exemption.

Another example may be a public transport provider offering an arrangement whereby an employer could pay a portion (e.g. 100%, 50% or 25%) of the fare and would be billed by the public transport provider for an aggregated amount for all employees using their travel cards over the month. This would be likely to be a fringe benefit and qualify for the proposed exemption.

SCHEDULE 32 - OVERSEAS DONEE STATUS

Clause 101

Summary of proposed amendment

The proposed amendments would add nine charities to the list of donee organisations in schedule 32 of the Income Tax Act 2007 (ITA) and rename an existing donee organisation following a restructure.

Background

Individual taxpayer donors to organisations listed in schedule 32 are entitled to a tax credit of 33½% of the monetary amount donated, up to the amount of their taxable income. Companies and Māori authorities may claim a deduction for donations up to the level of their net income. Charities that apply funds towards purposes that are mostly outside New Zealand must be listed in schedule 32 before donors become eligible for these tax benefits.

Effective date

The proposed amendments would take effect on 1 April 2022, with the following exceptions:

- the addition of Heilala Vanilla Foundation would take effect on 15 January 2022 and end on 31 March 2026
- the addition of Anglican World Aid (Aotearoa) Limited would take effect on 11 April 2022
- the addition of New Zealand for UNHCR (United Nations High Commissioner for Refugees) would take effect on 15 February 2022
- the removal of UNHCR (United Nations High Commissioner for Refugees) would take effect on 1 April 2023, and
- the addition of Pacific Island Food Revolution Limited would end on 1 April 2027.

Key features

The proposed amendments would:

- Add nine charitable organisations to schedule 32 of the ITA. Donors to these charities would be eligible for tax benefits on their donations.
- Change an existing reference following a restructure.

Detailed analysis

Additions to the list of donee organisations

Anglican World Aid (Aotearoa) Limited

Anglican World Aid (Aotearoa) Limited was set up on 11 April 2022 as the humanitarian aid arm of the Anglican Missions Board of the Church in Aotearoa, New Zealand and Polynesia (the Missions Board). The Missions Board supports aid and development projects and coordinates appeals for emergencies (primarily in neighbouring Pacific Island nations). It is heavily involved in the aid response in Tonga

to the 15 January volcanic eruption and subsequent tsunami. It is active in supporting economic development projects in Kolkata, Fiji, and Tonga. Other objectives include providing relief from the effects of poverty in Mozambique and supporting Al Ahli Hospital in Gaza. Anglican World Aid (Aotearoa) Limited will support the delivery of humanitarian aid projects coordinated by the Missions Board.

Cotton On Foundation Limited

Cotton On Foundation Limited is an Australian resident charity established by the Cotton On Group, which has a strong commercial presence in New Zealand. The Foundation's works are directed at the relief of poverty, with a worldwide focus on impoverished communities. It supports a number of projects directed at improving educational outcomes in Uganda, Thailand, and South Africa through developing new infrastructure, such as buildings, and providing educational resources.

Engineers Without Borders New Zealand Incorporated

Engineers Without Borders New Zealand Incorporated (EWBNZ) supports capability-building programmes for engineering service providers in developing countries in the Pacific. Working with in-country partners, EWBNZ puts programmes in place to support learning and development outcomes for engineers and technicians. Recent projects include providing learning support for projects in Vanuatu and Kiribati.

Family for Every Child New Zealand Trust

Family for Every Child New Zealand Trust provides a platform for civil society organisations to collaborate and supports the exchange of knowledge and practice around children's care by building skills in research, documentation, programme piloting, advocacy and technical assistance. It has headquarters in the United Kingdom and the United States, as well as New Zealand.

Forest for People Limited

Forest for People Limited supports development projects and programmes directed at enhancing the welfare of indigenous communities in sensitive ecosystems. The projects create sustainable economic systems in developing countries through improving education outcomes and contributing to local employment in environmentally sustainable industries.

Heilala Vanilla Foundation

In response to the state of emergency in Tonga following the Hunga Tonga–Hunga Ha'apai volcanic eruption and subsequent tsunami on 15 January 2022, Heilala Vanilla Foundation has provided immediate aid in the form of food staple packs and safety equipment to assist with the remapping of the coastlines to allow boat landings to recommence on outlying islands.

Heilala Vanilla Foundation's donee status is to be time limited and end on 31 March 2026. This is because, while the Foundation is well placed to support recovery efforts following the recent tsunami, it may not have as strong a role to play in terms of Tonga's overall future economic development.

Joyya Trust

Joyya Trust supports local capacity building in four communities known for extreme poverty and human trafficking in Kolkata and West Bengal, India. The Trust places special emphasis on education, local community initiatives and economic projects to alleviate urban poverty and empower women and girls into work to counteract human trafficking.

Pacific Island Food Revolution Limited

Pacific Island Food Revolution Limited (PIFR) promotes local, healthy food in the Pacific to combat the non-communicable disease crisis through a multi-media communication programme that uses TV, social and traditional media, and community partnerships.

PIFR's aim is to use local healthy food and knowledge to underpin economic development, tourism, health and wellbeing. This is in response to the health and development crisis declared by Pacific Island Governments in 2011 and its potential impact on national development.

PIFR's donee status is to be time limited and end on 31 March 2027. This is because the charity is moving from a government grants-based model to a private donations model. The limited period will give Inland Revenue a chance to review their performance after having sufficient time to establish a donor base.

Solomon Island Medical Mission Charitable Trust

Solomon Island Medical Mission Charitable Trust's primary purpose is to raise funds for a rural health clinic in Malaita and progressively upgrade its original hospital status. Work currently funded by the Trust, to be completed in the next few months, includes expanding the ablutions block and installing a water supply.

Maintenance change following restructure

The New Zealand Government granted UNHCR (United Nations High Commissioner for Refugees) overseas donee status in the 2008–09 income year. UNHCR has since reviewed its fundraising activities in Australasia and has decided to create a New Zealand charitable trust - "New Zealand for UNHCR (United Nations High Commissioner for Refugees)". Following this restructure, the overseas donee status should apply to this new entity instead.

The insertion of "New Zealand for UNHCR (United Nations High Commissioner for Refugees)" would apply from 15 February 2022, with the reference to "UNHCR (United Nations High Commissioner for Refugees)" being removed on 1 April 2023. The overlapping references ensure that donation tax credit entitlements are preserved for existing UNHCR donors while the restructure occurs. The earlier application date was granted in respect of UNHCR's relief work in Ukraine.

Housing remedial items

CLARIFICATION OF THE BRIGHT-LINE TEST EXCLUSION FOR INHERITED PROPERTY

Clauses 6(2), 32(5) and 59

Summary of proposed amendments

The proposed amendments clarify how multiple sections of the Income Tax Act 2007 (ITA) interact to provide relief under the bright-line test when residential land is transferred upon the death of the owner to the executor, administrator or relevant beneficiaries of the estate and subsequently disposed of.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

Inherited residential land is effectively exempt from the bright-line test. This outcome is achieved through three different sections in the ITA – sections CB 6A(2B), CZ 39(7), and FC 9 – but it is not always clear that they operate together.

Subpart FC deals with the distribution, transmission, and gifts of property, mainly in relation to the transfer of property on the death of a person. Section FC 9 deals with the transfer of residential land on the death of a person to either the executor or administrator of the estate or a beneficiary beneficially entitled to the residential land under the terms of the deceased's will or the rules governing intestacy. Under section FC 9(2), the bright-line test does not apply to the transfer of the land, including any intervening transfer to an executor or administrator.

Sections CB 6A(2B) and CZ 39(7) state that sections CB 6A and CZ 39 do not apply to an amount derived "by an executor or administrator described in section FC 1(1)(a) (Disposals to which this subpart applies), or a beneficiary described in section FC 1(1)(b)" in disposing of that land. Effectively, this means the bright-line test does not apply if the executor or administrator of the estate or the ultimate beneficiary sells the residential land.

Confusion can arise due to the wording of section FC 9(3). Section FC 9(3) provides that if the recipient disposes of the land and derives income, they take on the deceased person's acquisition date and acquisition cost. Without knowledge of sections CB 6A(2B) and CZ 39(7), it could be incorrectly assumed that this cost base deeming rule in section FC 9(3) means a subsequent disposal of the residential land would be subject to tax under the bright-line test.

The Bill proposes to amend sections, CB 6A(2B), CZ 39(7), and FC 9(2) to clarify this.

ROLLOVER RELIEF: BRIGHT-LINE TEST AND INTEREST LIMITATION

Clauses 6(1), 7 and 8

Summary of proposed amendment

Remedial amendments are proposed to the rules providing rollover relief for the bright-line test and the new interest limitation rules to ensure that the relief works as intended.

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

Effective date

The proposed amendments would generally take effect on the day after the date the Bill receives the Royal assent.

However, the following amendments would take effect on 27 March 2021:

- The proposed deletion of the words “and must not be to or from a person in their capacity of settlor, beneficiary, or trustee” from section CB 6AB(4).
- Proposed new sections CB 6AB(5)(d) and (6)(ab), which relate to close family beneficiaries.
- The proposed deletion of the words “, under section HF 2(3)(e)(i) (Who is eligible to be a Māori authority?)” from section CB 6AC(5).
- Proposed new section CB 6A(1AB)(b), which provides that if rollover relief applies to a transfer, the recipient of the land would be subject to the same bright-line test as the transferor.

The retrospective effect of these amendments to 27 March 2021 would mean they have the same effective date as the originally enacted provisions. Thus, they would have effect:

- for the interest limitation rules, on 1 October 2021 for loans drawn down for disallowed residential property on or after 27 March 2021, and
- for the bright-line test, for disposals occurring on or after 1 April 2022.

Background

Rollover relief under the bright-line test ensures that certain transfers of residential land are not taxed at the time of the transfer. Instead, the recipient takes on the original owner’s acquisition cost and date. When the recipient disposes of the residential land, this cost and acquisition date determines whether the disposal is taxed under the bright-line test and the amount of the gain that is taxable.

In the context of interest limitation, interest deductions for residential property are being gradually phased out between 1 October 2021 and 31 March 2025 for loans drawn down for residential property before 27 March 2021. For residential property loans drawn down on or after 27 March 2021, interest deductions have generally been denied since 1 October 2021 except in simple refinancing scenarios. Rollover relief ensures that certain restructures of the property’s legal ownership and the accompanying loan do not kick someone out of this phasing-out period and into full interest denial before 31 March 2025 for loan amounts first drawn down before 27 March 2021.

Bright-line test

The bright-line test, as introduced in 2015, included limited relief for certain transfers: relationship property, inherited property, and company amalgamations. The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 introduced additional rollover relief rules for certain legal transfers of residential land when there is no underlying change in economic ownership. The changes extended coverage of rollover relief to the following legal structures from 1 April 2022, provided certain conditions are met:

- Family trusts: standard trusts and Māori authority trusts
- Look-through companies
- Partnerships
- Treaty of Waitangi settlements
- Transfers within wholly-owned groups of companies.

The extent of relief under the bright-line test for these new categories generally depends on the amount of consideration paid for the transfer:

- If the transfer occurs at or below the original owner's acquisition cost (that is, the person has not realised a gain), no tax consequences arise for the original owner if the transfer is made within the relevant bright-line period. The recipient then takes on the original owner's bright-line start date and cost base.
- If the transfer occurs for more than the original owner's cost (that is, they have realised a profit), then that gain is taxed if the transfer is made within the relevant bright-line period. A rule that deems bright-line disposals to be made at market value is switched off to ensure any "paper profit" is not taxed. The recipient then takes on the original owner's bright-line start date but with an updated cost base of the amount for the transfer.

Interest limitation

Rollover relief for interest limitation purposes is provided in the same situations as the bright-line test but with no requirement regarding consideration.

The new interest limitation rules in subpart DH of the Income Tax Act 2007 deny deductions for interest incurred on loans on or after 1 October 2021 where those loans are drawn down on or after 27 March 2021 for "disallowed residential property" (DRP).

Loans drawn down before 27 March 2021 are "grandparented transitional loans", meaning that interest deductions are progressively denied over the period from 1 October 2021 to 31 March 2025 as "grandparented residential interest".

In limited circumstances, rollover relief is provided so that loans drawn down on or after 27 March 2021 also qualify as grandparented transitional loans.

If certain conditions are met, section DH 5(5)(d) provides that New Zealand dollar denominated loan amounts (ignoring re-drawings or additional borrowings on or after 27 March 2021) are grandparented transitional loans to the extent the loans are for DRP for which a previous owner (the original owner) also had a loan. The loan amounts must be equal to or less than the amount of the original owner's loan at the time the original owner transferred the property.

Problems with the rules

There are a number of technical issues with the rollover relief rules that apply for both bright-line test and interest limitation purposes. The rules need clarifying to ensure they operate as intended, particularly in relation to transfers to or from family trusts and transfers between different capacities.

Key features

The following remedial amendments are proposed to clarify the rollover relief rules:

- Proposed amendments to sections CB 6AB(2) and (3), and CB 6AC(2) and (3) would ensure that rollover relief applies to a transfer of residential land or DRP out of a family trust either back to the principal settlor or the group of settlors that originally transferred the land to the trust (provided that, for a group, at least one of the settlors is a principal settlor), even if the settlor (or settlors) is not an “original settlor” (as was required by the originally enacted provisions).
- That rollover relief would apply to a transfer of residential land or DRP out of a family trust to a principal settlor even if the settlor did not originally transfer the residential property in question to the trust.
- Proposed new sections CB 6AB(1)(b) and CB 6AC(1)(b) would provide that rollover relief would be available when residential land or DRP held in a qualifying family trust is resettled onto another family trust, provided certain conditions were met.
- Proposed amendments to sections CB 6AB(3) and (4), and CB 6AC(3) and (4) would clarify the wording and intention of the provisions providing rollover relief for transfers involving multiple legal structures or between different legal capacities.
- Proposed amendments to the definition of “close family beneficiary” in section CB 6AB(6) would include a company in which a 50 percent or more voting interest (or a 50 percent or more market value interest if a market value circumstance exists) is owned by a beneficiary that is a principal settlor of the trust, and the trustee of another trust if at least one beneficiary of the other trust is a close family associate of a beneficiary of the first trust.
- Proposed amendment to section CB 6AC(5) would ensure that rollover relief would be available for certain transfers to or from qualifying family trusts that are Māori authorities, or eligible to be Māori authorities, regardless of *how* they are eligible to be Māori authorities.
- Proposed new section CB 6A(1AB)(b) would clarify that when any of the rollover relief provisions applies to a transfer of residential land, the recipient of the land should be subject to the same bright-line test as the transferor was (that is, two, five or ten years).

Detailed analysis

Transfers to settlors (sections CB 6AB(2) and (3), and CB 6AC(2) and (3))

Rollover relief is available under either section CB 6AB(2) or CB 6AC(2) for a transfer of residential land or DRP from a qualifying family trust back to the settlors of the trust, provided certain conditions are met. One such condition is that the settlor must have originally transferred the land to the trust – or, in other words, they were the original owner of the land. Consequently, rollover relief is not currently available for transfers of residential land or DRP from the trust to the settlor where the settlor instead made cash settlements on the trust or guaranteed its obligations to enable the trust to acquire the land. Also, because the settlor must be an “original settlor” (meaning they made the original settlement of property on the trust), rollover relief is not currently available if the land is transferred to a person who became a principal settlor of the trust *after* the original settlement of property on the trust. This applies even if the settlor was in fact the original owner of the land and had become a principal settlor at, or by, the time they transferred the land to the trustee.

The Bill therefore proposes to replace existing sections CB 6AB(2) and (3) and CB 6AC(2) and (3) with redrafted versions that would clarify that rollover relief would apply in these situations.

Note that the proposed amendments would also replace existing sections CB 6AB(1) and CB 6AC(1). However, these amendments are not intended as a policy change, but rather a streamlining of the provisions in the style of new sections CB 6AB(2) and CB 6AC(2).

Removal of "original settlor" requirement

Proposed new section CB 6AB(2)(a) provides that the bright-line acquisition date for land when a settlor of a family trust (the transferee) disposes of the land is the bright-line acquisition date of the trustee (being the previous owner), provided the following conditions are met:

- the trustee transfers the land to the transferee(s) on or after 1 April 2022
- if there is more than one transferee, the transferees acquire proportionally the same amount of land they originally transferred to the trustee, and
- at the time that the trustee transfers the land to the transferee(s):
 - all transferees are beneficiaries of the trust
 - at least one transferee is a principal settlor, and
 - the trust is a "rollover trust".

The definition of "rollover trust" in section CB 6AB(5) is also proposed to be amended, so that it would mean, at the time of a relevant transfer to or from the trust:

- all principal settlors are beneficiaries of the trust
- all principal settlors are close family associates,¹⁸ and
- all beneficiaries are close family beneficiaries.¹⁹

This would remove the "original settlor" requirement in the currently enacted provision, meaning that rollover relief would apply under section CB 6AB in the situation where a settlor receives land back from a qualifying family trust that the settlor previously sold the land to, or settled the land on – including in circumstances where the transferee is not the "original settlor" of the trust.

Proposed new section CB 6AC(2)(a) similarly provides that, for a settlor of a Māori rollover trust, the bright-line acquisition date for land when the settlor (the transferee) disposes of it is the bright-line acquisition date of the Māori trustee (being the previous owner), provided the following conditions are met:

- the Māori trustee transfers the land to the transferee(s) on or after 1 April 2022
- if there is more than one transferee, the transferees are all settlors of the trust and acquire proportionally the same amount of land they originally transferred to the Māori trustee, and

¹⁸ Two people are "close family associates" under section CB 6AB(7) if they are within four degrees of blood relationship, or are married, in a civil union or de facto relationship, or one person is within four degrees of blood relationship to the other person's spouse, civil union partner or de facto partner.

¹⁹ "Close family beneficiary" would be defined in proposed new section CB 6AB(6) to mean, for the relevant trust, a beneficiary that is one or more of the following: a principal settlor; a trustee of another trust and at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust; a close family associate of another beneficiary who is also a principal settlor; a company in which a 50 percent or more voting interest, or a 50 percent or more market value interest if a market value circumstance exists, is owned by a beneficiary who is a principal settlor or a close family associate of another beneficiary who is a principal settlor; or a charity registered under the Charities Act 2005.

- at the time that the trustee transfers the land to the transferee(s):
 - all transferees are beneficiaries of the trust
 - the trust is a “Māori rollover trust”.

It is proposed to amend the definition of “Māori rollover trust” in section CB 6AC(4) so that it would mean, at the time of a relevant transfer:

- all beneficiaries of the trust are either members of the same iwi or hapū, or descendants of the same tipuna (living or dead), and
- the land is subject to Te Ture Whenua Māori Act 1993.

Provided the above conditions are met, rollover relief would apply if the trustee is a Māori authority or eligible to be one (see the definition of “Māori trustee” in section CB 6AC(5)).

Example 37: Sale to family trust by non-original settlor

In 2005, Martha settles a new family trust, with herself, her husband Bill and their children, Jack and Sean, as the beneficiaries of the trust.

In 2007, Jack makes substantial settlements on the trust such that he becomes the principal settlor.

In 2009, Jack acquires an investment property for \$250,000. He later sells it to the trust in May 2019 for \$600,000.

In November 2022, the trust sells the property back to Jack for \$600,000, even though the market value of the property is now over \$1 million. At the time of the sale, Jack is still the principal settlor of the trust.

As the amount paid by Jack for the property is equal to the amount the trustee originally paid for the property, full rollover relief would apply to the transfer under the proposed amendments. This means that the trust would not be subject to tax under the bright-line test on the transfer of the property to Jack in November 2022. This is because the trustee would be treated as disposing of the land at cost, meaning that their net income arising under the bright-line test is zero.

Jack would be deemed to have a bright-line acquisition date of May 2019 for the land (being the date the trustee acquired the property) and a cost base of \$600,000.

Principal settlor not original owner of land

Proposed new section CB 6AB(2)(b) would provide another route for rollover relief to apply when residential land or DRP is transferred from a qualifying family trust (referred to as a “rollover trust” in the legislation) to a principal settlor. Proposed new section CB 6AB(2)(b) would provide rollover relief when land is transferred from a rollover trust to a settlor or group of settlors, provided all settlors receiving the land are principal settlors at both the time the land is acquired by the trustee and the time the trustee transfers the land to the settlor(s).

Rollover relief would not apply to transfers to settlors who are not principal settlors of the trust either at the time the land was acquired by the trustee or the time the trustee transfers the land. This timing requirement is to ensure that a beneficiary of the trust cannot become a principal settlor immediately before the transfer to them just so that they receive the land without bright-line test tax implications. It also

ensures that rollover relief does not apply to a transfer to someone who is no longer a principal settlor of the trust.

Example 38: Transfer from family trust to principal settlor who made cash settlement on trust

In August 2019, Nikki decides to settle a family trust with himself, his father, William, and his sister, Mary, as the beneficiaries of the trust. The only property settled on the trust at that time is \$900,000 in cash contributed by Nikki, making Nikki the principal settlor of the trust (being the settlor whose settlements for the trust are greatest or greatest equal). Shortly afterward, in September 2019, the trustee uses the funds settled on the trust by Nikki to purchase a residential property for \$850,000.

In January 2023, the trustee transfers the property to Nikki for its cost of \$850,000, even though at that time it is worth \$1.2 million. At the time of the transfer, Nikki is still a principal settlor of the trust. Mary is also a principal settlor as she made a cash settlement on the trust of \$900,000 in December 2019.

As the amount paid by Nikki for the property is equal to the amount the trustee originally paid for the property, full rollover relief would apply to the transfer under the proposed amendments. This means that the trust would not be subject to tax under the bright-line test on the transfer of the property to Nikki in January 2023. This is because the trustee would be treated as disposing of the land at cost, meaning that their net income arising under the bright-line test is zero.

Nikki would be deemed to have a bright-line acquisition date of September 2019 for the land (being the date the trustee acquired the property) and a cost base of \$850,000.

If the property had instead been transferred by the trustee to Mary, that transfer would not have qualified for rollover relief. This is because Mary was not a principal settlor at the time the land was acquired by the trustee.

Resettlements of family trusts (sections CB 6AB(1)(b) and CB 6AC(1)(b))

Proposed new sections CB 6AB(1)(b) and CB 6AC(1)(b) would provide that rollover relief would be available when residential land or DRP held in a qualifying family trust (the head trust) was resettled onto another family trust (trust A).

If certain conditions are met, proposed new section CB 6AB(1)(b) would provide that a person holding residential land as trustee of a sub-trust (trust A), where the land was transferred to them from a head trust, would have the same bright-line acquisition date for the land that the trustee of the head trust had. This treatment would apply if trust A and the head trust were both rollover trusts and if, for trust A:

- all the beneficiaries were the same as for the head trust, or
- all the natural person beneficiaries were either the same as, or close family associates of a principal settlor of, the head trust.

In other words, rollover relief would only be available if both trusts met all the usual requirements for rollover relief in section CB 6AB(5).

To qualify for rollover relief, each natural person beneficiary of trust A would have to be a close family beneficiary, or in the case of other principal settlors, each principal settlor would have to be a close family associate of the other principal settlors. At a

minimum, each natural person beneficiary of trust A would have to also be a principal settlor, or a close family associate of a principal settlor, of the head trust.

Trust A may not necessarily have the same beneficiaries as the head trust. However, provided the above conditions were met this would not preclude the resettlement from qualifying for rollover relief. For example, if an additional generation is added to trust A's beneficiaries, rollover relief would still be available if the close family beneficiary requirements were satisfied.

Rollover relief would also apply even if the principal settlor of the head trust is deceased.

Example 39: Resettlement of family trust

Dr X is the principal settlor and a beneficiary of his family trust, which meets the definition of a "rollover trust" in proposed new section CB 6AB(5).

In April 2021, the trustee of the trust resettles the trust property, which includes residential land on a new family trust.

The beneficiaries of the new family trust include relatives of Dr X within four degrees of blood relationship and their spouses, as well as a couple of registered charities. Aside from Dr X, the new trust has one other principal settlor, Dr X's wife, Mrs X, who is also a beneficiary of the trust.

Because the new trust would meet the requirements of the proposed amendments to sections CB 6AB(5)(b) to (d), including that all principal settlors (including Dr X) are close family associates and all beneficiaries are close family beneficiaries as defined in proposed section CB 6AB(6), and the transfer to the new trust at nil consideration is for less than the cost of the land to the trustee of the head trust, the transfer of the residential land from the head trust to the new trust would qualify for full rollover relief. This means that the trustee of the head trust would be treated as disposing of the land at cost, meaning that their net income arising under the bright-line test would be zero, and the trustees of the new trust would be deemed to have the same bright-line acquisition date and cost base for the land as the trustee of the head trust.

Proposed new section CB 6AC(1)(b) would similarly provide rollover relief for resettlements of Māori rollover trusts.

It is proposed to amend the definition of "Māori rollover trust" in section CB 6AC(4) so that it would mean, at the time of a relevant transfer:

- all beneficiaries of the trust are either members of the same iwi or hapū, or descendants of the same tipuna (living or dead), and
- the land is subject to Te Ture Whenua Māori Act 1993.

Provided that the head trust and sub-trust (trust A) have the same beneficiaries and are both Māori rollover trusts, rollover relief would apply under section CB 6AC(1)(b) if, for each of the trusts, the trustee is a Māori authority or is eligible to be one (see the definition of "Māori trustee" in section CB 6AC(5)). As with the rule for general family trusts above, this would include the situation where one of the settlors of the head trust is deceased.

Transfers to self but in a different capacity and transfers involving multiple legal structures (sections CB 6AB(3) and (4), CB 6AC(3) and (4))

Section CB 6AB provides rollover relief for transfers of residential land or DRP to trusts, partnerships and look-through companies (LTCs), as well as transfers out of

these structures to the land's original owner. For example, rollover relief is provided for the transfer of residential land held on family trust back to the original settlor. Rollover relief is also provided if that person then decides to transfer the land to an LTC of which they are the sole shareholder. For efficiency, it makes sense to provide rollover relief where the same result is achieved in one transaction, rather than two.

Existing section CB 6AB(3) accordingly provides rollover relief for such composite transfers, as does section CB 6AC(3) for composite transfers involving family trusts that are Māori authorities or are eligible to be Māori authorities. The rules provide rollover relief where the original owner receives the residential land from the legal structure but in a different capacity, for example, if the settlor of a family trust receives the land from the trust in their capacity as a shareholder of an LTC. However, these provisions contain some wording errors and ambiguous phrasing, and as a result the meaning and intention of these provisions is not clear.

Existing section CB 6AB(4) provides rollover relief if a person transfers residential land or DRP to themselves in a different capacity (such as a shareholder in an LTC or a partner in a partnership) and there is no intervening transfer to a third party. Similarly, this provision also contains some wording inaccuracies.

Therefore, the following amendments are proposed to clarify the effect and intention of these provisions:

- Redrafting sections CB 6AB(3) and CB 6AC(3) so that the proportionality and capacity rules are in separate provisions, rather than being combined into a single provision as at present. The proportionality rule²⁰ is proposed to be shifted to sections CB 6AB(2) and CB 6AC(2), while the capacity rule is proposed to remain in sections CB 6AB(3) and CB 6AC(3), albeit in a revised form. The latter amendment would remove the references to a person having a capacity "other than settlor or original settlor" in favour of stating that the transferors or transferees (as applicable) may have a different capacity for the purposes of subsections (1)(a) and (2) from the one in which they became a settlor of the trust.
- Removing the requirement in section CB 6AB(4) that the transfer "must not be to or from a person in their capacity of settlor, beneficiary or trustee". This wording was originally inserted with the aim of making it clear that either section CB 6AB(3) or CB 6AC(3) is the relevant rollover provision that applies when land is transferred from a trustee of a family trust to the original settlors' LTC or partnership (or to the LTC owners or partners in the instance when it was the LTC or the partnership that originally transferred the land to the family trust), but the chosen wording was imprecise and caused confusion.

Definition of "close family beneficiary" (section CB 6AB(6))

Amendments are proposed to the definition of "close family beneficiary" in section CB 6AB(6) as follows:

- Adding a new paragraph (ab) so that the definition would include a trustee of another trust if at least one beneficiary of the other trust is a close family associate of a beneficiary of the relevant trust. The words "or trustees of another trust and at least one beneficiary of the other trust is a close family beneficiary of the relevant trust" in section CB 6AB(5)(d) would be deleted.
- Expanding the scope of paragraph (c) so that it would include a company in which a 50 percent or more voting interest – or a 50 percent or more market value interest, if a market value circumstance exists – is owned by a beneficiary that is a

²⁰ Basically, the rule is that when land is transferred from a family trust back to a group of settlors who originally transferred the land to the trust, the settlors should acquire proportionally the same amount of land they each held before it was transferred to the trust.

principal settlor (see new subparagraph (i)). This would be in addition to the existing inclusion of a company in which a 50 percent or more voting interest (or market value interest) is owned by a beneficiary that is a close family associate of another beneficiary that is a principal settlor (now contained in subparagraph (ii)).

Māori family trusts rollover relief (section CB 6AC(5))

Section CB 6AC provides rollover relief for transfers of land subject to Te Ture Whenua Māori Act 1993 to or from a trust that is either a Māori authority or eligible to be a Māori authority, and where all beneficiaries are members of the same iwi or hapū or are descendants of the same tipuna. This is intended to mirror the general family trust rollover rule while recognising that Māori family trusts may be structured differently.

The policy intent is that rollover relief should be available regardless of the reason why the trustee is a Māori authority or eligible to be one. However, the current provision is restricted to situations where the trustee is (or is eligible to be) a Māori authority who, on behalf of Māori claimants, receives and manages assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi. This is because the existing section CB 6AC(5) specifically refers to a trustee of a trust that is either a Māori authority, or eligible to elect to be a Māori authority, under section HF 2(3)(e)(i).²¹

This restriction is not necessary because another section provides rollover relief for Treaty of Waitangi settlements. Accordingly, an amendment is proposed to section CB 6AC(5) to delete the cross-reference to section HF 2(3)(e)(i) so that the provision would apply to any trust that is eligible to elect to be a Māori authority.

Relevant bright-line period (section CB 6A(1AB)(b))

When a transfer of residential land is eligible for rollover relief, the intent is that the bright-line period does not reset. This includes both the start date of the bright-line period (that is, when the “clock” runs from) and which bright-line test applies (for example, the five-year or ten-year test). The start date of the bright-line period is determined by the date on which legal title was transferred, whereas which bright-line test applies is determined by the date of acquisition (generally when a person enters into the agreement to purchase a property).

The current wording of the legislation provides that, when rollover relief applies, the recipient only takes on the original owner’s bright-line start date, not the underlying acquisition date.²² This means that, while the start date does not reset, the recipient becomes subject to a ten-year bright-line period if the transfer is made on or after 27 March 2021. For example, a property acquired in 2016 would have been subject to the two-year test and could have been disposed of without tax under the bright-line test from 2018 onwards. However, if a transfer eligible for rollover relief occurs in 2022, the recipient would become subject to the ten-year bright-line test and would need to retain the property until 2026 to be able to dispose of the property without tax under the bright-line test.

This is not the policy intent, and so the Bill would insert new section CB 6A(1AB)(b) to ensure that the recipient would also take on the relevant bright-line test length and other settings – including where no bright-line test applies because the land was originally acquired before 1 October 2015.

²¹ Section HF 2(3) sets out the circumstances in which the trustees of a trust are eligible to make an election to become a Māori authority. Paragraph (e)(i) of that section applies to the trustees of a trust who, on behalf of Māori claimants, receive and manage assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi.

²² See sections CB 6AB(1), (2), (4), CB 6AC(1), (2), CB 6AE(1) and FB 3A(3).

Proposed new section CB 6A(1AB)(b) would provide that the ten-year bright-line test (section CB 6A) would not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, CB 6AC or CB 6AE and the transferor first acquired an estate or interest in the land before 27 March 2021.

Example 40: Land purchased before 27 March 2021 and sold to owners' LTC after 27 March 2021

Geoff and his wife, Tate, purchase residential land in their own names for \$670,000 on 6 May 2018, each of them holding a 50 percent share of the land. On 17 July 2023, they sell the land to a look-through company, A Co, that they jointly own 50:50, for \$950,000. The market value of the land at that time is \$1.12 million.

Geoff and Tate are subject to the five-year bright-line test for the land, but because they held the land for five years before selling it to A Co, there is no tax liability under the bright-line test.

Under the proposed amendments, partial relief would apply to the sale to A Co, meaning that A Co would take on Geoff and Tate's original acquisition date of 6 May 2018 but not their acquisition cost of \$670,000. A Co's cost base would instead be the amount of consideration it provided, being \$950,000. A Co would also be subject to the five-year bright-line test for the land, being the bright-line test period that Geoff and Tate were subject to.

CHANGES IN CO-OWNERSHIP OF RESIDENTIAL LAND

Clauses 6(1), (3) to (6) and 32(1) to (4)

Summary of proposed amendment

The proposed amendments would clarify the application and effect of sections CB 6A(5B) and (5C), and CZ 39(5B) and (5C) of the Income Tax Act 2007 (ITA), which concern changes in co-ownership of residential land. A further amendment would clarify which bright-line test applies to shares in residential land that a person acquires at different times.

Effective date

The proposed amendments to section CB 6A would take effect on 27 March 2021. The proposed amendments to section CZ 39 would take effect on 29 March 2018.

Background

The bright-line test provides that income from the disposal of residential land is taxable when the disposal is within 10 years of the instrument of title being registered under the Land Transfer Act 2017.²³

The bright-line test was originally introduced as a two-year test. The two-year bright-line period applied for residential land acquired on or after 1 October 2015 and up to 28 March 2018. A five-year test applies for residential land acquired on or after 29 March 2018 and up to 26 March 2021, and the 10-year bright-line test applies to residential land acquired on or after 27 March 2021.

When there is a change to the shares that co-owners have in residential land, or where a co-owner is added or removed, the disposal of the share that changes hands may be subject to tax under the bright-line test. The start of the bright-line period should reset only for the ownership share that has changed hands. Similarly, when a joint tenancy is converted to a tenancy in common or vice versa, the start of the bright-line period should only reset to the extent that the co-owners' proportional ownership shares (or nominal shares) in the land have changed. Provisions to clarify this were included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, but they contain a number of wording inaccuracies and ambiguities.

There is also a transitional issue relating to which bright-line test applies and whether different tests apply to shares a person acquires at different times. The application provisions for the earlier two-year and five-year tests provide that they apply when someone first acquires an interest in residential land on or after 1 October 2015 and 29 March 2018 respectively. However, the application provision for the 10-year test omits the word "first".

Key features

The following remedial amendments are proposed to the bright-line rules in sections CB 6A and CZ 39:

- In the provisions concerning changes to the form of co-ownership of residential land, it is proposed that references to a joint tenancy or tenancy in common being

²³ In some cases, a different start date may apply.

“acquired” be amended to refer to the form of tenancy being “converted”. This would better reflect that the provision is concerned with changes to the form of co-ownership rather than the acquisition of land.

- Proposed amendments would clarify that, when a person disposes of land, the bright-line test length and associated settings that will apply depend on when the person first acquired an interest in the land. If they acquired an interest in residential land before 27 March 2021 and then acquired an additional interest or share in the land after that date, when the land is sold it will all fall into the bright-line test length (and associated settings) that applied at the time they acquired their first interest in the land being sold.

Detailed analysis

Changes in the form of co-ownership (sections CB 6A(5B), (5C), CZ 39(5B) and (5C))

Under a joint tenancy, co-owners do not have defined shares in the property. However, when considering how the bright-line test applies to conversions between joint tenancy and tenancy in common, joint tenants are seen as equal co-owners. For example, for two co-owners of a property held under a joint tenancy, each co-owner is considered to hold a notional 50 percent, and for four co-owners, each is considered to hold a notional 25 percent.

While the registration of a transfer instrument to effect a change in the **form** of co-ownership of land should not be considered a disposal for the bright-line test, registration of a transfer instrument under the Land Transfer Act 2017 sets the start date of the bright-line period.²⁴ As such, a question arose as to whether the registration of a transfer instrument to change the form of co-ownership of a parcel of land would reset the bright-line “clock”, meaning the bright-line period would start again from that point.

New sections CB 6A(5B) and (5C), and CZ 39(5B) and (5C) of the ITA were introduced by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to clarify that the bright-line clock is not reset when a transfer instrument is registered to effect a change in the form of co-ownership of land to the extent the economic ownership of the land has not changed.

Sections CB 6A(5B) and CZ 39(5B) apply when a joint tenancy is converted to a tenancy in common, while sections CB 6A(5C) and CZ 39(5C) apply in the reverse situation when a tenancy in common is converted to a joint tenancy. The intent of these provisions is to provide that the bright-line acquisition date of residential land held under a tenancy in common or joint tenancy is not impacted by a change to a different form of co-ownership. However, the existing provisions state that the bright-line acquisition date is the date the joint tenancy²⁵ or the tenancy in common in equal shares²⁶ was “acquired”, which is not technically correct. Consistent with IS 22/03, those forms of co-ownership are not things that can be owned (and, therefore, acquired), so it is more accurate to refer to the date the form of co-ownership is changed. Amendments are therefore proposed to replace the references to the date the tenancy was “acquired” with references to the date the tenancy was “converted”.

²⁴ For further information, see IS 22/03 “Income Tax – Application of the land sale rules to co-ownership changes and changes of trustees” available at <https://www.taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-03>.

²⁵ In the case of a conversion from a joint tenancy to a tenancy in common – see existing section CB 6A(5B).

²⁶ In the case of a conversion from a tenancy in common to a joint tenancy – see existing section CB 6A(5C).

The provisions also refer to the bright-line acquisition date (which is when the bright-line "clock" runs from) being the date the tenancy in common or joint tenancy (as appropriate) was acquired. However, the date the bright-line clock should run from is whatever date it ran from before the change to the form of co-ownership. This will typically be the date the land was originally transferred to the co-owners, not the date the land was originally "acquired" (which is typically when a sale and purchase agreement was entered into).

Conversion from joint tenancy to tenancy in common

Proposed new section CB 6A(5B) would provide that, when a joint tenancy is converted to a tenancy in common, the bright-line acquisition date for the definitions of "10-year test land" and "5-year test land" is the same as it was before the conversion.

For the five-year bright-line test (which applies to disposals of residential land first acquired on or after 29 March 2018), proposed new section CZ 39(5B) would provide that when a joint tenancy is converted to a tenancy in common, an amount that a person derives from disposing of the land is income of the person if the disposal date is within five years of the date that was the person's bright-line acquisition date for the land before the conversion.

Example 41: Change from a joint tenancy to a tenancy in common

Tony and Greta started a relationship in 2015. Both have children from previous relationships. In 2019, Tony and Greta purchased a rental property together as joint tenants. Two years later, they decide that, in the event of one of them dying, they want the share of the partner who dies to go to that partner's children. In June 2021, LINZ registered their land transfer to change their ownership of the property from a joint tenancy to a tenancy in common (50:50).

For the bright-line test to apply, there must have been a disposal of residential land by Tony and/or Greta. In this case, there has not been a disposal of land by either of them.

Tony and Greta own the same land (the estate in fee simple) before and after the transfer. Before the transfer, they each had an interest in the whole of the property and a notional equal separate share (that is, 50 percent) they had the right to sever during their lifetime. After the transfer, they each still have an interest in the whole of the property, and they each now have a present entitlement to a 50 percent share. No land has passed from one party to another.

Under the proposed amendments, the bright-line acquisition date is **not** reset in June 2021 when LINZ registered the transfer to change the form of co-ownership of the property. Tony and Greta's bright-line period still starts on the date in 2019 when the property was originally transferred to Tony and Greta.

Conversion from tenancy in common to joint tenancy

Proposed new section CB 6A(5C) would provide that, when a tenancy in common is converted to a joint tenancy, the bright-line acquisition date for the definitions of "10-year test land" and "5-year test land" is the same as it was before the conversion.

For the five-year bright-line test, proposed new section CZ 39(5C) would provide that when a tenancy in common is converted to a joint tenancy, an amount that a person derives from disposing of the land is income of the person if the disposal date is within five years of the date that was the person's bright-line acquisition date for the land before the conversion.

Relevant bright-line period (section CB 6A(1AB)(a))

Proposed new section CB 6A(1AB)(a) would provide that the 10-year bright-line test (section CB 6A) does not apply to land if the person first acquired an estate or interest in the land before 27 March 2021. This would ensure that, when a person acquires a part share in residential land before 27 March 2021 and subsequently acquires an additional share in the same land on or after 27 March 2021, when the land is sold it will all fall into the bright-line test length and associated settings that applied at the time they acquired their first interest in the land.

Example 42: Part share acquired in 2018 and additional share acquired in December 2021

In July 2018, Sarah and Hans bought a rental property as 50:50 owners. Sarah's financial position changes in 2021, and so she asks Hans if he is interested in buying out her share of the property. He is keen to do this, so he buys Sarah's 50 percent share at market value. LINZ registers the transfer in December 2021, and the register shows that the land is now held solely by Hans. This means that, for the bright-line test, Sarah has disposed of a 50 percent share in the land. The amount that Sarah sold the 50 percent share to Hans for is income to Sarah under the bright-line test, as the disposal was within the relevant bright-line period (five years). Sarah can deduct the amount she paid for her original 50 percent share of the property.

Under the proposed amendments, when Hans eventually sells the rental property, it would be subject to the five-year bright line test – being the relevant bright-line test that applies if the owner *first* acquired an estate or interest in the residential land between (and including) 29 March 2018 and 26 March 2021. Note, however, that Hans has a July 2018 bright-line acquisition date for 50 percent of the land but a December 2021 bright-line acquisition date for the 50 percent share acquired that month. Therefore, if Hans sells the rental property before the relevant date in December 2026, 50 percent of the amount from the sale would be income under the bright-line test.

UPDATES TO DEFINITIONS USED FOR INTEREST LIMITATION RULES AND THE BRIGHT-LINE TEST

Clauses 9, 35, 98(4) and (18)

Summary of proposed amendments

The proposed amendments would update the definitions of “business premises”, “principal settlor” and “settlement”, which are used for the bright-line test and the interest limitation rules.

Effective date

The proposed amendments would take effect on 27 March 2021.

Background

The Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 and the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 introduced several changes to the way residential property is taxed in New Zealand. This included changes to the bright-line test and the introduction of the interest limitation rules.

Many existing defined terms were used, but in some situations the corresponding definitions were not updated. In addition, when a term is used for more than one regime, it is considered appropriate to define the term in section YA 1 of the Income Tax Act 2007 (ITA) rather than within the regime for which it was first used.

Key features

The proposed amendments would update the following defined terms to better reflect their relevance for the interest limitation rules and bright-line test:

- business premises,
- principal settlor, and
- settlement

Detailed analysis

Business premises

The interest limitation rules in subpart DH of the ITA do not apply to the extent disallowed residential property is used as business premises. However, the section YA 1 definition of “business premises” states it “is defined in section DD 11 (Some definitions) for the purposes of subpart DD (Entertainment expenditure) and the land sales provisions”. “Land sales provisions” is defined in section EL 3 only for the purposes of subpart EL and comprises sections CB 6A to CB 15 and CZ 39.

The Bill proposes to repeal the definition of “business premises” in section DD 11 and move the substantive definition to section YA 1. The proposed updated definition in section YA 1 would apply for the purposes of subpart DD and DH, as well as sections CB 6A to CB 15 and CZ 39.

Principal settlor

The term “principal settlor” is relevant when determining whether rollover relief is available for the interest limitation rules and the bright-line test in certain family trust situations. It is also used to determine whether the main home exception applies for the bright-line test and interest limitation rules.

Before the enactment of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, “principal settlor” was defined in section CB 16A(7) and applied for the purposes of section CB 16A, section CZ 40, and subpart EL. The section YA 1 definition of “principal settlor” previously simply referred back to section CB 16A(7).

To account for the broader application of the term, the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 replicated the section CB 16A(7) definition in section YA 1. However, the now redundant definition in section CB 16A(7) was not repealed.

Therefore, the Bill proposes to repeal the definition of “principal settlor” in section CB 16A(7).

Settlement

“Settlement” is defined in section YA 1. Paragraph (c) of that definition provides a specific definition of “settlement” for the definition of “principal settlor” in section CB 16A(7).

In line with the proposed repeal of the definition of “principal settlor” in section CB 16A(7), the Bill proposes to remove this reference to section CB 16A(7) in the definition of “settlement”. Paragraph (c) of the definition of “settlement” would continue to apply for the definition of “principal settlor” as defined in section YA 1.

INTERPOSED ENTITIES: PROPERTY EXCLUDED FROM CALCULATION OF INTERPOSED RESIDENTIAL PROPERTY PERCENTAGE

Clause 39(1)

Summary of proposed amendment

The proposed amendment would ensure that all disallowed residential property (DRP) that is excluded from the interest limitation rules is also excluded from the calculation of the interposed residential property (IRP) percentage of an interposed residential property holder (IRPH).

Effective date

The proposed amendment would take effect on 27 March 2021.

Background

The interposed entity rules support the integrity of the interest limitation rules in subpart DH of the Income Tax Act 2007. The rules deny interest deductions for taxpayers who indirectly hold DRP through an IRPH and borrow money to acquire ownership interests in, or become a beneficiary of, the IRPH. An IRPH is a company or trust that has DRP as a percentage of its total assets that exceeds a specified percentage. The rules deny interest deductions for a person based on the IRP percentage of the IRPH.

Section DH 6 contains the rules for calculating the IRP percentage of an IRPH. Section DH 6(1) sets out the following formula to calculate the IRP percentage:

disqualified assets ÷ total assets.

Section DH 6(2) defines the items used in the formula. Section DH 6(2)(a) provides that "disqualified assets" is the value of the IRPH's DRP. Section DH 6(2)(a)(i) excludes from "disqualified assets" property described in sections DH 4(1) to (3).

Sections DH 4(1) to (5) provide subpart DH does not apply to interest incurred in relation to the land described in those sections, and section DH 4(6) provides that subpart DH does not apply to Kāinga Ora—Homes and Communities and its wholly-owned subsidiaries.

However, while property described in sections DH 4(1) to (3) is expressly excluded from "disqualified assets" in section DH 6, property described in sections DH 4(4) to (6) is not. As a result, under current law taxpayers who borrow money to acquire such property through an IRPH will be denied deductions for interest on the borrowed money. This result was unintended, and the proposed amendment rectifies this.

Key features

The proposed amendment excludes all DRP described in section DH 4 from the definition of "disqualified assets" in section DH 6.

This would ensure that DRP that is subject to an exemption is not treated as a "disqualified asset".

INTERPOSED ENTITIES: WHEN DRP IS A MIXED-USE ASSET

Clause 39(2)

Summary of proposed amendment

The proposed amendment would ensure the interposed entity rules apply where disallowed residential property (DRP) is held through a close company by providing that property that is DRP and a mixed-use asset (MuA) is not excluded from the definition of “disqualified assets”.

Effective date

The proposed amendment would take effect on 27 March 2021.

Background

The interposed entity rules support the integrity of the interest limitation rules in subpart DH of the Income Tax Act 2007. They deny interest deductions for taxpayers who indirectly hold DRP through interposed residential property holders (IRPHs) and borrow money to acquire ownership interests in such entities. They work by denying interest deductions based on an IRPH’s interposed residential property (IRP) percentage.

The MuA rules in subpart DG deal with the deductibility and apportionment of expenditure incurred in relation to specified types of assets that are used partly for income-earning purposes, partly for private purposes, and not at all for at least 62 days in an income year. This means that DRP, such as a holiday home, can be a MuA.

Section DH 6 contains the rules for calculating the IRP percentage of an IRPH. Section DH 6(1) sets out the following formula to calculate the IRP percentage:

disqualified assets ÷ total assets.

Section DH 6(2) defines the items used in the formula. Section DH 6(2)(a) provides that “disqualified assets” is the value of the IRPH’s DRP. Section DH 6(2)(a)(ii) excludes property that is subject to subpart DG from “disqualified assets”.

The effect of the exclusion in section DH 6(2)(a)(ii) is that a close company that holds DRP that is a MuA may not be an IRPH. This would occur if, for example, a person borrows to acquire shares in a close company that only holds a holiday home, and that holiday home is used for private purposes and to earn income (and is not used for at least 62 days in an income year). In such a case, the MuA rules would allow an apportioned interest deduction based on the time that the holiday home is used to earn income. This result was unintended. The policy intent is that the interest deduction should be fully denied under the interest limitation rules.

The proposed amendment would rectify this.

DENIAL OF DEDUCTIONS ON FOREIGN CURRENCY LOANS

Clause 41

Summary of proposed amendment

The proposed amendment would repeal section DH 9 of the Income Tax Act 2007, which is redundant.

Effective date

The proposed amendment would take effect on 27 March 2021, the date the provision originally applied from.

Background

Section DH 9 currently overrides sections DH 8(2) and (3) to deny all interest deductions on foreign currency loans in two situations.

Phasing out of deductions

Interest on a loan to fund disallowed residential property is denied a deduction under section DH 8(1). However, if the interest is grandparented residential interest, the interest deductions are phased out under section DH 8(2). Section DH 9 provides that, despite section DH 8(2), deductions are denied for all interest on foreign currency loans. This was to ensure that phased-out deductions are not available for foreign currency loans due to the impact of fluctuations in foreign currency rates during the phasing-out period. However, foreign currency loans are already excluded from the application of section DH 8(2) because they cannot generate grandparented residential interest.

Under section DH 5(5) a "grandparented transitional loan means loan amounts denominated in New Zealand dollars...". As a foreign currency loan cannot be denominated in New Zealand dollars, it cannot be a grandparented transitional loan and cannot generate grandparented residential interest. Therefore, the phasing out of deductions in section DH 8(2) cannot apply to a foreign currency loan. It is therefore unnecessary for section DH 9 to override section DH 8(2).

Interposed close companies

Deductions are also denied for interest incurred to acquire an interest in a close company that is an interposed residential property holder. The formula in section DH 8(3) denies a portion of interest incurred by the shareholder in proportion to the amount of disallowed residential property held by the interposed residential property holder. There is no reason for section DH 9 to override this apportionment for a foreign currency loan.

Section DH 9 is therefore redundant. The proposed amendment would repeal section DH 9.

MIXED-USE ASSET RULES: APPORTIONMENT OF INTEREST FOR DRP

Clauses 37 and 38

Summary of proposed amendments

The proposed amendments would correct a minor drafting error to ensure that interest incurred by a person, including a close company, on disallowed residential property (DRP) that is a mixed-use asset (MuA) is apportioned, separately from any other expenditure, under the formula in section DG 9(2) of the Income Tax Act 2007 (ITA).

Effective date

The proposed amendments would take effect on 27 March 2021.

Background

The MuA rules are in subpart DG of the ITA and apply to natural persons and to close companies. Under the rules, interest incurred by natural persons for a MuA is apportioned between income-earning use, private use, and no use, using the formula in section DG 9(2). Interest incurred by close companies is apportioned under the applicable formula in section DG 11. The rules allow a deduction for the interest apportioned to income-earning use.

The policy intent is that interest incurred by a close company for DRP that is a MuA is to be apportioned using the formula in section DG 9(2) and subject to the interest limitation rules in subpart DH.

The legislation does not currently achieve this intent because interest incurred by a close company for DRP that is a MuA is not subject to the MuA rules. This is because, when the interest limitation rules were enacted, interest incurred by a close company for DRP that is a MuA was removed from apportionment under the applicable formula in section DG 11 and no provision was included for such interest to be apportioned using the formula in section DG 9(2).

The current legislation is also not clear that interest incurred for DRP that is a MuA is to be apportioned separately from other expenditure under the formula in section DG 9(2). This is because the definition of the item "expenditure" in section DG 9(3)(a) aggregates all expenditure. Separate apportionment is required because if the apportioned interest is denied under section DH 8, it may be allowed under section DH 11 on the disposal of the DRP that is a MuA if the amount derived is taxable income.

Key features

The proposed amendments would insert new section DG 5(2)(d) and amend existing section DG 11(1)(b) to ensure that a person (being a natural person or a close company) must apportion interest for DRP that is a MuA using the formula in section DG 9(2) and must treat that interest as the item "expenditure" in section DG 9(3)(a).

PARTITIONING OF LAND AMONG CO-OWNERS

Clause 98(6)

Summary of proposed amendment

The proposed amendment would ensure that the allocation of subdivided land among the co-owners of the original undivided land does not constitute a disposal for the land sales provisions.

Effective date

The proposed amendment would have effect for partitions occurring on or after 27 March 2021.

For partitions occurring before 27 March 2021, Inland Revenue would not apply resources to identify non-compliance based on the current law interpretation.

Background

Taxpayers sometimes purchase land together as co-owners to pool resources. It is not uncommon in this situation for the co-owners to then subdivide the land and allocate the subdivided parcels to each of the co-owners based on their ownership interests in the original parcel. This is known as partitioning.

Inland Revenue's Tax Counsel Office (TCO) consulted on a draft Interpretation Statement in 2021 that stated that the partitioning of land among co-owners constitutes a disposal under the bright-line test and other land sales provisions.²⁷

Section GC 1 of the Income Tax Act 2007 (ITA) deems the partitioning to occur at market value.

An income tax liability can therefore arise on partitioning even where there is no effective change in economic ownership or where the person will not be taxed on the eventual sale of the property (for example, because it is their main home, or they hold the property for longer than the bright-line period).

Example 43: Subdivided land allocated among co-owners – outcome under current law

Gordon and Elena buy a parcel of residential land as 50:50 co-owners to subdivide into two equal parcels.

The bright-line acquisition date of this parcel of land is 23 July 2022.

The subdivision occurs on 30 November 2022, with Gordon and Elena showing as 50:50 co-owners on each title. When the land is subdivided, Gordon and Elena each legally own 50% of the two parcels.

Together they build two houses, one on each parcel, and split the costs accordingly. On 5 July 2023, one parcel is transferred to Gordon and the other to

²⁷ PUB00411, "Income tax – Application of the land sale rules to changes to co-ownership, subdivisions, and changes of trustees". The draft has now been finalised as IS 22/03, "Income Tax – Application of the land sale rules to co-ownership changes and changes of trustees".

Elena. Gordon uses the property as his main home, while Elena rents her property out.

On 5 July 2023 when one parcel is allocated to Gordon, Elena has legally disposed of her 50% interest in that parcel to Gordon. When the other parcel is allocated to Elena, Gordon has legally disposed of his 50% interest in that parcel to Elena.

There is no payment between Elena and Gordon for this allocation because the values of the allocated properties align with their ownership of the original parcel of land and the construction costs were split accordingly.

The properties are valued at \$1 million each at the time the partition occurs.

The disposals on 5 July 2023 are taxed under the bright-line test at market value. Before costs are deducted, Gordon's bright-line income is \$500,000 (arising from his disposal of his 50% share in Elena's allocated property, i.e. 50% of \$1 million). Elena's bright-line income is \$500,000 (arising from her disposal of her 50% share in Gordon's allocated property, i.e. 50% of \$1 million). The main home exclusion does not apply because Gordon did not use Elena's allocated property as his main home and Elena did not use Gordon's allocated property as her main home.

For taxpayers on revenue account who are also taxed on the eventual disposal of the land, the current law interpretation means there are two taxing points – the partition or allocation, and the final sale. While section GC 1 of the ITA provides an uplift in the cost base to ensure there is no double taxation of the same income, taxpayers may face additional compliance costs and timing issues if the partition and eventual sale occur in different income years.

Key features

The proposed amendment to the definition of "dispose" in section YA 1 of the ITA would exclude the allocation of subdivided land among co-owners from being a disposal for sections CB 6A to CB 16, CB 18, CB 19, CB 21, CB 22, CZ 39 and subpart EL of the ITA.

This exclusion would apply to the extent that the value of the allocated properties under the partition aligns with the co-owners' interests in the original undivided parcel of land and contributions to development and construction costs. Any difference in these proportions (including any wash-up payments between the parties) would continue to be subject to income tax where applicable, as this difference would represent an economic change in ownership and actual disposal.

Detailed analysis

Proposed new paragraph (ab) in the definition of "dispose" in section YA 1 of the ITA would exclude the allocation of subdivided properties among co-owners from being a disposal for sections CB 6A to CB 16, CB 18, CB 19, CB 21, CB 22, CZ 39 and subpart EL of the ITA. These sections comprise the bright-line test and other land sales provisions, as well as the corresponding residential, business and farmland exclusions.

The type of subdivision is irrelevant. For example, the proposed amendment would apply to fee simple subdivisions as well as unit titles issued under the Unit Titles Act 2010.

Sections CB 6A(4) and CZ 39(3) would continue to apply so that, where the bright-line test applies, the relevant bright-line test acquisition date(s) for the allocated

subdivided parcels should be the bright-line acquisition date for the original undivided parcel of land.

The proposed amendments would apply for those who hold their land on capital account (and would therefore only pay income tax under the bright-line test if they sell within the relevant bright-line period) as well as those who hold their land on revenue account (for example, because they acquired the land with a purpose or intent of disposal or have a business of developing land).

Example 44: Subdivided land allocated among co-owners

Assume the same facts as in example 43. Under the proposed amendments, the allocation of the two properties on 5 July 2023 would not constitute a disposal, and Gordon's and Elena's respective bright-line acquisition dates would both be 23 July 2022 (that is, the bright-line acquisition date of the original undivided parcel).

Elena enters into an agreement to sell her property on 7 March 2028. The new build bright-line test applies, so Elena needs to consider whether the agreement to sell is within five years of her bright-line acquisition date. As 7 March 2028 is not within five years of 23 July 2022, Elena's disposal is not subject to income tax under the bright-line test.

Gordon enters into an agreement to sell his property on 28 November 2028. The disposal is not taxed under the bright-line test because Gordon used the property as his main home for the whole period he owned it.

Proposed new paragraph (ab) of the definition of "dispose" would only apply to the extent the transfer results in the same proportionate economic ownership as before the transfer or other change of ownership. This requirement is not based on land area. Rather, it would consider the market values of the allocated properties and compare these to the ownership of the original undivided land and the co-owners' contributions to development and construction costs.

If there is a difference in how the divided properties are allocated, this difference would continue to be subject to income tax where applicable. This is because this difference in values represents a change in economic ownership and an effective disposal for at least one party.

Example 45: Unequal allocation of subdivided properties

Ash and Larna are 50:50 co-owners of a parcel of residential land. They subdivide the land into two parcels and build a house on each parcel.

One property is allocated to Ash and the other to Larna. At the time of the allocation, the property allocated to Ash is worth \$600,000, while the property allocated to Larna is worth \$400,000.

The proposed amendment applies to the extent there is no change in Ash and Larna's relative interests before and after the allocation. Larna had a 50% ownership interest before the allocation but, based on the market value of the properties at the time of the allocation, her equivalent ownership interest is now 40% (being $\$400,000 / (\$600,000 + \$400,000)$).

At the time of the allocation, Larna is therefore considered to have disposed of \$100,000 of residential land, which Ash has acquired.

RING-FENCED RESIDENTIAL RENTAL LOSSES WHEN A TAX DEBT IS WRITTEN OFF

Clauses 162(2) and 179

Summary of proposed amendments

The proposed amendments would enable the Commissioner of Inland Revenue to extinguish excess deductions ring-fenced under subpart EL of the Income Tax Act 2007 (ITA) when a taxpayer's tax debt is written off.

Effective date

The proposed amendment would have effect for tax debts written off on or after 1 April 2023. This would apply even if the ring-fenced residential rental loss relates to a previous income year.

Background

Section 177C(5) of the Tax Administration Act 1994 (TAA) requires the Commissioner to extinguish a taxpayer's tax loss if a tax debt is written off. This ensures that taxpayers are not able to "double dip" and benefit from having a tax debt written off while still being able to use any accrued losses in the future.

The residential rental loss ring-fencing rules have been in effect since the 2019–20 income year. Under section EL 4 of the ITA, deductions relating to residential rental property cannot exceed a person's residential rental income for the year. Any excess amount is effectively ring-fenced and cannot be offset against other non-residential property income that year (for example, salary and wages). The excess amount is carried forward to a later year when the person derives residential income.

"Tax loss" is undefined in the TAA, but it is defined in the ITA with reference to section IA 2(1) of the ITA. There is uncertainty around whether section EL 4 excess deductions form part of a taxpayer's tax loss and can therefore be extinguished when they have a tax debt written off.

Key features

Proposed new section 177C(5BA) of the TAA would clarify that the Commissioner must extinguish a taxpayer's ring-fenced residential rental losses (excess deductions under section EL 4 of the ITA) when he writes off a taxpayer's tax debt. The amount extinguished would be limited to the amount of the tax debt written off, taking into account the tax value of the ring-fenced residential rental losses using a 33% rate for non-companies and 28% for companies.

If, in addition to ring-fenced residential rental losses, a taxpayer also has a tax loss and/or a tax credit carried forward under section LE 3 of the ITA, the proposed amendment to section 177C(5C) would provide that the tax loss must be extinguished first, followed by the ring-fenced residential rental losses, and then finally, the tax credit.

Section 89C of the TAA requires the Commissioner to issue a notice of proposed adjustment (NOPA) when making an assessment unless a specific exception applies. In line with existing section 89C(lb), which provides that a NOPA is not required when a tax loss is extinguished under section 177C(5), proposed new section 89C(lbb) would provide a similar exception for ring-fenced residential rental losses.

Foreign trust remedial items

ALIGNING THE FOREIGN-SOURCED INCOME EXEMPTION WITH THE FOREIGN TRUST DISCLOSURE RULES

Clauses 70(1), (3) and (5), 141(4), 152(2), 153(1) to (4), 154(1), (3), (5) and (6), 155(1), (2) and (6) and 157(1), (2) and (3)(b)

Summary of proposed amendments

The proposed amendments would introduce a new definition of a “foreign exemption trust”. A foreign exemption trust would include any trust that is currently a foreign trust, but it would also include trusts where a trustee makes use of the foreign-sourced income exemption under section HC 26 of the Income Tax Act 2007 (ITA), unless there is an election under section HC 33 in effect.

The “foreign exemption trust” definition would replace the “foreign trust” definition for the purposes of applying the foreign trust disclosure obligations. This would align the foreign-sourced income exemption in the ITA with the foreign trust disclosure rules in the Tax Administration Act 1994 (TAA).

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

Since 1987, New Zealand has taxed trusts based on the settlor’s tax residence. A trust with a New Zealand resident settlor is taxed on its worldwide income. This is the case even if its trustees are non-residents: see section HC 25. Conversely, a trust that has never had a New Zealand resident settlor is only taxed on its New Zealand-sourced income, even if its trustees are residents. This is achieved through the foreign-sourced income exemption in section HC 26 of the ITA.

In 2017, the disclosure requirements for foreign trusts were substantially strengthened in response to concerns that they were being used to avoid foreign income tax. For a “foreign trust” to use the foreign-sourced income exemption, it must now comply with the foreign trust disclosure rules in sections 59B to 59D of the TAA. However, this requirement only applies to a “foreign trust”. Some trusts can use the foreign-sourced income exemption without technically being a “foreign trust” and therefore without complying with the foreign trust disclosure rules. This misalignment is contrary to the original policy intent.

Key features

The proposed amendments would correct this misalignment as follows:

- A new definition of “foreign exemption trust” would be added to denote which trustees must register and comply with the foreign trust disclosure rules. The new definition would include any trust that currently has to comply with the foreign trust disclosure rules as a “foreign trust”. However, the new definition would also include a trust for which the trustee uses, or has previously used, the foreign-sourced income exemption in section HC 26 of the ITA. An exception applies if an election under section HC 33 is effective for the trust.
- A trustee of a foreign exemption trust would not be required to apply the domestic trust disclosure rules.

Detailed analysis

A misalignment arises between the foreign trust disclosure rules and the foreign-sourced income exemption. This is because the exemption works by exempting the income of trusts that do not have a New Zealand resident settlor in a given *income year*. The exemption has always worked in this way as the ITA considers income on a yearly basis. It envisages that settlors may migrate to and from New Zealand and taxes accordingly. In contrast, the definition of “foreign trust” does not envisage settlors’ circumstances changing. A trust will only be a foreign trust if it has not had a New Zealand resident settlor since 1987, when the current tax regime for trusts was introduced.

As a result of this misalignment, some trusts can use the foreign-sourced income exemption without technically being a “foreign trust”.

For example, a trust that had a New Zealand resident settlor in a previous income year, but not in its current income year, may qualify for the foreign-sourced income exemption. This is the case even though such a trust will not technically be a “foreign trust”. It will not have to, and indeed cannot, comply with the foreign trust disclosure rules, which only apply to “foreign trusts”. Often these trusts will not have to comply with the domestic trust disclosure rules in sections 59BA and 59BAB either, as they do not have any New Zealand-sourced income.²⁸ Such trusts can therefore use New Zealand’s settlor-based trust regime to escape taxation in their home countries, without being required to disclose any information about their income to Inland Revenue. This was exactly the mischief the 2017 disclosure requirements were intended to address.

The proposed amendment would resolve this issue by creating a new definition of “foreign exemption trust” to denote which trusts should comply with the foreign trust registration and disclosure obligations. In addition to those trusts that must already comply with the disclosure rules, a “foreign exemption trust” would explicitly include any trust, whether currently a foreign trust or not, that has derived income that is, or has been, exempt under the foreign-sourced income exemption. The definition would exclude trusts for which an election under section HC 33 is in effect.

Use of the foreign-sourced income exemption

A trust that has had a New Zealand settlor at some point after 1987 is not a “foreign trust” under current law. It is proposed that such a trust would only become a “foreign exemption trust” if its trustee uses, or has previously used, the foreign-sourced income exemption. Some trustees may derive income that qualifies for the exemption, but not use it, instead making an election under section HC 33. Other trustees will not use the exemption because they derive no foreign-sourced income, even though they would qualify for the exemption if they did. Such trusts would not have to comply with the foreign trust disclosure rules. This will reduce unnecessary compliance and administration costs.

²⁸ The domestic trust disclosure rules only apply to trusts that derive assessable income” for a tax year. “Assessable income” does not include exempt income: section BD 1(5). As a result, if a trust only derives foreign income, and that income is exempt under the foreign-sourced income exemption in section HC 26, the trust will not have any assessable income.

Example 46: Trust with New Zealand rental portfolio

In 2022, Meritiana, a New Zealand resident, sets up a trust with New Zealand trustees to hold her New Zealand rental portfolio. The trustees derive assessable income and will have to comply with the domestic trust disclosure rules.

In 2026, Meritiana moves to Australia. The trustees continue to derive only New Zealand-sourced rental income so do not use the foreign-sourced income exemption. The trust therefore does not have to comply with the foreign trust disclosure rules and continues to comply with the domestic trust disclosure rules. The New Zealand tax consequences and disclosure requirements for the trust are identical to those for a purely domestic trust.

In 2030, Meritiana moves back to New Zealand. Despite Meritiana's movements, the trust never has to comply with the foreign trust disclosure rules because it never uses the foreign-sourced income exemption (and it had a New Zealand resident settlor after a settlement was first made on the trust).

A New Zealand resident trustee becomes required to register if a trust falls within the proposed "foreign exemption trust" definition. For some trustees this would be once they use the foreign-sourced income exemption.

- For trustees that have already used the exemption before the Bill receives the Royal assent, the requirement to register would be triggered on the Royal assent date. The trustee would then have until 30 April 2023 to apply for registration.
- In any other case, the requirement to register would commence on the due date for an income tax return in which the trustee first takes a tax position that foreign income of the trust is exempt under section HC 26 of the ITA.²⁹ The trustee would then have to apply for registration within 30 days.

In either of the two cases above, the trustee may be entitled to the longer grace period of 4 years 30 days if the requirements of section 59C(3) are met.

The proposed amendment would also require the trustee to provide an annual return that includes the period in which the exemption is first claimed (even if that period occurred before the requirement to register is triggered). The annual return would have to meet the requirements of section 59D of the TAA.

Example 47: Trust using the foreign-sourced income exemption

In 2022, Rory, a New Zealand resident, sets up a trust with a New Zealand corporate trustee. The trust's assets consist solely of foreign shares, which return foreign investment fund (FIF) income. The trust complies with the domestic trust disclosure rules and has a standard balance date of 31 March.

In June 2026, Rory moves to Luxembourg. For the income year ending 31 March 2027, the trust cannot use the foreign-sourced income exemption as it had a New Zealand resident settlor during the income year. Nor is it a foreign exemption trust as it has had a New Zealand resident settlor after 1987. Therefore, it must still comply with the domestic trust disclosure rules.

²⁹ The trustee may take a tax position by filing a return that only includes New Zealand-sourced income, even while it has foreign-sourced income, or by not filing a return at all when it only has foreign-sourced income.

For the income year ending 31 March 2028, the trust has no New Zealand resident settlor. It therefore uses the foreign-sourced income exemption for the 2027–28 income year. The trust has a tax agent, so the due date for its 2027–28 income tax return is 31 March 2029.

Under the proposed amendments to section 59C, the trustee would have to apply for the trust to be registered as a foreign exemption trust within 30 days of 31 March 2029.

Under the proposed amendments to section 59D, the trustee would have to provide an annual return for the period 1 April 2027 to 31 March 2028, being the first year in which the exemption is claimed. This return would have to be provided at the same time that the trustee applied for registration.

The new “foreign exemption trust” definition would replace the current “foreign trust” definition only for the purposes of applying the foreign trust disclosure rules. A trust that is registered as a “foreign trust” under current law would be treated as already being registered as a “foreign exemption trust” and would not have to reapply for registration. Consequently, such a trust would continue to be subject to the foreign trust disclosure rules under the new “foreign exemption trust” definition, regardless of whether it has used the foreign-sourced income exemption.

Exception for trusts with a section HC 33 election

If a person makes an election under section HC 33 to satisfy the income tax liability of the trustee, it is proposed that the trust would stop being a foreign exemption trust from the date the election applied. This would ensure that trusts taxed on their worldwide income are subject to the domestic trust disclosure rules rather than the foreign trust disclosure rules.

Example 48: Trust with section HC 33 election

In 2019, Emilia, a Swiss resident, sets up a trust with a New Zealand trustee to hold her share portfolio and Swiss rental properties. Assume the trust has a standard balance date of 31 March. The trust is a foreign trust. It registers with Inland Revenue and complies with the foreign trust disclosure rules from its inception. The trustee also uses the foreign-sourced income exemption in section HC 26.

Emilia subsequently moves to New Zealand and stops being a transitional resident on 15 May 2026. On 1 April 2027, she makes an election under section HC 33 to satisfy the income tax liability of the trustee.

Once Emilia becomes New Zealand resident, the trust would not fall under limb (a) of the proposed “foreign exemption trust” definition but would still fall under limb (b) of that definition as its trustee has previously used the section HC 26 exemption. It must continue to comply with the foreign trust disclosure rules.

From the date of the election the trust would not fall under either limb of the proposed “foreign exemption trust” definition. It would no longer have to comply with the foreign trust disclosure rules and would instead comply with the domestic trust disclosure rules. The trustee would therefore file a final foreign exemption trust return for the 2026–27 year. From the 2027–28 year onwards, the trust would have to comply with the domestic trust disclosure rules.

Interaction with “foreign trust” definition

The “foreign exemption trust” definition applies for the disclosure rules in the Tax Administration Act. The “foreign trust” definition applies for working out how its distributions are taxed under the Income Tax Act. The two definitions apply for different purposes and can therefore operate independently. A trust will often be both a “foreign trust” and a “foreign exemption trust” at the same time. However, it could also be a “foreign exemption trust” but not a “foreign trust”.

Example 49: Foreign exemption trust but not a foreign trust

On 1 May 2020 Jacques, a non-resident, sets up a trust with a New Zealand trustee to hold his European rental properties. Assume the trust has a standard balance date of 31 March.

Jacques becomes a New Zealand resident but remains a transitional resident until 6 October 2025. No election under section HC 33 is made for the trust.

The trust uses the foreign-sourced income exemption for its European rental income in each income year from 1 May 2020 until 31 March 2025 (inclusive). It cannot use the exemption in the 2025–26 income year as Jacques stopped being a transitional resident in that year.

From 1 May 2020, the trust would be a foreign exemption trust under the proposed amendments. The trust would have to register with Inland Revenue and comply with the foreign trust disclosure rules.

Once Jacques becomes a New Zealand resident (even while he is a transitional resident), the trust would no longer be a foreign trust. However, it would remain a foreign exemption trust because it has previously used the section HC 26 exemption but has not made an election under section HC 33.

POWER TO DEREGISTER A TRUST

Clause 156

Summary of proposed amendment

The proposed amendment would create an explicit power for the Commissioner of Inland Revenue to deregister a trust if the trust does not meet the requirements for registration under section 59B of the Tax Administration Act 1994. This power would be exercised on the Commissioner's own initiative or on application by the trust.

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent.

Detailed analysis

The legislation does not provide a power to deregister trusts, despite the Income Tax Act referring to deregistered trusts in section HC 26(1)(c)(iii). A trust may need to be deregistered if it no longer meets the requirements for registration or was mistakenly registered because it did not meet the requirements for registration in the first place. For example, this may occur if the trust is not a foreign trust or foreign exemption trust,³⁰ or it does not have a New Zealand resident trustee.

The proposed amendment would address this by explicitly granting the Commissioner the power to deregister a foreign trust either by his own initiative or on application by a trust.

The deregistration would be able to be backdated to the date when the trust stopped meeting the statutory requirements for registration. For example, if a trust stopped being a foreign trust on 1 January 2024 (and is not a foreign exemption trust), but the Commissioner did not become aware of this until 15 March 2024, the Commissioner would be able to backdate the deregistration to 1 January 2024.

Under the proposed amendment, when the Commissioner exercises the power to deregister on his own initiative, he must give the contact trustee at least 30 days' notice before the deregistration takes effect. The contact trustee then has an opportunity to respond if they consider the trust should remain registered, providing supporting information to the Commissioner as appropriate.

A contact trustee of a trust must also apply for the trust to be deregistered if they become aware that the trust does not meet the requirements for registration. The trustee would have to provide the Commissioner with certain information, such as:

- the reasons for deregistration
- final annual returns that include the date before it is deregistered, and
- any further information required by the Commissioner, such as supporting evidence where appropriate.

Final annual returns could be part-year accounts (for example, if the trust winds up) or full-year accounts that include the date before deregistration (for example, if a trust

³⁰ A "foreign exemption trust" is explained earlier in the Commentary in the item "Aligning the foreign-sourced income exemption with the foreign trust disclosure rules".

continues to exist but has stopped being a foreign trust because its trustees have moved offshore).

REQUIRE SIGNED DECLARATION FROM POST-REGISTRATION SETTLORS

Clause 155(5)

Summary of proposed amendment

The proposed amendment would extend the requirement for the contact trustee to provide a signed declaration for each settlor of a trust on registration to also require a signed declaration for persons who become a settlor after registration.

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent.

Background

When applying for registration of a foreign trust, sections 59B(3)(c)(i) and (4) of the Tax Administration Act 1994 (TAA) require trustees to provide certain information, including a signed declaration, for any settlor of the trust. The signed declaration must state that each settlor has been informed of, and agreed to, certain TAA and anti-money laundering requirements, or that the settlor is deceased or cannot be located.

However, some settlors may not make their first settlement on the trust until after the trust has been registered, and therefore it is unclear whether the requirement to provide a signed declaration applies.

While section 59D(2)(c) does require the trustee to provide the same information about such new post-registration settlors in the annual return, this requirement does not extend to the signed declaration.

The proposed amendment would extend this requirement to provide information in the annual return to include a signed declaration for post-registration settlors. The signed declaration would be required for all annual returns filed after the date the Bill comes into force.

TREATMENT OF RESIDUAL BENEFICIARIES

Clauses 153(8) and (13)

Summary of proposed amendment

The proposed amendment would clarify that residual beneficiaries are subject to the same disclosure requirements as discretionary beneficiaries.

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent.

Background

Residual beneficiaries, also known as final beneficiaries, are beneficiaries that have a right to any undistributed trust property when the trust is wound up. The current disclosure rules do not mention residual beneficiaries and only refer to beneficiaries of fixed and discretionary trusts (for example, sections 59B(3)(c), (d) and (e) of the Tax Administration Act 1994). It is therefore currently unclear what disclosure requirements residual beneficiaries should comply with.

The disclosure requirements for beneficiaries of fixed trusts on registration are more stringent than those for beneficiaries of discretionary trusts. The reason is because a beneficiary of a fixed trust has a fixed and certain interest in the trust property. In contrast, a beneficiary of a discretionary trust does not have a certain interest in the trust property and only has a right to be considered for a distribution. Sometimes discretionary beneficiaries are only stated as a class in the trust deed (for example, all descendants of the settlor) such that it cannot be known at the time of registration who all the discretionary beneficiaries of the trust are. Accordingly, when applying for registration of a discretionary trust, the contact trustee only has to provide enough details for the Commissioner of Inland Revenue to determine, when a distribution is made under the trust, whether a person is a beneficiary (section 59B(3)(e)). Further details, such as the name, address and tax residence of a discretionary beneficiary, are only required when a distribution is made to that beneficiary (section 59D(2)(e)).

Residual beneficiaries are similar to discretionary beneficiaries in that they do not have a certain interest in the trust property and may be stated in the trust deed as a class. The proposed amendment would therefore clarify that residual beneficiaries are subject to the same disclosure requirements as those that apply to discretionary beneficiaries.

UPDATING TRUST INFORMATION WHEN IT CHANGES

Clauses 153(10) and (11), 154(2) and 155(4)

Summary of proposed amendments

The proposed amendments would require contact trustees to update information provided in an annual return if it changes. Changes to trustees or contact details would have to be updated within 30 days of the contact trustee becoming aware of it. Changes to other information would have to be updated in the next annual return at the latest.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

Section 59B(5) of the Tax Administration Act 1994 (TAA) requires contact trustees to update information provided on registration, including the signed declarations for trustees, when that information changes. They are required to do this within 30 days after becoming aware of the addition or alteration (section 59C(2)).

In addition, section 59B(6) provides that a contact trustee who anticipates ceasing to be contact trustee must also provide the Commissioner with certain details when the contact trustee or their details change. Changes in trustees and trustee details generally are subject to the 30 day time limit (see sections 59B(3)(c)(v), 59B(5) and 59C(2)).

However, there is no corresponding requirement to update information that changes when it was provided in an annual return (for example, details of new settlors or beneficiaries). This was not intended. The need for information to be up-to-date applies regardless of whether it was first provided in an annual return or on registration.

In addition, the 30-day time limit for updating information provided on registration can be inconvenient for trustees and may result in inadvertent non-compliance. For most types of information, it is sufficient if the information is updated in the next annual return. However, an exception is for changes to contact trustees or their contact details. It is important for the Commissioner of Inland Revenue to have reliable contact information for contact trustees, and therefore this information should continue to be provided within the 30-day time limit.

Key features

The proposed amendments would clarify that contact trustees are required to update information provided in an annual return if the information changes.

The proposed amendments would also address the timeframes within which updates must be provided:

- Changes to contact trustees (under section 59B(6)) or their contact details (under proposed new section 59B(6B)) would have to be provided to the Commissioner within 30 days of the trustee becoming aware of it.
- Changes to other information, regardless of whether it was given on registration or in an annual return, would have to be provided to the Commissioner in the next

annual return at the latest. Contact trustees would retain the option to provide information earlier, outside the annual return cycle, if they wanted.

TESTAMENTARY TRUSTS

Clauses 70(2) and (4), and 153(9)

Summary of proposed amendments

The proposed amendments would treat a will creating a trust as a trust deed for the purposes of the foreign-sourced income exemption.

Effective date

The proposed amendments would take effect on 21 February 2017.

Background

Section HC 26 of the Income Tax Act 2007 provides for foreign-sourced income to be exempt from tax if certain requirements are met. One such requirement is that the trust must have a trust deed (sections HC 26(1)(c)(i) and (1)(d)(i)). Testamentary trusts created by wills do not have trust deeds, as wills are not legally trust deeds. This means testamentary trusts cannot access the exemption.

It was never intended for foreign trusts created under a will to be treated differently from a foreign trust created by a living settlor under a trust deed. The proposed amendments would therefore allow a will creating a trust to be treated as a trust deed for section HC 26.

The proposed amendments would have retrospective effect from 21 February 2017 – the date when foreign trusts were first required to comply with the disclosure rules to use the foreign-sourced income exemption.

COMMISSIONER'S DISCRETION TO BACKDATE REGISTRATION

Clause 153(2)

Summary of proposed amendment

The proposed amendment would give the Commissioner of Inland Revenue the discretion to backdate a foreign trust's registration where a trustee has made reasonable efforts to be registered on time.

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent, regardless of whether the trust applied for registration before or after that date.

Background

To use the foreign-sourced income exemption in section HC 26 of the Income Tax Act 2007, a foreign trust must meet certain conditions. One condition is that it must be registered both at the beginning of the income year and at the time when the foreign-sourced income is derived.

Section HC 26(1B)(b) gives the Commissioner the discretion to allow the foreign-sourced income exemption to apply despite minor compliance failures with the disclosure rules. However, this discretion does not apply where a foreign trust is not registered in time. This may be excessively harsh in some cases where the trustee made reasonable efforts to be registered on time.

Instead of giving the Commissioner the discretion to allow the foreign-sourced income exemption in cases where a trust is not registered in time, the proposed amendment would allow the Commissioner to backdate the trust's registration. This is expected to be simpler, particularly where the trust has derived multiple items of foreign-sourced income in the relevant period.

NEW CIVIL PENALTY AND GREATER DISCRETION FOR FOREIGN-SOURCED INCOME EXEMPTION

Clauses 70(6) and 169

Summary of proposed amendments

The proposed amendments would allow for a more flexible and proportionate response to non-compliance with the foreign trust disclosure rules by introducing a new civil penalty for failure to comply with the rules and granting the Commissioner of Inland Revenue greater discretion to allow a trust to use the foreign-sourced income exemption in cases of minor non-compliance.

Effective date

The proposed new civil penalty would have effect for any failures to comply occurring on or after the day after the date the Bill receives the Royal assent.

The proposed discretion to allow the foreign-sourced income exemption would be able to be exercised on or after the day after the date the Bill receives the Royal assent.

Background

When the foreign trust disclosure requirements were enacted in 2017, the penalties were not updated. The current penalties that apply are the general criminal penalties in the Tax Administration Act 1994 (TAA). In practice, the main consequence for a foreign trust that does not comply with the disclosure requirements in an income year is that it cannot use the foreign-sourced income exemption that year. This result can be too harsh (if the non-compliance was relatively minor) or too lenient (if the trust has no foreign-sourced income).

Under section HC 26(1B)(b) of the Income Tax Act 2007 (ITA), the Commissioner currently has a discretion to allow the foreign-sourced income exemption where there has been a failure to comply, but only if a trustee has corrected that failure within a reasonable time. However, some failures may not be able to be corrected – for example, the age of the trust, or prior mismanagement, may result in the loss of historical information on settlors or settlements – but are still so minor that the loss of the foreign-sourced income exemption is disproportionate to the extent of the failure.

Key features

The proposed amendments would:

- introduce a new civil penalty of up to \$1,000 for failure to comply with the disclosure rules, and
- give the Commissioner a discretion to allow a trust to use the foreign-sourced income exemption.

Detailed analysis

New civil penalty

The new civil penalty would be applied for failure to comply with the disclosure rules, such as when a trustee misses a deadline, provides an incomplete annual return, or provides false information. This penalty could apply instead of, or in addition to, the trust being denied the foreign-sourced income exemption. The penalty would not

apply to a failure to meet the disclosure requirements if the Commissioner is satisfied that the failure occurred through no fault of the trustee or that the trustee made reasonable efforts to meet the requirements.

Discretion to allow the foreign-sourced income exemption

The Commissioner's discretion would only be able to be exercised where the trustee had made reasonable efforts to:

- comply with the requirements of sections 22, 59B, 59C and 59D of the TAA (as required in section HC 26(1) of the ITA), and
- correct any failures to comply, even if the failure could not in fact be corrected.

CLARIFICATIONS TO THE TRUST RULES

Clauses 98(20), 141(7), 153(2), (5), (6), (7), (12) and (13), 154(2), (4) and (5), 155(3), 157(3)(a) and (4), and 175(1)

Summary of proposed amendments

The Bill proposes a number of amendments that would clarify the rules by

- replacing certain references in the Tax Administration Act 1994 (TAA) to beneficiaries of a “fixed trust” or “discretionary trust” with references to beneficiaries with fixed or discretionary interests in a trust
- replacing the confusing, undefined references to trustees “in the business of providing trustee services” in the TAA with the broadly similar, existing defined term of “professional trustee”
- updating the definition of “trust rules” in section YA 1 of the Income Tax Act 2007 (ITA) to refer to the relevant sections of the foreign trust disclosure rules in the TAA
- amending sections 59B(3)(d) and 59D(2)(e) of the TAA to refer to the “date of birth” of the minor beneficiary instead of their “age”
- amending references to a “resident foreign trustee” in the TAA to refer to a “trustee”, and
- updating several minor cross-referencing errors in the TAA’s penalties provisions.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

References to fixed and discretionary trusts

The TAA refers to beneficiaries of a “fixed trust” or a “discretionary trust” in sections 59B(3)(c)(vi), (vii), (d) and (e).

A trust deed can provide for both fixed and discretionary beneficiaries in the same deed. It is unclear in such a case if the trust is a “fixed trust” or a “discretionary trust”. Arguably, the single trust deed can create multiple trusts – some fixed, some discretionary. However, this is not consistent with how the legislation is ordinarily understood and such an interpretation could cause unintended consequences (for example, separate disclosures having to be made or multiple registration and filing fees being paid in respect of the same trust deed). The proposed amendments would remove this uncertainty.

Replacing references to trustees “in the business of providing trustee services” with “professional trustee”

Sections 59B(3)(b)(i), 59C(3)(c), and 59E(5)(b) of the TAA currently refer to a trustee “in the business of providing trustee services”. This phrase is not a defined term. The term “professional trustee” is a defined term, and it is better understood and captures largely the same idea. It would therefore be clearer to use that existing defined term in these sections.

The current definition of “professional trustee” in section 3 of the TAA only applies for the purposes of section 43B. However, section 43B now uses the term “professional

persons" instead of "professional trustees". The proposed amendment would therefore update the definition of "professional trustee" so that it can apply for the purposes of the foreign trust disclosure rules.

Updating the definition of "trust rules"

The definition of "trust rules" in section YA 1 of the ITA does not refer to the relevant sections of the foreign trust disclosure rules. As a result, some provisions and definitions that should apply to the foreign trust disclosure rules do not. The proposed amendment would rectify this.

Referring to the "date of birth" rather than "age" of minor beneficiaries

Sections 59B(3)(d) and 59D(2)(e) of the TAA currently require a trustee to disclose the "age" of any minor beneficiaries of a fixed trust. Technically this requires trustees to notify the Commissioner of Inland Revenue of the minor beneficiary's new age every year as it changes, which is impractical. The proposed amendment would therefore require disclosure of a minor beneficiary's "date of birth" instead.

Changing references from "resident foreign trustee" to "trustee"

The TAA currently uses the term "resident foreign trustee" in various places to refer to a New Zealand resident trustee of a foreign trust. This term is confusing as it can imply the trustee is foreign, even though it refers to a New Zealand resident trustee. The proposed amendments would remove this confusion.

Updating penalties provisions cross-references

Sections 143(1B) and (1C) of the TAA, which set out how the absolute liability offences in section 143(1) apply to resident foreign trustees, reflect the wording of the pre-2017 disclosure regime.

Section 143(1C) currently refers only to section 59B (registration and initial disclosure requirement) and not to section 59D (annual return requirement).

Section 143(1C)(b) refers to the appointment of another resident foreign trustee under section 59B(7) even though that subsection no longer provides for the appointment of a trustee.

The proposed amendments to section 143 of the TAA would:

- ensure that subsection (1C) refers to section 59D, and
- remove the reference to section 59B(7).

GST remedial items

GST TREATMENT OF GOVERNMENT GRANTS PAID TO PUBLIC AUTHORITIES

Clauses 106(2) and (10)

Summary of proposed amendment

The proposed amendment removes the exclusion for public authorities from the government grants and subsidies rule in section 5(6D) of the Goods and Services Tax Act 1985 (GST Act).

Effective date

The proposed amendment would have effect for government grants and subsidies paid to public authorities on or after 1 April 2023.

Background

The GST Act contains a rule for payments in the nature of a grant or subsidy made by, or on behalf of, the Crown (the government grants and subsidies rule).

The government grants and subsidies rule requires GST-registered recipients of government grants and subsidies to include these amounts in their GST returns as sales and pay GST on the amounts received. This ensures that GST-registered recipients, who are generally able to claim an input tax credit for expenses paid for with the government grant or subsidy, are no better off than recipients who are not registered for GST.

The government grants and subsidies rule does not apply to public authorities. This means that, unless the amount of the grants or subsidies paid to public authorities is reduced by the amount of GST that would be payable on those grants or subsidies if the exclusion for public authorities did not exist, public authorities receive a greater economic benefit than other GST-registered persons or unregistered persons. This was not intended.

The Bill proposes amending the government grants and subsidies rule to remove the exclusion for public authorities. This will ensure that any public authority that receives a government grant or subsidy will be required to account for GST on the amounts received.

GST – IMPROVEMENTS TO PLACE OF SUPPLY RULES

Clauses 107(2), 108 and 109

Summary of proposed amendments

The Bill proposes several improvements to the GST “place of supply” rules to reduce compliance costs for users of these rules and create consistency with similar rules currently used for imported remote services and distantly taxable goods.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

The remote services and distantly taxable goods rules allow non-resident suppliers to use certain commercial proxies, assumptions, or practices to determine whether their supply is a taxable supply to a New Zealand resident consumer. This minimises compliance costs for these suppliers.

However, other types of suppliers can also find it difficult to determine the tax residency of their customers or whether their customers are GST-registered businesses. The Bill proposes to reduce compliance costs for these suppliers by allowing them to apply similar rules.

Detailed analysis

The proposed amendments would enable a broader range of suppliers to use the proxies available to non-resident suppliers of remote service and distantly taxable goods to determine the GST treatment of their supplies.

Allowing the residency proxies in section 8B to be used for exported remote services

Section 8B of the Goods and Services Tax Act 1985 provides a list of various items of commercial information relevant for determining a recipient’s residency (for example, billing address, internet protocol address, bank details, and phone number). If two of the items support the conclusion that the recipient of the supply is a New Zealand resident, then the remote services rules treat that person as a New Zealand resident. Section 8B is currently limited to imported remote services supplied by a non-resident supplier. The Bill proposes allowing resident suppliers to apply these rules to determine if their supplies of remote services are being exported to a non-resident recipient and can therefore be zero-rated under sections 11A(1)(k), (l) or (m).

Non-resident suppliers of imported goods to GST-registered customers

Section 8(4) currently allows the non-resident supplier of goods that are outside New Zealand at the time of supply and the GST-registered recipient of those goods to make an agreement that the supply is made in New Zealand. Such agreements allow the non-resident supplier to charge 15% GST on the supply of the goods and to claim input tax deductions for costs incurred to make the supply (such as GST imposed by Customs when the goods enter New Zealand). Stakeholders have submitted that it can be burdensome to enter into and manage these agreements in circumstances where non-resident importers have a lot of GST-registered customers.

Therefore, the Bill proposes replacing the requirement to have an agreement with the recipient of the goods with an option for the non-resident supplier to unilaterally treat the supply as being made in New Zealand. The non-resident supplier would implement this by charging 15% GST on the supply of the goods. The proposed approach is consistent with existing rules for remote services and distantly taxable goods in sections 8(4D) and 8(4F), which allow a non-resident supplier to treat the supply of services as being made in New Zealand.

The Bill also proposes expanding the application of section 8BB to allow non-resident importers to use the sources of information outlined in that section to determine whether the recipient is GST registered for the purposes of section 8(4). The use of section 8BB is currently limited to situations where a non-resident is supplying remote services or distantly taxable goods.

LIABILITIES INCURRED DURING A VOLUNTARY ADMINISTRATION

Clause 128

Summary of proposed amendments

The proposed amendments would clarify that administrators are personally liable for GST liabilities incurred as an agent of a company in voluntary administration.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Background

When a registered person dies, becomes incapacitated, or goes into bankruptcy, receivership, or liquidation they become an "incapacitated person" for the purposes of the Goods and Services Tax Act 1985 (GST Act). Section 58 of the GST Act deems the person carrying on the taxable activity on behalf of the incapacitated person (the specified agent) to be carrying on that taxable activity, including being GST registered.

This means the incapacitated person is not treated as carrying on the taxable activity during the period, and the specified agent is liable for GST obligations of the incapacitated person during the agency period.

There has been uncertainty as to whether an administrator, carrying on a voluntary administration, is currently within the scope of section 58. Voluntary administration is described in Part 15A of the Companies Act 1993, and "administrator" is a defined term in section 239B of the Companies Act 1993.

It is understood that some administrators have taken a broad view of the definition of "incapacitated person" and interpreted a company in voluntary administration as being incapacitated under section 58. The administrator is therefore liable for the GST obligations of the company in voluntary administration.

However, others have read the plain words of the provision and concluded that the absence of any reference to voluntary administration means it is outside the scope of the provision. On that basis, therefore, the administrator files GST returns on behalf of the company but is not personally liable for GST incurred during the voluntary administration period.

The proposed amendments would provide certainty and consistency to the treatment of GST obligations incurred during a voluntary administration.

Key features

The proposed amendments would amend the section 58 definition of "incapacitated person" to include voluntary administration and the definition of "specified agent" to include administrator. This would mean the administrator would be deemed to be a registered person carrying on the taxable activity of the company or limited partnership in voluntary administration.

CLARIFICATIONS TO THE COMPULSORY ZERO-RATING OF LAND RULES

Clauses 106(9) and 113

Summary of proposed amendments

The Bill proposes the following three amendments to the GST business-to-business compulsory zero-rating of land rules to ensure they work as intended:

- The first amendment would allow supplies that wholly or partly consist of the grant of an interest in land (such as the grant of a commercial lease) to be zero-rated, provided they meet the requirements set out in section 11(1)(mb) of the Goods and Services Tax Act 1985 (GST Act).
- The second amendment would standard-rate periodic payments made under an agreement for periodic supplies of an interest in land (such as a commercial lease) following an irregular lump-sum payment of more than 25% of the total consideration under the agreement.
- The third amendment would clarify aspects of section 5(23), which applies when it is discovered a supply that is wholly or partly of land has been incorrectly zero-rated.

Effective date

The proposed amendments would take effect on the day after the date the Bill receives the Royal assent.

Detailed analysis

The GST business-to-business compulsory zero-rating of land rules are in place to address the risk of phoenix fraud and reduce compliance costs for GST-registered persons. The rules apply to supplies that are wholly or partly of land, provided the requirements in section 11(1)(mb) are met. In some circumstances, the zero-rating rules apply to commercial leases and associated payments, as outlined in section 11(8D).

First proposed amendment

The first proposed amendment would include in section 11(8D)(a) a supply that wholly or partly consists of a grant of an interest in land, provided it meets the requirements of section 11(1)(mb). This is intended to capture the situation where the purchase of business assets by a GST-registered person is made conditional on the grant of a lease over the business premises.

In some situations, this type of transaction could be zero-rated as a going concern under section 11(1)(m). However, the supply will not always fit the GST Act definition of a “going concern” and applying a going-concern treatment will not always make commercial sense for the given transaction. If a pre-existing lease had instead been assigned to the GST-registered purchaser alongside the asset purchase, this transaction would be zero-rated under section 11(8D)(a).

The proposed amendment is not intended to affect the GST treatment of the subsequent rental payments made under a newly granted lease. This is because section 11(8D)(b) provides that regular periodic payments made under an agreement providing for periodic payments for supplies of an interest in land (a lease) are not zero-rated supplies of land. Instead, these regular rental payments would generally be

for standard-rated supplies (such as rents on a commercial property) or exempt supplies of accommodation in a dwelling (such as rents under a residential tenancy).

Second proposed amendment

Under section 11(8D)(b), a payment made under an agreement providing for supplies of an interest in land (a lease) must be zero-rated if it meets the requirements of section 11(1)(mb), is not a regular payment, and is more than 25% of the consideration specified in the agreement. Subsequent regular periodic payments made under the agreement must also be zero-rated. This treatment of subsequent payments was intended to reduce compliance costs for taxpayers. However, Inland Revenue has been informed by taxpayers that it has the opposite effect.

The second proposed amendment would therefore require regular periodic payments made following an irregular payment to be standard rated (15% GST). The amendment would clarify that it is only irregular lump-sum payments of more than 25% of the total consideration specified in the lease agreement that are zero-rated.

The proposed amendment would also clarify that the value of the lump-sum payment is based on the combined value of irregular payments made. This is to ensure that lump-sum payments are not split-up to avoid the application of zero-rating treatment.

Third proposed amendment

Currently, section 5(23) applies where it is discovered, after the date on which the relevant transaction was settled, that section 11(1)(mb) was incorrectly applied to zero-rate a taxable supply of goods that did not meet the requirements of that section. Section 5(23) deems the recipient of those goods to make a supply of the goods themselves, and therefore they must return output tax (15% GST) on the purchase price. This rule would be retained in proposed new section 5(23B).

The Bill includes amendments that would clarify aspects of the application of this rule.

First, it would clarify that it must be the supplier who incorrectly zero-rated the supply of goods in a GST return provided by them.

Second, it would require either the supplier or the Commissioner to find that section 11(1)(mb) was incorrectly applied to the supply of goods.

Third, it would specify that the rule applies to require the recipient to return output tax when the recipient did not provide the supplier with correct or sufficient information under section 78F to enable the supplier to determine whether the supply should be zero-rated. This would address the concern that malicious suppliers might use section 5(23) to shift the output tax liability onto unwitting recipients.

If the deeming rule in proposed new section 5(23B) applied, no changes to the supplier's GST assessment in respect of the incorrectly zero-rated supply would be necessary.

If a person who receives a supply that was incorrectly zero-rated is not registered for GST, the person would be required to register for GST so they could account for output tax on the deemed supply under proposed new section 5(23B). In this situation, the person's GST registration would relate solely to this supply, and there would be no other GST consequences. The registration could be cancelled once a GST return including the supply had been provided.

ASSOCIATING MEMBERS OF JOINT VENTURES WITH THE JOINT VENTURE

Clause 104

Summary of proposed amendment

The proposed amendment would associate members of a joint venture with the joint venture for GST purposes.

Effective date

The proposed amendment would take effect on the date of introduction of the Bill.

Detailed analysis

A joint venture can register for GST in its own right and exist separately from its members under section 57 of the Goods and Services Tax Act 1985 (GST Act). The proposed amendment would include a rule in section 2A of the GST Act associating a joint venture with its members (the joint venturers) for GST purposes. This would reflect the aligned economic interests of joint ventures and their members. This is also consistent with the rules that apply for other unincorporated bodies, such as partnerships and trusts.

The effect of parties to a transaction being associated for GST purposes includes the following:

- a supply of goods and services between associated persons is subject to GST at open market value
- the value of secondhand goods input tax credits on supplies made between associated persons are appropriately limited, and
- the time of supply for goods and services supplied between associated persons is deemed to take place when the services are performed or when the goods are either removed or made available, as appropriate.

The existing rules in section 2A(1)(b) that associate companies and other persons will continue to apply to joint ventures that are companies.

The proposed amendment would come into effect on the date of introduction of the Bill to prevent a fiscal risk that could arise from the proposed amendment highlighting that members of a joint venture are not currently associated with the joint venture itself for GST purposes.

INPUT TAX DEDUCTIONS FOR GOODS AND SERVICES NOT YET AVAILABLE FOR USE IN MAKING TAXABLE SUPPLIES

Clauses 117(5), (7), (8), (18), (19) and (20)

Summary of proposed amendments

The proposed amendments would clarify that a GST-registered person can claim an input tax deduction when goods or services are supplied to them to the extent those goods or services are intended to be used by them in making taxable supplies.

A number of consequential amendments are also proposed to clarify the application of sections 20(3L) and (3LB) of the Goods and Services Tax Act 1985 (GST Act).

Effective date

The proposed amendments would take effect on the following dates:

- 1 April 2011 for the amendments to section 20(3C)(a) and (b)
- 30 March 2022 for the amendment to the words before paragraph (a) in section 20(3C)
- 1 April 2014 and 30 March 2022 for the amendments to section 20(3L), and
- 30 March 2022 for the amendment to section 20(3LB).

Detailed analysis

Under current section 20(3C), a GST-registered person can claim an input tax deduction for GST paid on goods and services supplied to them to the extent to which the goods or services are used for, or available for use in, making taxable supplies. However, tax advisors have notified us that current practice is to claim an input tax deduction at the time of supply (apportioning for any non-taxable or exempt use) even in cases where the goods or services are not yet available for use in making taxable supplies.

Current practice is consistent with the policy intention, which is to allow input tax deductions to be recognised in the same taxable period in which the GST time of supply occurred.

The proposed remedial amendments to section 20(3C)(a) and (b) would therefore clarify that a GST-registered person is able to claim an input tax deduction to the extent to which goods and services supplied to them are used for, or intended to be used by them in, making taxable supplies. This would align the timing of the input tax deduction with the GST time of supply, which is determined by section 9 of the GST Act.

For example, where a GST-registered person purchases goods ahead of them being produced, the proposed amendment would allow them to claim an input tax deduction at the time of supply to the extent to which they intend to use those goods in making taxable supplies.

Under section 21G(2)(a), the adjustment period for input tax deductions claimed by a registered person begins when the goods or services are physically acquired or made available to them. Therefore, a GST-registered person that claims an input tax deduction in line with the proposed amendment (for example, on the basis that they intend to use the goods or services in making taxable supplies) would not have to

consider the adjustment rules until those goods or services were physically acquired or made available to them.

As the proposed amendment would align the law with the policy intention, it would have a retrospective effective date of 1 April 2011, the date on which the current section 20(3C) wording was included in the GST Act.

To ensure consistency, equivalent amendments are also proposed to sections 20(3L) and (3LB) to allow GST-registered non-residents to claim an input tax deduction for GST paid on goods and services supplied to them to the extent to which those goods or services are used or intended to be used by them in making taxable supplies (treating all their supplies as if they were made and received in New Zealand). These proposed amendments would take effect on 30 March 2022. The amendment to section 20(3L) would also take effect from 1 April 2014 to ensure it applies to an earlier version of that provision.

It is also proposed that, with effect on 30 March 2022, section 20(3C) would be amended to clarify that it only applies if sections 20(3D), (3L) or (3LB) do not apply.

MODERNISING INFORMATION REQUIREMENTS FOR GST

Clauses 117(1), (2), 188, 189, 190 and 191

Summary of proposed amendments

The proposed amendments would clarify several amendments made to the Goods and Services Tax Act 1985 (the GST Act) by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 (the 2022 Amendment Act) to reform the tax invoicing rules for GST (now known as taxable supply information). These changes reform the way in which the GST system interfaces with 21st century business record-keeping, both digital and manual, by simplifying record-keeping requirements for GST purposes.

Effective date

The proposed amendments to the provisions in the 2022 Amendment Act would take effect on the same dates as the relevant provisions in that Act took effect.

This is achieved by proposing that the amendments to the 2022 Amendment Act in this Bill take effect on 30 March 2022, the day before that Act came into force.

Detailed analysis

The proposed remedial amendments to the taxable supply information requirements are listed in the table below. The section references discussed in the "Description of change" column in the table refer to the relevant sections in the GST Act.

Table 3: Remedial changes to the taxable supply information requirements

Section of the 2022 Amendment Act	Description of change	Clause of Bill
Section 5(4)(b)	The use of the term "peculiar" in the section 2 definition of "recipient details" is ambiguous. The proposed amendment would replace this term with "relevant".	188(1)
Section 5(4)(e)	The reference to "the date of the supply" in the section 2 definition of "supply information" is ambiguous and could refer to various dates. This reference would be replaced with "the date of the invoice, or where no invoice is issued, the time of supply".	188(2)
Section 19(1) (section 19E(1)(d) of the GST Act)	Section 19E(1)(d) requires that supply correction information expresses the difference between the amount of consideration shown for the supply and the correct amount. The proposed amendment would provide that "supply correction information" can be corrected in a much less prescriptive manner, including allowing for corrections to be dealt with by cancelling the incorrect invoice and	189(1)

Section of the 2022 Amendment Act	Description of change	Clause of Bill
	issuing a new one, which better reflects commercial practice.	
Section 19(1) (section 19E(2)(b) of the GST Act)	<p>Section 19E(2)(b) sets out what taxable supply information means for a supply that has a value that exceeds \$200 but does not exceed \$1,000. As the rule is currently proposed, this includes a statement that the amount of consideration includes tax charged for the supply or a statement of the amount of tax charged for the supply.</p> <p>The problem is this could lead to a purchaser mistakenly thinking the price includes GST at the standard rate and claiming an input tax credit that they are not entitled to. For example, if A purchases a zero-rated supply for \$800 from B, and the information provided merely includes a statement that the amount of consideration includes tax charged, B may mistakenly claim an input for 3/23 of the purchase price, thinking the standard GST rate of 15% applies. The proposed amendment ensures that the statement will specify the GST inclusive and exclusive amounts in these circumstances.</p>	189(5)
Section 19(1) (section 19E(2)(a), (b) and (c) of the GST Act)	<p>Section 19E(2)(a), (b) and (c) refer to a supply that "has a value that" exceeds the relevant threshold. This is problematic because "value of the supply" is a GST exclusive amount, whereas "consideration in money for the supply" is a GST inclusive amount.</p> <p>The proposed amendments would change "has a value that" to "the consideration in money for the supply". This would align with the previous thresholds in section 24 of the GST Act, which referred to consideration in money.</p>	189(2), 189(5) and 189(6)
Section 19(1) (section 19E(2)(a)(iii) of the GST Act)	The requirement for address details for the recipient under section 19E(2)(a)(iii) is redundant because "recipient details" in section 19E(2)(a)(ii) already requires identifying details for the recipient. Section 19E(2)(a)(iii) would therefore be repealed.	189(3)

Section of the 2022 Amendment Act	Description of change	Clause of Bill
Section 19(1) (section 19E(2)(a)(iv) of the GST Act)	The reference to “the date of the supply” in section 19E(2)(a)(iv) is ambiguous and could refer to various dates. This reference would be replaced with “the date of the tax invoice, or where no invoice is issued, the time of supply”.	189(4)
Sections 19(1) (section 19F of the GST Act) and 40 (section 75 of the GST Act)	<p>Section 19K(7)(a) provides that a supplier is not required to provide taxable supply information if the amount of consideration for the supply does not exceed \$200. However, there is no corresponding threshold for the purchaser not to have to hold this taxable supply information.</p> <p>The proposed amendments to both sections 19F and 75 would provide that a registered person who makes or receives a taxable supply of goods or services is not required to keep records of any taxable supply information for a supply if the consideration in money for the supply does not exceed \$200.</p> <p>An additional amendment to section 19F would clarify that a registered person who receives goods or services only needs to keep records if they are acquiring the supply to make taxable supplies (that is, if receiving goods or services for private use or to make an exempt supply, no records must be kept).</p>	189(8) and 191
Section 19(1) (section 19G(2)(b) of the GST Act)	The reference to “the date on which, or the period during which, the supply was received” in new section 19G(2)(b) is ambiguous and could refer to various dates. This reference would be replaced with “the date of the invoice, or where no invoice is issued, the time of supply”.	189(9)
Section 19(1) (section 19G(2)(e) of the GST Act)	The proposed amendment would repeal section 19G(2)(e), as “the time by which payment of the consideration for the supply is required” is not relevant.	189(10)
Section 19(1) (section 19H(1) and 19H(3) of the GST Act)	The proposed amendment to section 19H(1) would clarify that a registered person who receives a supply of secondhand goods that is not a taxable supply only needs to keep records of those goods if they have claimed an input tax deduction in respect of them (and therefore intend to use them to make taxable supplies). With the inclusion of the threshold amount in amended section 19H(1), section 19H(3) is no longer required.	189(11) and (12)

Section of the 2022 Amendment Act	Description of change	Clause of Bill
Section 19(1) (section 19K(1) and (5) of the GST Act)	The proposed amendments to sections 19K(1) and 19K(5) would replace the requirement to provide taxable supply information within 28 days of the supply to within 28 days of a request for this information.	189(13) and (14)
Section 19(1) (section 19K(10) of the GST Act)	<p>Section 19K(10) provides that taxable supply information does not need to be issued if the Commissioner is satisfied that there are sufficient records to establish the particulars of the supply and it would be impractical to require taxable supply information to be provided.</p> <p>The proposed amendment would provide for a further option in these situations. This option would give the Commissioner discretion to allow the omission of certain particulars from taxable supply information (see previous law, section 24(6)(a) of the GST Act 1985). This would provide greater flexibility than simply allowing the taxable supply information to not be issued at all.</p> <p>In addition, a minor drafting error would be corrected by replacing "tax supply information" with "taxable supply information" in both places it appears.</p>	189(15)
Section 19(1) (sections 19E(2)(f) and 19L of the GST Act)	<p>Section 19L(1) sets out the taxable supply information required for supplies made by members of a GST or supplier group. Section 19L(1) would be replaced by new sections 19L(1) and (2) to ensure the requirement to provide a name and registration number only applies to either the supplying member or the representative/issuing member.</p> <p>A consequential amendment to section 19E(2)(f) would give effect to this change.</p>	189(7) and (16)
Section 19(1) (section 19N(2) of the GST Act)	The proposed amendment to section 19N(2) would make the provision of supply correction information less prescriptive. The registered person would still be required to provide supply correction information, but the requirements of a date as agreed by the parties (section 19N(2)(a)) or within 28 days of the supply (section 19N(2)(b)) would be removed because they do not reflect commercial realities.	189(17)

Section of the 2022 Amendment Act	Description of change	Clause of Bill
Section 21(1) and (2)	<p>The proposed amendment would rectify an error in effective dates.</p> <p>Section 21(1) of the 2022 Amendment Act, which amends section 20(2) of the GST Act, is scheduled to come into effect on 1 April 2023. The amendment would change this effective date to 30 March 2022.</p> <p>Similarly, section 21(2)(a) of the 2022 Amendment Act came into effect on the date of Royal assent. The proposed amendment would change this to 1 April 2023.</p>	117(1), 117(2) and 190

Other remedial items

TAX TREATMENT OF EXPENDITURE ON DISTRIBUTION NETWORKS

Clauses 34, 45, 46, and 98(22), (23) and (24)

Summary of proposed amendments

The proposed amendments would ensure that distribution network owners apply the component items approach, rather than the network approach, for depreciation and repairs and maintenance. A retrospective application date will validate the position of nearly all distribution network owners who have always applied the component items approach. The small number of network owners who apply a network approach for repairs and maintenance would be required to consistently apply the component items approach to both depreciation and repairs and maintenance from 1 April 2024.

Effective date

The proposed amendments would be effective for the 2008–09 and later income years for distribution network operators that have always applied the component items approach

For distribution network operators that have either filed a return before 1 April 2022 that does not apply the component items approach or have a binding ruling that allows the network approach, the proposed amendments would be effective for the 2024–25 and later income years.

Background

Distribution networks convey electricity, gas, water, and telecommunications. An example is the electricity distribution network of an electricity lines company. Its components include poles, cables, transformers, and switches.

Deductions for expenditure on depreciable property are spread over the economic life of the property. Deductions for expenditure on repairs and maintenance are allowed in the year the expenditure is incurred.

An issue in relation to distribution networks is whether the asset (for both depreciation and for repairs and maintenance purposes) is the network or its component items. If the asset is the network, expenditure to acquire or build the network will usually be depreciable over the life of the network and expenditure to replace its component items will usually be immediately deductible repairs and maintenance. If the assets are the component items, expenditure to acquire or replace a component item will usually be capitalised and depreciated over the life of the component (which is shorter than the life of the network).

Network owners have, in nearly all instances, been depreciating component items of networks in accordance with the Commissioner's depreciation schedule and treating component items as the relevant item of property for repairs and maintenance purposes since the depreciation rules were introduced on 1 April 1993 (component items approach). There is a high degree of uniformity in distinguishing capital expenditure from revenue expenditure for financial reporting purposes, Commerce Commission regulatory purposes and tax under the component items approach. The depreciation schedule has never included a depreciation rate for a distribution network

and the Commissioner considers it would be inappropriate to apply the default rate³¹ to a network.

In 2021, the Tax Counsel Office (TCO) of Inland Revenue concluded its view that, in accordance with case law, the asset for repairs and maintenance in the context of an Electricity Distribution Business is the "network" and not its components. TCO agree the "Asset" for repairs and maintenance considerations must be the same "Asset" for depreciation purposes, and consequently, they rejected the component items approach, which relied on the Commissioner's itemised depreciation schedule. It concluded that, for the purposes of the depreciation rules and for determining whether expenditure on repairs and maintenance is deductible, a network, and not its component items, is the relevant asset (network approach). The network approach by extension applies to all distribution networks, including those that are not physically connected, such as cell phone towers. The network approach does not affect how the law applies to non-network assets, such as how depreciation applies to distinct chattels within residential property.

Example 50: Component items approach

The Ogdenville Community Trust owns and operates the electricity distribution network for Ogdenville and has always applied the component items approach. Their tax fixed asset register identifies 10,000 different items (mostly power poles) consistent with the items on the depreciation schedule with a depreciated tax value of \$100m. This \$100m can be broken into \$98m of assets that will still exist at the end of the year and \$2m of assets that are not fully depreciated but will be replaced during the year (assume the assets are disposed of for no consideration). During the current year, they spend \$25m on the network. This can be broken down to \$10m repairing existing assets (none of which improved the capital value), \$5m replacing assets that have reached the end of their useful life and \$10m extending and improving their network to provide additional capacity.

The deductions during the current year for each of these categories is:

- The existing assets that still exist at the end of the year are depreciated at their individual component rates. This provides a deductible depreciation loss of \$8.8m.
- For the existing assets that were disposed of, a deduction is available for their remaining adjusted tax value of \$2m.
- Expenditure on repairing existing assets of \$10m is immediately deductible.
- The \$5m spent replacing assets and the \$10m spent extending and improving the network are both amounts of capital expenditure and so are not immediately deductible. Assets with a cost of \$15m will be added to the fixed asset register and will then be depreciable at individual component rates.

This approach is broadly similar to the approach Ogdenville Community Trust applies for financial reporting and Commerce Commission purposes. There are differences in the depreciation rates for tax and for other purposes, so the depreciation amounts are likely to be different, but conceptually they are equivalent.

³¹ The default rate is for the remainder of items after allocating assets into the categories on the depreciation schedule. It is not intended to apply to the entire asset base of a distribution network.

Example 51: Network approach

North Haverbrook Community Trust owns and operates the electricity distribution network for North Haverbrook. The Trust has previously applied the component items approach but has adopted the network approach for the current year. Their tax fixed asset register and expenditure in the current year are identical to the Ogdenville Community Trust in example 50.

The deductions during the current year for each of these categories is:

- The existing assets that still exist at the end of the year are depreciated at their individual component rates.³² This provides total depreciation of \$8.8m.
- For the existing assets that were disposed of, a deduction is available for their remaining tax value of \$2m.
- Expenditure on repairing existing assets of \$10m is immediately deductible.
- The \$5m spent on replacing assets is not significant, relative to the \$100m value of the network, so is treated as repairs and maintenance and is immediately deductible.
- The \$10m spent extending and improving the network is capital expenditure. Assets with a cost of \$10m will be added to the fixed asset register³³ and will then be depreciable at individual component rates.

The network approach provides a higher deduction for repairs and maintenance than that available to the Ogdenville Community Trust in example 50. Over time the lower asset base will result in lower depreciation deductions and, if a network rate was issued, depreciation would likely be lower still. In aggregate, depending on a distribution network's individual circumstances, this can provide a significant tax timing advantage over applying the component items approach.

Over time original assets will be fully depreciated and/or replaced. The cost of replacement assets is not added to total assets, and therefore the tax value of the network will only represent the depreciated cost of extensions or improvements to the network. This will create a significant divergence between the tax value of the network and the value for accounting or regulatory purposes.

Key features

New definitions of "utilities distribution asset", "utilities distribution network" and "utilities distribution network operator" would be added to section YA 1 of the Income Tax Act 2007.

Under proposed new section DB 68, when a utilities distribution network operator incurs expenditure on a utilities distribution asset or a utilities distribution network, the expenditure would be treated as relating to a utilities distribution asset, rather than the utilities distribution network, for determining whether the expenditure was capital in nature.

³² This is how distribution networks currently apply the network approach as there is no network depreciation rate. If the Commissioner issued a network depreciation rate, they would depreciate the network as a single asset at the network rate. It is likely the depreciation rate for a network would be lower than the average rate of its individual components.

³³ As with footnote 32, this is because there is no network rate. If a network rate was added, they would increase the cost of the network asset by \$10m and depreciate the new higher cost base at the network rate.

Proposed new section EE 6(2B) would confirm that utilities distribution assets are separate items of property for depreciation purposes, and proposed section EE 7(fc) would confirm that a utilities distribution network is not an item of depreciable property.

Detailed analysis

Definition of a “utilities distribution network operator”

The proposed amendments would be specifically restricted to applying to distribution networks. This is because the TCO interpretation appears to have the most applicability to these industries. This is not intended to limit the application of an approach broadly equivalent to a component items approach in other sectors. A further extension of these principles could be considered in the future if taxpayers were found to be applying a different asset identification for depreciation and for repairs and maintenance purposes, as this misalignment would not be consistent with the policy intent.

A definition of a “utilities distribution network operator” would be added to section YA 1. This definition would limit the scope of the other proposed amendments by ensuring the amendments apply only to electricity distribution, water, gas and telecommunication networks. For the avoidance of doubt, the proposed amendments are not intended to cover other networks, such as electricity generation, roads or railways.

Definition of a “utilities distribution asset”

The proposed definition of a “utilities distribution asset” would cover the assets that are used, or available for use, by the network operator to provide their goods and services. These assets will typically be those included in the Commissioner’s depreciation schedule, but the network operator will retain the flexibility how to classify smaller items. For example, a possum guard attached to a power pole could be included in the value of the power pole or could be separately identified (in which case the default depreciation rate would likely apply to that guard).

Likewise, divisible assets, such as a length of electrical cable or a pipe, could continue to be classified in whatever way the network operator was reasonably categorising these. This may include methods such as a cable for a particular length, geographic area or installed during a specific period.

A utilities distribution asset is not intended to cover groups of disparate assets, especially when those assets are separately identified on the depreciation schedule. Examples of groupings of assets that are not intended to be a utilities distribution asset include an entire network for a large area, such as a town, or a group of disparate assets (for example, power poles, cables, switches and a substation) within a smaller area, such as a suburb.

This proposed amendment is not intended to limit the existing ability to pool assets with a value of under \$5,000 per item or those with a greater value with a relatively homogeneous nature under a determination under section 91AAL of the Tax Administration Act 1994, which we understand some distribution networks are already applying.

Whether expenditure is of a capital nature

Proposed new section DB 68 would confirm that when a utilities distribution network operator incurs expenditure on utilities distribution assets, or their utilities distribution network, they must treat this expenditure as relating to the relevant utilities distribution asset, rather than the network.

The proposed amendment would not change the test as to whether expenditure is deductible revenue account expenditure or non-deductible capital account expenditure. The proposed amendment would simply confirm that the existing tests should be applied based on the expenditure being for separate assets, rather than the entire network.

For example, expenditure on replacing an entire substation with an equivalent replacement item would meet the tests to be capital expenditure on the basis that all the asset has been replaced. However, if the network was instead chosen as the relevant asset, it is probable that the value of the substation would be low relative to the value of the entire network, and therefore applying the capital/revenue tests may have led to a different conclusion.

Depreciation

Proposed section EE 6(2B) would confirm that utilities distribution assets are separate items of depreciable property, and proposed section EE 7(fc) would confirm that a utilities distribution network is not depreciable property. This treatment is consistent with the depreciation schedule and officials' understanding of the approach utilities distribution network operators have been applying since 1993. This amendment would prevent the distribution network, or a smaller group of disparate assets, from being treated as the item of depreciable property.

Effective date

The proposed amendments would be effective for the 2008–09 and later income years for distribution network operators that have always applied the component items approach. It would be technically correct for this amendment to take effect on 1 April 1993; however, these earlier periods are covered by the time bar so making the amendment effective on 1 April 2008 removes the need to amend the Income Tax Act 1976, Income Tax Act 1994 and Income Tax Act 2004 while having no practical effect on these earlier returns.

For distribution network operators that have either filed a return before 1 April 2022 that does not apply the component items approach or have a binding ruling that allows the network approach, the proposed amendments would be effective for the 2024–25 and later income years. This would allow distribution network operators who have already applied the network approach to continue to do so until the start of the 2024–25 year.

STUDENT LOAN TIME BAR

Clause 165

Summary of proposed amendment

The proposed amendment would limit the ability to adjust a past student loan repayment obligation once four years have passed. This amendment aligns student loan deductions, that relate to amendments to Employer Information, with other PAYE deductions for time bar purposes.

Effective date

The proposed amendment would take effect on 1 April 2023.

Background

The Tax Administration Act 1994 (TAA) imposes a four-year time bar on the amendment of tax assessments. The time bar means that, once four years have passed, the Commissioner of Inland Revenue may not amend an assessment to increase the amount assessed or decrease the amount of a net loss. There are a limited number of exceptions to this four-year period, most notably that it does not apply in instances of fraud.

The time bar was extended to include KiwiSaver employer and employee deductions and ACC earners' levy deductions by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022.

The Student Loan Scheme Act 2011 deems incorrect student loan deductions to be full and final unless the amount of the under- or over-deduction is significant. However, there is no time bar for significant over- or under-deductions. There is nothing to prevent corrections to previously filed employment income information from amending an assessment of student loan deductions in the TAA.

The consequence of not having a time bar for student loans is that it creates uncertainty for borrowers. This is because an employer can amend employment income information at any time. Such amendments can flow through and impact on a borrower's loan repayment obligations and loan balance. The worst-case scenario is where an employer makes an amendment that results in a previously closed student loan having to be re-opened. The lack of a time bar also imposes an administrative burden on Inland Revenue, as Inland Revenue needs to explain to the individual that their student loan repayment obligations or balance has been affected by their employer correcting a past error.

Key features

The proposed amendment would insert new section 108AC into the TAA. The provision would prevent the Commissioner from amending an assessment that includes an amount of salary and wage deductions made under the SLSA after a period of four years.

The existing limited exception to the time bar period would apply to this amendment, that is, where the employment income information provided by a taxpayer is fraudulent or wilfully misleading. In addition, the proposed new section would provide for an exception where not allowing an amendment of an assessment would have a significant adverse effect on a borrower.

BUSINESS CONTINUITY TEST – MEASUREMENT OF OWNERSHIP

Clause 75

Summary of proposed amendment

The proposed amendment would modify the beginning of the period of measurement for shareholder continuity for a company carrying forward tax losses under the business continuity test (BCT) from the date the loss was incurred to the date the company became subject to the BCT to ensure the ownership continuity provisions work correctly.

Effective date

The proposed amendment would be effective for the 2020–21 and later income years.

Background

The BCT, which was enacted in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021, allows companies to carry forward tax losses to future years when they have a change in ownership if there is no major change in the nature of the business activities of the company.

Continuity of ownership is usually counted from the date a loss is incurred to the date the loss is used or the business continuity period ends. However, for a company that is maintaining losses under the BCT, this period is no longer appropriate, given the initial breach. In that case, the appropriate period would be from the date the company became subject to the BCT to the date the loss is used or the business continuity period ends.

The amendment therefore proposes to amend the shareholder continuity test for the purposes of the BCT only to ensure it works correctly once there has been an initial shareholding breach.

EARLY PAYMENT DISCOUNT AND TAX POOLING

Clauses 192 and 193

Summary of proposed amendment

The proposed amendments would change the effective date of the amendments made to the early payment discount (EPD) and tax pooling rules by sections 168 and 170 of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to the 2017–18 and later income years.

Effective date

The proposed amendments would take effect on 30 March 2022.

Background

Amendments were made to sections RP 17 and RP 19 of the Income Tax Act 2007 by sections 168 and 170 of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022. These changes were needed to ensure the treatment of EPD and tax pooling was the same throughout Inland Revenue's transition from its former tax software platform, FIRST, to its new tax software platform, START. The changes were backdated, as requested by submitters, to the 2019–20 income year, as this is the year tax pooling and EPD began to be processed in START.

However, cases relating to earlier income years were also processed in START (for example, late filers for the 2017–18 income year), but these cases were not able to enjoy the benefit of the recent amendments.

As these amendments were intended to cover all transfers under START, the proposed amendments will change the effective date of these earlier amendments to the 2017–18 and later income years.

FINANCIAL ARRANGEMENT RULES: DEBT-EQUITY SWAPS

Clause 50

Summary of proposed amendment

The proposed amendments would ensure that arrangements for an insolvent company debtor to issue shares for consideration on the basis that all or part of that consideration is used to repay a debt owed to the shareholder are treated in the same way as a direct issue of shares in repayment of debt.

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent.

Background

Under general tax principles, the forgiveness of a debt gives rise to taxable income because the debtor is in a better economic position than they were prior to the debt being forgiven.

Under the current rules, tax consequences follow the form of the arrangement. This means that debt-forgiveness income can be avoided by using a two-step debt-equity swap. If shares are issued directly in exchange for a reduction in debt and the shares are worth less than the amount of the reduction, the debtor is taxed on debt forgiveness income. This is because the shares are worth less than the debt forgiven. However, if the arrangement is an issue of shares for cash and the debtor is required to use that cash to reduce or repay the debt, the shares can be treated as worth the same as the debt reduction, regardless of their actual value, and therefore no debt-forgiveness income arises.

The proposed amendments would ensure that the financial arrangements rules operate as intended and taxpayers cannot avoid deriving debt-forgiveness income by using a two-step process for debt-equity swaps.

Key features

The proposed amendments would apply where there is an arrangement for an insolvent company to issue shares for consideration on the basis that all or part of that consideration is used to make a payment under a financial arrangement to which the company or an associated person is a party.

Under the proposed amendments, that part of the consideration for which the shares are issued and the use of that consideration to make a payment under the financial arrangement would be disregarded.

The issue of the shares would instead be treated as a payment under the financial arrangement. The amount of the payment would be the market value of the shares.

FINANCIAL ARRANGEMENTS – IMPAIRED CREDIT ADJUSTMENTS

Clauses 48 and 194

Summary of proposed amendments

The proposed amendments would clarify that reversals of impaired credit adjustments to financial assets under the IFRS method are non-assessable to the extent that the reversal offsets a previous decline.

Effective date

The proposed amendments would take effect on 1 April 2007.

Background

Taxpayers who adopt the IFRS method are required to allocate the annual gain or loss in the value of a financial arrangement to an income year. However, if the financial arrangement is a financial asset, section EW 15D(2)(a) of the Income Tax Act 2007 requires that an amount arising from an impaired credit adjustment must not be allocated to an income year.

This means that an adjustment due to the decline in the credit quality of a financial asset under IFRS is not tax deductible. This is the correct policy result, as these adjustments are provisions for doubtful debts. Doubtful debts are not tax deductible until they are written off as bad debts.

Section EW 15D(3)(a) provides that an "impaired credit adjustment" means:

for a financial arrangement accounted for under the fair value method, the movement in fair value through the decline in credit quality of the arrangement.

Therefore, as the current law only considers declines in credit quality, an adjustment in recognition of a financial asset's credit upgrade that reverses some, or all, of a previously reported credit loss is taxable income, even though the initial recognition was not deductible.

This is an incorrect result and inconsistent with the policy intent of the subsection. In practice, Inland Revenue has been allowing reversals of impaired credit adjustments to be non-assessable. The proposed amendments would align the legislation with existing practice.

Detailed analysis

The proposed amendment to section EW 15D(3)(a) would ensure that reversals of impaired credit adjustments for financial arrangements accounted for under the fair value method are non-assessable to the extent they offset a previous decline. Increases in credit quality above, or in the absence of, a previous decline will still be required to be allocated to an income year and will remain assessable.

A corresponding amendment will also be made to section EW 15C(4) of the Income Tax Act 2004 for completeness.

Example 52: Reversal of an impaired credit adjustment

A company recognises a financial asset under the IFRS method with an initial fair value of \$100.

There is a decline in credit quality of the financial asset during the first year. In recognition of an estimated credit loss, the company makes an impaired credit adjustment of \$10 at the end of Year 1, resulting in a decrease in fair value of the asset to \$90. This adjustment is not tax deductible.

During Year 2 there is an improvement in the credit quality of the financial asset. The company revises its estimated credit loss for the asset and makes an upwards adjustment of \$8 to partially reverse the previous impaired credit adjustment. This results in an increase in fair value of the asset to \$98.

The proposed amendments would ensure that the \$8 gain is not required to be allocated to an income year and is not assessable income as it is a reversal of an impaired credit adjustment.

Example 53: Improvement in credit quality above a previous decline

Assume the same facts as in example 52 above. During Year 3, there is a further improvement in the credit quality of the financial asset. The company revises its estimated credit loss for the asset to a credit gain and makes an upwards adjustment of \$5. This results in an increase in fair value of the asset to \$103.

The proposed amendments would provide that \$2 of the \$5 adjustment would be non-assessable, as this is the proportion of the adjustment that is offsetting an earlier decline. The remaining \$3 is not a reversal of an impaired credit adjustment and will be assessable income.

GENERAL AND LIFE INSURANCE – REPLACEMENT OF NZ IFRS 4 WITH NZ IFRS 17

Clauses 20, 44, 58, and 98(10), (13), (14) and (25)

Summary of proposed amendments

The proposed amendments would update the Income Tax Act 2007 (ITA) to reflect that the NZ IFRS 4 accounting standard will be replaced by a new standard, NZ IFRS 17, from 1 January 2023.

Effective date

The proposed amendments would take effect on 1 January 2023.

Key features

The proposed amendments would:

- replace existing references to NZ IFRS 4 with references to NZ IFRS 17, and
- grandparent existing life financial reinsurance arrangements between Inland Revenue and taxpayers.

Detailed analysis

Life and general insurers currently use the NZ IFRS 4 accounting standard when calculating their Outstanding Claims Reserve (OCR). However, NZ IFRS 4 will be replaced by the new accounting standard, NZ IFRS 17, from 1 January 2023.

To ensure taxpayers can continue to use IFRS accounting standards to calculate their OCR, the proposed amendments would replace the existing references to NZ IFRS 4 with references to the new NZ IFRS 17 accounting standard.

Inland Revenue has agreements in place with taxpayers that determine the spreading method to be used for life financial reinsurance contracts. These agreements were reached under NZ IFRS 4. The proposed amendments contain a grandparenting provision that preserves these existing agreements once the new NZ IFRS standard takes effect. This will allow the existing spreading agreements to remain in force after NZ IFRS 4 is replaced.

UPDATING LEGISLATIVE REFERENCES TO OECD TRANSFER PRICING GUIDELINES

Clauses 66, 98(12) and (26), and 141(5)

Summary of proposed amendments

The proposed amendments would update the definition of “OECD transfer pricing guidelines” in section YA 1 of the Income Tax Act 2007 (ITA) to refer to the 2022 version of the guidelines (2022 Guidelines) instead of the 2017 version (2017 Guidelines). A savings provision gives taxpayers time to become familiar with the new guidelines.

Effective date

The proposed amendments would take effect on 20 January 2022.

However, a taxpayer may choose to apply the 2017 Guidelines for the 2022–23 and earlier income years or for the period of any existing binding ruling applying the 2017 Guidelines (even if the period of the ruling extends beyond the 2022–23 income year).

Background

Transfer pricing rules apply to cross-border transactions between associated persons. Under section GC 6 of the ITA, the domestic transfer pricing rules are to be applied consistently with the “OECD transfer pricing guidelines”.

The definition of “OECD transfer pricing guidelines” in section YA 1 currently refers to the 2017 Guidelines.³⁴ A deliberate decision was made to refer to a specific version of the guidelines, rather than to the guidelines as updated from time to time. This was so New Zealand did not automatically incorporate into domestic law any changes made at the OECD level without knowing, and considering, those changes.

On 20 January 2022, the OECD published an updated version of the transfer pricing guidelines.³⁵ Officials have considered the changes made in the 2022 Guidelines and concluded the new guidelines are consistent with current transfer pricing practices. The 2022 Guidelines also provide additional guidance on the transfer pricing aspects of financial transactions. The 2017 Guidelines are therefore out of date, and references to the 2017 Guidelines in the ITA should be updated to refer to the 2022 Guidelines.

Detailed analysis

Transfer pricing rules apply to cross-border transactions between a New Zealand resident and an associated non-resident. Where the non-resident is in a country with which New Zealand has a double tax agreement (DTA), the transaction is covered by the relevant DTA article based on Article 9 (Associated Enterprises) of the OECD Model Tax Convention (OECD Model). However, where the non-resident is in a country with which New Zealand does *not* have a DTA, the applicable rules are found in

³⁴ OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017.

³⁵ OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022: <https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm>

sections GC 6 to GC 14 of the Income Tax Act 2007. New Zealand currently has 40 bilateral DTAs in force.

The proposed amendments will only affect transactions not covered by a DTA. Cross-border transactions covered by an existing DTA will instead be governed by that DTA. DTAs are generally interpreted using an “ambulatory” approach, which means that guidance issued after the DTA came into force can still be considered in its interpretation. Although this has an element of retrospectivity, the convention is that updates to commentary and guidance are clarificatory only. Substantive changes should instead be made by changing the OECD Model itself, which will not automatically affect existing DTAs.

Consistent with this convention, the differences between the 2017 Guidelines and the 2022 Guidelines are relatively minor and clarificatory in nature. They are also unlikely to affect most New Zealand taxpayers. One change relates to the “transactional profit split” transfer pricing method, which is rarely used in New Zealand. Another change provides guidance on certain hard-to-value intangibles, which are not generally observed in the New Zealand market. The most significant change is the inclusion of a new chapter on financial transactions. However, the guidance in that chapter is consistent with existing general transfer pricing principles and simply provides more detail and examples of how those principles apply to particular transactions.

We also note that the changes in the 2022 Guidelines are from three OECD reports released in 2018 and 2020. Those reports were subject to public consultation, and therefore most transfer pricing practitioners were already aware of the changes before the 2022 Guidelines were published.

The proposed amendments update the references to the 2022 Guidelines in section GC 13(1C) and the definition of “OECD transfer pricing guidelines” in section YA 1 of the ITA.

Savings provision

The savings provision is intended to give taxpayers more time to familiarise themselves with the new 2022 Guidelines. As noted above, however, the proposed amendments (and therefore the savings provision) will only affect transactions not covered by a DTA.

Note that section GC 13(1C) currently refers to a particular paragraph of the 2017 Guidelines and it is proposed that this will be updated to refer to the new paragraph number for the relevant paragraph in the 2022 Guidelines. If a taxpayer relies on the savings provision and applies the 2017 Guidelines, they should continue to refer to the relevant paragraph in the 2017 Guidelines.

INCOME OF DECEASED PERSONS RECEIVED AFTER DATE OF DEATH

Clauses 21 and 69

Summary of proposed amendments

The proposed amendments would allow the tax return for a deceased person to include reportable income received up to 28 days after their date of death (DOD).

Effective date

The proposed amendments would be effective for the 2022–23 and later income years.

Background

Section HC 8 of the Income Tax Act 2007 currently provides that, in the case of a deceased person, an amount that would have been income of the person if they had been alive when it was received is treated as income of the trustee of the person's estate. This requires the estate of the deceased person to register for an IRD number and file a separate tax return for the estate. Where the person has received only cash basis income this requirement seems excessive and results in unnecessary compliance costs, particularly where there is no tax to pay as the income has been fully taxed at source.

This particularly affects payments by the Ministry of Social Development, whose current policy is to make payments to a deceased person up to 28 days after DOD. Under the current legislation, such payments are technically not considered to be payments received by the deceased person but rather by the estate. The estate is required to file a return for these payments under an estate IRD number.

Key features

Proposed new section HC 8(1B) would enable reportable income received up to 28 days after a person's DOD to be treated as income of the deceased person and included in a return filed under their IRD number. The result will be that the executor of the deceased person's estate will not need to apply for an estate IRD number nor file a return for any reportable income received by the deceased person up to 28 days after DOD.

A consequential amendment is proposed to section CV 12 to ensure the amount of any such reportable income is not income of the trustee of the estate if it was received within 28 days of the person's DOD.

NON-ACTIVE TRUSTS

Clauses 151 and 152(1)

Summary of proposed amendments

The proposed amendments would ensure that trusts and estates that derive small amounts of income are not required to file a tax return and therefore not required to comply with the new trust disclosure requirements.

Effective date

The proposed amendments would be effective for the 2021–22 and later income years.

Background

Section 43B of the Tax Administration Act 1994 provides an exclusion for trustees of non-active trusts and executors or administrators of non-active estates from their tax filing obligations. Given the increased disclosure requirements under the new trust disclosure rules, the definitions in section 43B are overly restrictive and require more trusts and estates to file returns and comply with the new trust disclosure requirements than was intended.

Some specific issues relating to the section are as follows:

- It requires small testamentary trusts to file a return and meet the increased disclosure requirements, which may increase fees that would erode the corpus of the trust before vesting.
- It does not apply to trusts with small amounts of income other than bank interest.
- The de minimis of \$200 for income and deductions is set too low and means that trusts that have immaterial amounts of income where tax has been deducted at source are required to file a return.
- It is arguable that the wording in one of the exceptions does not deal with interest expenditure relating to dwellings owned by the trust.
- It is unclear whether every non-active trust is required to notify Inland Revenue that it is non-active even if the trust does not have an IRD number.

Key features

The proposed amendments would include more trusts and estates within the ambit of section 43B, therefore removing them from the tax return filing obligations and increased trust disclosure requirements. In particular, the proposed amendments would:

- No longer require a person to provide a declaration to the Commissioner that the trust or estate is non-active if the trust or estate does not have a IRD number.
- Increase allowable administration costs from \$200 to \$1,000.
- Extend the income exception from bank interest to reportable income.³⁶
- Increase the threshold of the income exception from \$200 to \$1,000.

³⁶ Assuming the trust is a natural person for the definition of "reportable income".

- Clarify that interest is included in the expenditure relating to dwellings owned by the trust.
- Ensure that testamentary trusts with small amounts of income will not be required to file a tax return so that the administrative costs associated with filing returns do not unduly diminish the value of the trust. This would apply to a trust that:
 - is a testamentary trust
 - has distributions during the income year that do not exceed \$100,000
 - earns reportable income not exceeding \$5,000 for the income year and has tax deducted from that income at the correct rate, and
 - if the trust derives non-reportable income of \$1,000 or less, has deductions against that income of at least \$800 for the income year.

PROVISIONAL TAX – STANDARD UPLIFT CALCULATION METHOD FOR THE SECOND INSTALMENT

Clause 88

Summary of proposed amendments

The proposed amendments would clarify the “uplift” factor a taxpayer using the standard method must use to calculate provisional tax payable for the year if they have not filed the preceding tax year’s tax return on or before the second instalment date.

Effective date

The proposed amendments in clauses (1) and (2) would have effect for provisional tax payments for the income years corresponding to the 2008–09 and later tax years.

The proposed amendments in clauses (3)-(6) would be effective for the 2017–18 and later income years.

Background

For taxpayers using the standard “uplift” factor to calculate their provisional tax liability, section RC 5(3) of the Income Tax Act 2007 is unclear which uplift factor should be used by a taxpayer.

The policy intent is that a taxpayer using the standard method to calculate their provisional tax liability for a tax year can initially use 110% of their residual income tax for the tax year before the preceding tax year to calculate their standard “uplift” amount (the 10% uplift). However, once they file the preceding tax year’s return the 110% option becomes unavailable to them, and they must use the 5% uplift factor (based on 105% of their residual income tax for the preceding tax year).³⁷

As the legislation currently reads, if a taxpayer has not filed their preceding year’s tax return before their first instalment date for provisional tax, it is arguable they can then use the 10% uplift for their second instalment date. This is the case even if they file their preceding tax year’s return after the first instalment date but before, or on, the second instalment date. This does not reflect the policy intent.

In addition, there appears to be some confusion as to which “uplift” factor must be used when an instalment date falls on a day that is not a working day and taxpayers pay that instalment on the next working day but also file their preceding year’s tax return on that same day.

The policy intent was correctly reflected in the Income Tax Act 2004. The uncertainty appears to have arisen as an unintended consequence of the rewrite of the legislation. The proposed amendments would clarify the position to reflect the policy intent.

³⁷ This also applies if the relevant instalment is the final instalment.

INCOME TAX TREATMENT OF GRANTS PAID BY PUBLIC PURPOSE CROWN-CONTROLLED COMPANIES

Clauses 30 and 36

Summary of proposed amendments

The proposed amendments would ensure that grants paid by public purpose Crown-controlled companies (PPCCCs) have the same income tax treatment as grants paid by public authorities.

Effective date

The proposed amendments would have effect for grants and subsidies paid by PPCCCs on or after 18 March 2019.

Background

On the advice of Crown Law, Inland Revenue changed its interpretation of a “public authority” in 2015. This resulted in a number of entities no longer qualifying as public authorities.

A new income tax exemption for PPCCCs (section CW 38B of the Income Tax Act 2007) was enacted by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 with effect from 18 March 2019. Section CW 38B provides an income tax exemption for companies that meet specific criteria, including having a primary purpose of carrying out a public policy objective of the Government. Section CW 38B effectively restored the income tax exemption to certain companies that no longer qualified as public authorities following the change in interpretation.

Grants paid by public authorities are exempt income of the recipient (section CX 47). The recipient is denied a deduction, to the extent of the amount of the grant, for expenditure that corresponds to the grant from the public authority (section DF 1).

The Commissioner of Inland Revenue applied administrative discretion to treat PPCCCs as public authorities between the change of interpretation of “public authority” in 2015 and the enactment of section CW 38B on 18 March 2019. This meant that while PPCCCs were considered public authorities, grants paid by PPCCCs were exempt income of the recipient and deductions were denied for the corresponding expenditure.

When section CW 38B was enacted on 18 March 2019, no consideration was given to how grants paid by PPCCCs should be treated by the recipients. Since 18 March 2019, these grants have been taxable income to the recipient and deductions have been allowed.

Key features

The proposed amendments would treat grants paid by PPCCCs as exempt income in the hands of the recipients and would deny deductions for expenditure relating to the grants. This would ensure that these grants are treated the same as grants from public authorities.

LTC ELECTION – ROLLOVER OF ACQUISITION DATE FOR COMPANY ASSETS

Clause 68

Summary of proposed amendment

The proposed amendment would clarify that, for a company making an election to become a look-through company (LTC), the LTC has the same acquisition date for the company's assets as the superseded company.

Effective date

The proposed amendment would take effect on 1 April 2011, being the original effective date for section HB 13(6) of the Income Tax Act 2007.

Background

When a company makes an election to become an LTC, it is effectively deemed to have been replaced by the LTC. The policy intent is that the LTC steps into the shoes of the superseded company for all purposes under the LTC rules. In line with this intention, section HB 13(6) provides that an entity that ceases to be a company upon becoming an LTC is treated as having, as an LTC, the same status, intention, purpose and tax book values it had as a company for its assets, liabilities and associated legal rights and obligations. However, the section does not explicitly refer to the LTC having the same acquisition date for the assets as the superseded company. The proposed amendment would remedy this by providing that the LTC has the same tax book timings as the superseded company.

REFERENCES TO ADOPTION IN THE ITA AND THE TAA

Clauses 67, 71, 98(17), 99, 167 and 177

Summary of proposed amendments

The proposed amendments would remove redundant references to adopted children from the Income Tax Act 2007 (ITA) and Tax Administration Act 1994 (TAA).

Effective date

The proposed amendment would take effect on the day after the date the Bill receives the Royal assent.

Background

The Adoption Act 1955 provides that, once an adoption order has been made, an adopted child is deemed to become the child of the adoptive parents for all purposes, civil, criminal, or otherwise. The child is also deemed not to be the child of the birth parents. This is subject to the provisions of any enactment that distinguishes in any way between adopted children and other children.

Therefore, the ITA and TAA do not need to specifically refer to children by adoption to ensure they are treated the same as children by birth, as they are already included within references to blood relatives. Both Acts contain several references to adoption, and these could create a negative inference for other provisions that do not include such a reference.

Key features

The Bill proposes to remove redundant references to adopted children in the ITA and TAA. The proposed amendments would not change the treatment of adopted children, who are already treated as blood relatives unless specifically provided otherwise. The amendments would simply remove any potential uncertainty around their treatment under the ITA and TAA.

The proposed amendments are summarised in the table below. Certain references are deliberate and would be retained.

Table 4: References to children by adoption in the Income Tax Act 2007 and Tax Administration Act 1994

References to be removed	References to remain unchanged
Section HA 7(3)(a) of the ITA	Section HC 36(5) of the ITA and the reference to section 7(4) of the Adoption Act 1955 in the definition of "guardian"
Section HC 36(5) of the ITA in the definition of "relative"	Section 80KB of the TAA
Section YA 1 of the ITA in paragraph (a)(iv) of the definition of "relative"	
Section YB 4(3) of the ITA	

References to be removed	References to remain unchanged
Section 124G(4)(b) of the TAA	
Sections 173M(5) and (6)(c) of the TAA in relation to the definition of 'relative'	

INVESTMENT IN AUSTRALIAN UNIT TRUSTS

Clauses 14, 31, 51, 52, 55, 56 and 57

Summary of proposed amendments

The proposed amendments would:

- allow New Zealand resident investors who hold 10% or more of the interests in an Australian unit trust (AUT) to use the fair dividend rate (FDR) method for calculating their attributable foreign investment fund (FIF) income, and
- reduce economic double taxation by removing from taxation in New Zealand the income sourced from certain attributing interests in a FIF that will already be subject to tax under the FIF rules.

Effective date

The proposed amendment to the availability of the FDR method would be effective for income years commencing on or after 1 July 2014. The proposed amendments to limit the risk of economic double taxation would be effective for income years commencing on or after 1 April 2023.

Background

AUTs are an investment vehicle popular in Australia, particularly for large-scale infrastructure investments like public-private partnerships. AUTs are treated as trusts under Australian tax law but are considered companies under New Zealand tax law.

In many AUTs, the beneficiaries of the unit trust (unit holders) have fixed rights to trust income that are not subject to trustee discretion. Income rights are divided amongst the beneficiaries based on how many units have been issued to them. The AUTs can be treated as 'flow-through' for Australian income tax purposes, with the unit holders treated as receiving the AUT income.

The FIF rules tax investments held by New Zealand residents in a range of foreign funds, including foreign unit trusts. The FIF rules apply to portfolio interests (less than 10%) and, in some situations, to non-portfolio interests. The investor is taxed on their income from the investment on accrual. There are several methods available to investors under the FIF rules to calculate their attributable FIF income. FIF distributions are generally not taxed to prevent double taxation. The intent of the FIF rules is to ensure that New Zealand residents do not escape New Zealand income tax on their foreign investments.

Under the FIF rules, the FDR method deems 5% of the opening value of a person's investment to be taxable income. The FDR method is the standard method for many New Zealand residents for calculating attributable FIF income.

The controlled foreign company (CFC) rules apply to interests held by New Zealand residents in foreign companies where generally five or fewer New Zealand residents hold 50% of the shareholding. The CFC rules tax mobile passive income as it accrues so that New Zealand income tax cannot be avoided by sheltering foreign income offshore.

However, the current FIF and CFC rules can cause undesirable outcomes for New Zealand resident investors in AUTs in certain situations. The proposed amendments would rectify this.

Key features

The proposed amendments would:

- amend the definition of an “opening value” of a FIF interest in sections EX 52(5) and EX 53(5) of the Income Tax Act 2007 (ITA) to ensure that taxpayers can calculate their FIF income from an attributable interest in an AUT under the FDR method
- extend the current treatment of distributions received from an AUT (which are treated as excluded income and not dividends) to include distributions from an AUT that are sourced from an attributing interest in a FIF, and
- amend the CFC rules to exclude certain amounts from being an attributable CFC amount. This exclusion would apply to distributions received by an AUT CFC from an attributing interest in an AUT FIF, where an appropriate FIF calculation method is applied to that FIF. A consequential change is also proposed to the CFC rules to limit the funding costs deduction for distributions made by the AUT CFC.

Detailed analysis

Inability to use FDR method

New Zealand resident investors who hold 10% or more of the interests in an AUT are currently unable to use the FDR method for calculating their attributable FIF income.

Before 2014, interests of 10% or more in AUTs were exempt from the New Zealand FIF and CFC rules. In 2014, the FIF exemption for most AUTs was removed. However, certain consequential changes to the FIF rules were not made. In particular, the definition of “opening value” in the FDR method calculation rules was not amended to accommodate AUTs, which means that calculating FIF income under the FDR method is not possible. This omission inadvertently limits the options available for a New Zealand resident investor to calculate their FIF income from AUTs.

The proposed amendment would ensure that New Zealand resident investors in AUTs can use the FDR method to calculate their FIF income in relevant situations. This change would be effective retrospectively to income years commencing on or after 1 July 2014 to preserve the position of taxpayers that may have calculated attributable FIF income using the FDR method since that date.

Double taxation of FIF income from certain indirect AUT interests

Where a New Zealand tax resident holds a direct interest in a FIF and one of the FIF methods listed in section EX 59 of the ITA are used to calculate income, the rules ensure no further taxation arises from that FIF interest to avoid double taxation. This is done by treating distributions from certain attributing interests in a FIF as excluded income and as not being a dividend. However, there is no corresponding exclusion of distributions from indirect FIF interests held by a CFC.

This means if a New Zealand resident holds their FIF investment through an overseas subsidiary, rather than directly, a distribution from that indirect FIF interest can be taxable. An example of this is where an AUT that is a CFC holds the FIF interest. Distributions from an AUT generally do not qualify for the foreign dividend exemption and are taxed in New Zealand. This can result in double taxation of a New Zealand investor on the same economic income – once as attributed FIF income, and again as the distribution from the AUT.

The proposed amendment would extend the dividend exclusion and excluded income treatment to a distribution paid by an AUT from funds sourced from certain attributing interests in a FIF. This would help to ensure that the economic income of the relevant FIF is only taxed once.

Over taxation of AUT CFC income

Where a New Zealand resident investor owns an AUT CFC that holds an interest in an AUT FIF, a distribution from the AUT FIF to the CFC may be an attributable CFC amount for the New Zealand resident. The CFC rules provide a deduction for distributions by an AUT CFC in certain circumstances, but this is limited to a proportion based on the CFC's assets that derive attributable CFC amounts relative to its total assets. While an AUT CFC must return the entire distribution from the AUT FIF as income, only a portion of that distribution is deductible when the AUT CFC passes that distribution on to its investors. Double economic taxation can arise because the New Zealand investor returns income under the FIF rules on its indirect investment in the AUT FIF and a portion of this is also returned by the taxpayer as income from its direct interest in the AUT CFC under the CFC rules.

The proposed amendment would update the CFC rules to exclude amounts received by an AUT CFC from an attributing interest in an AUT FIF where the FIF income or loss of the AUT FIF will separately be attributed to a New Zealand resident under one of the methods listed in section EX 59 of the ITA. This will ensure that the economic income of the relevant FIF will only be taxed once to the New Zealand investor. An additional change will ensure that a deduction is not available under the CFC rules to the extent the AUT CFC on-pays the FIF distribution to its investor(s).

INTEREST RATE SWAPS HELD BY MULTI-RATE PIES

Clause 72

Summary of proposed amendment

The proposed amendment would reduce volatility for multi-rate portfolio investment entities (PIEs) by allowing them to choose to use Method C in Determination G27 to spread income and deductions from interest rate swaps if they meet the requirements for the method.

Effective date

The proposed amendment would be effective for the 2023–24 and later income years.

Background

Section HM 35(8) of the Income Tax Act 2007 contains a timing rule that requires a multi-rate PIE to allocate income and deductions:

- as reflected in the PIE’s valuation of investor interests (for example, unit pricing) if such valuations are made, or
- as shown in the PIE’s financial statements if it does not value investor interests.

This rule overrides other timing rules, including the spreading methods in the financial arrangements rules. The intention is to tax PIE income as it accrues to an investor rather than later when the investor may have already exited the PIE.

Interest rate swaps, which change in value as interest rates change, are usually taxed under the financial arrangements rules. Method C in Determination G27 contains one of the available spreading methods for these swaps. This method effectively ignores unrealised fair value gains or losses on interest rate swaps for tax purposes, meaning only interest rate swap cashflows are taxed. This reduces volatility and is appropriate because, while there can be significant fair value movements (both gains and losses) over the life of a swap, these movements should net to zero if it is held to maturity.

Multi-rate PIEs cannot currently use this determination method because of section HM 35(8). This results in volatility because fair value movements on interest rate swaps are included in the taxable income of a multi-rate PIE. The proposed amendment would remedy this.

MEANING OF HIGHLY EFFECTIVE HEDGING

Clause 54

Summary of proposed amendment

The proposed amendment would clarify what highly effective hedging means for non-ordinary shares under the foreign investment fund (FIF) regime.

Effective date

The proposed amendment would take effect on 26 June 2019.

Background

The comparative value (CV) method in section EX 44(1)(c) of the Income Tax Act 2007 must be used to calculate FIF income from all interests that are non-ordinary shares. One of the requirements for a non-ordinary share in section EX 46(10)(c)(ii) is that the FIF's assets must be denominated in New Zealand dollars or be hedged to New Zealand dollars by a hedging instrument that is highly effective under IFRS 9. Alternatively, section EX 46(10)(cb)(iii) requires that the interest in the FIF itself must be hedged to New Zealand dollars by a hedging instrument that is highly effective under IFRS 9. However, IFRS 9 does not refer to, or define, a highly effective hedge. This means it is not clear when the CV method must be used.

This problem is the result of a change made to sections EX 46(10)(c)(ii) and (cb)(iii) on 26 June 2019 that updated the accounting standard reference from NZIAS 39 to IFRS 9. Before this change, the non-ordinary share rules required a hedging instrument to be highly effective under NZIAS 39. NZIAS 39 defined a "highly effective hedge" as a hedging instrument that removes 80% to 125% of the foreign currency risk for the hedged item. This was a simple bright-line test for taxpayers to apply.

Key features

The proposed amendment would remedy this problem by amending section EX 46(10)(c)(ii) to require the FIF's assets to be denominated in New Zealand dollars or have a value in New Zealand dollars that is governed by a foreign currency hedge that removes 80% to 125% of the foreign currency risk for the assets.

It would also amend section EX 46(10)(cb)(iii) to require the interest in the FIF to have a value in New Zealand dollars that is governed by a foreign currency hedge that removes 80% to 125% of the foreign currency risk for the interest.

R&D TAX INCENTIVE – NOTIFICATION OF CHANGES IN ACTIVITIES

Clauses 159 and 160

Summary of proposed amendment

The proposed amendments would amend the R&D tax incentive (RDTI) to:

- remove the requirement for businesses with multi-year general approvals to notify the Commissioner that there have been no material changes in their business, and
- clarify when a business is required to apply for a variation to an existing approval to cover any material changes.

Effective date

The proposed amendments would be effective for the 2020–21 and later income years.

Detailed analysis

Removal of existing notification requirement

Businesses with a general approval of their R&D activities for multiple income years (up to three) are currently required to notify the Commissioner, in each of the second and third years of those approvals, that there have been no material changes for their business for the relevant income year. The first year for which this notification is required is the 2021–22 income year (for multi-year general approvals from the 2020–21 income year).

The proposed amendment would repeal section 68CB(1)(d) of the Tax Administration Act 1994 to remove this requirement as it imposes unnecessary compliance costs on businesses. It is more sensible to require businesses to notify the Commissioner when there is a material change in their business rather than when there is not one.

Requirement to apply for variation

In practice, businesses are already required to apply for a variation to an existing approval if there is a material change in their activities or their criteria and methodologies if they want that change to be covered by the existing approval. This is because a business cannot be credited the RDTI for activities or criteria and methodologies that are not covered, or are materially different from those covered, by their approval. Sections 68CB(7) and (7B) (for general approvals) and section 68CC(8) (for criteria and methodologies approvals) set out the Commissioner's obligations for approving applications for variations. However, they do not specifically state under what circumstances a business must apply for a variation.

Proposed new section 68CB(3B) would apply for activities covered by general approvals. It would clarify that if there is a material change in activities after a business has received approval, and the business wants the change to be covered by the existing approval, it would need to apply to the Commissioner for a variation of its existing approval by the deadline provided for in section 68CB(7) or (7B), as applicable.

Proposed new section 68CC(4B) would apply for criteria and methodologies approvals. It would clarify that if there is a material change in criteria and methodologies after a business has received approval, and the business wants the change to be covered by

the existing approval, it would need to apply to the Commissioner for a variation of its existing approval by the deadline provided for in section 68CC(8).

Both proposed new sections are intended to be clarifications only and would not change the existing processes or obligations for when there is a material change in activities or criteria and methodologies. If there is a material change during the income year (for example, a business performs a new R&D activity during the year not initially covered by its existing RDTI approval), but the business does not wish to claim the RDTI for expenditure associated with that change, then there is no obligation to apply for a variation.

PETROLEUM DECOMMISSIONING

Clause 82

Summary of proposed amendment

The proposed amendment would correct an error with the petroleum decommissioning rules to ensure a refundable credit is not disallowed in a particular circumstance where the intent is that a refundable credit should be available.

Effective date

The proposed amendment would take effect on 30 March 2022 to align with the date that the previous amendments were effective from.

Background

The petroleum decommissioning rules were amended by the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to ensure they applied correctly when a petroleum miner abandoned an exploratory well. Further detail on how these rules apply is in *Tax Information Bulletin* Vol 34, No 5, June 2022.

These amendments included introducing the term “exploration abandonment excess”, which is intended to limit a refundable credit when insufficient tax has been paid by the petroleum miner since drilling for the purposes of exploration ceased. This excess is calculated in one of three different ways depending on the circumstances outlined in sections LT 1(4D)(a) to (c).

However, one particular circumstance inadvertently fell within paragraph (c) instead of paragraph (a). This circumstance is where a petroleum miner has not abandoned any exploratory wells but has a loss for the year that is higher than their expenditure on previously unallocated development deductions (section LT 1(1)(a)(i)) and decommissioning development wells (section LT 1(1)(a)(ii)). In this case, the exploration abandonment excess should be zero (rather than calculated under the formula in section LT 1(4D)(c)) as there is no abandonment expenditure to contribute to the refundable credit.

Key features

Section LT 1(4D)(a) would be amended so that it applies whenever a petroleum miner has not incurred expenditure in plugging and abandoning an exploratory well during the year such that the amount in section LT 1(1)(a)(iii) is zero.

REMOVING TRANSITIONAL PROVISION

Clause 168

Summary of proposed amendment

The proposed amendment would remove a redundant provision.

Effective date

The proposed amendment would have effect for penalties imposed on or after 1 April 2023.

Background

Provisions allowing the Commissioner a discretion not to impose penalties where it was necessary due to resource constraints imposed by the co-existence of two Inland Revenue software platforms were included in the Tax Administration Act 1994. As new tax products were progressively introduced into Inland Revenue's new computer system, START, these provisions have been repealed.

However, the last of these provisions, section 139A(9), was retained until the completion of the business transformation programme as there was a concern that penalties could have arisen in relation to late returns where it would have been appropriate to grant remission. As sufficient time has now passed since all tax products were migrated to START, section 139A(9) is now redundant and should be repealed to avoid any confusion for taxpayers. Consequential amendments are also required to sections 139A(6) and (7) as these provisions refer to section 139A(9).

TRUSTS - IMPUTATION CREDITS AND DISTRIBUTIONS

Clauses 12 and 80

Summary of proposed amendments

The proposed amendments would ensure that the amount of the tax credits apportioned to a beneficiary of a trust after a dividend distribution match the imputation credits included in their assessable income to ensure the beneficiary is only taxed on the imputation credits they actually receive.

Effective date

The proposed amendments would be effective for the 2008–09 and later income years.

Background

Section CD 15(1) of the Income Tax Act 2007 provides that the amount of a dividend received by a person includes any imputation credits attached to the dividend. Section LE 1 provides that if the person's assessable income includes an imputation credit, then they have a tax credit that is equal to the imputation credit (plus any credits from prior years that have been carried forward).

Section LE 5 applies when a person receives an imputed dividend in their capacity as a beneficiary of a trust. The section adjusts the beneficiary's tax credit under section LE 1 so that the amount of tax credit they have under that section is proportionate to the trust distributions they have received.

However, under the Income Tax Act 2004, there was a provision in addition to section LE 5. That additional provision applied if a beneficiary's tax credit was adjusted, and it ensured the beneficiary's imputation credit was also adjusted. This meant the imputation credit included in the beneficiary's assessable income was the adjusted (or limited) amount.

That additional provision was not carried over from the Income Tax Act 2004 to the Income Tax Act 2007. This means that, under current law, a beneficiary can be taxed on a portion of an imputation credit they have not actually received. This was not an intended change in the rewrite of the Income Tax Act. The proposed amendments would therefore correct this.

Key features

The proposed amendments would ensure that any limitation on the tax credit a beneficiary receives following a dividend distribution is also applied to limit the associated imputation credit they receive. The amendments would ensure that only the amount of imputation credit the beneficiary actually receives is included in their assessable income.

Detailed analysis

The proposed amendment to section LE 5(2) would extend the formula prescribed to limit a person's tax credit to also limit the associated imputation credit included in the person's assessable income.

The proposed amendment to section CD 15(1)(a) would then ensure that the imputation credit included in a person's dividend under that section is reduced to take into account any limitation to the imputation credit made under section LE 5. That is, the adjusted imputation credit amount would be included in the person's assessable income if section LE 5 applied to limit their tax credit.

The proposed amendments would ensure that, if the imputation credit is limited because of section LE 5(2), only the imputation credit the person actually receives is included in their assessable income rather than the full imputation credit.

PRIORITY ACCORDED TO KIWISAVER EMPLOYER CONTRIBUTIONS

Clauses 142, 176, 195 and 196

Summary of proposed amendments

The proposed amendments would clarify that KiwiSaver employer contributions have the same preferential debt status whether the employer is a natural person or a company or association.

Effective date

The proposed amendments would take effect on 1 April 2023.

Background

Where an employer is a natural person who has been bankrupted, unpaid KiwiSaver employer contributions are treated as preferential debt under section 167(2)(a) of the Tax Administration Act 1994 (TAA).

Where an employer is a company or an association that is being liquidated, section 167(2)(b) of the TAA provides that KiwiSaver employer contributions have the ranking provided for in schedule 7 of the Companies Act 1993.

However, KiwiSaver employer contributions are not separately identified in schedule 7. This is creating confusion regarding whether they are preferential debt because, in all other cases, taxes with preferential status are separately identified in schedule 7.

There is no reason that KiwiSaver employer contributions should have a different status where the employer is a company or association. The proposed amendments would clarify this.

Maintenance items

MAINTENANCE AMENDMENTS

Summary of proposed amendments

The proposed amendments in table 5 reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

Effective date

Effective dates for the proposed amendments are outlined in table 5.

Minor maintenance items

The proposed amendments in table 5 would correct any of the following:

- ambiguities
- compilation issues
- cross-references
- drafting consistency, including readers' aids – for example, the defined terms lists
- grammar
- consequential amendments arising from substantive rewrite amendments, and
- inconsistent use of terminology and definitions.

Table 5: Maintenance amendments

Enactment	Clause	Section	Amendment	Effective date
Income Tax Act 2007	5	AA 1	Correcting terminology	Day after date of Royal assent
	19	CQ 5(1)(c)(viii)	Correcting terminology	29 September 2018
	24	CX 10(2)(b)	Correcting terminology	29 March 2018
	29	CX 35(2)(b)	Correcting terminology	29 March 2018
	33	DB 53(1)(b)	Correcting terminology	1 April 2020
	40	DH 7(2)	Correcting terminology	27 March 2021
	42	DH 12(2)	Correcting terminology	27 March 2021
	43	DN 6(1)(c)(viii)	Correcting terminology	29 September 2018
	49	EW 46C(6)	Correcting terminology	29 March 2018

Enactment	Clause	Section	Amendment	Effective date
	53	EX 38(1)(f)	Correcting terminology	29 September 2018
	65	GB 28(6)(a)	Correcting terminology	Day after date of Royal assent
	73	HM 40	Correcting terminology	1 April 2020
	74	HR 12(3)(d)	Correcting terminology	Day after date of Royal assent
	76	IC 4(2)	Correcting terminology	29 March 2018
	98(15)	YA 1 (profit distribution plan)	Correcting terminology	29 March 2018
	98(16)	YA 1 (profit distribution plan)	Correcting terminology	29 September 2018
	98(21)	YA 1 (unit trust)	Correcting terminology	29 March 2018
Goods and Services Tax Act 1985	130	60C(2)	Correcting terminology	Day after date of Royal assent
Tax Administration Act 1994	161(1)	89AB(3)	Removing redundant provision	1 April 2009
	161(2)	89AB(4)	Removing redundant provision	1 April 2009
	163	91C(4)	Removing redundant provision	1 April 2009
	170	141(7C) and (7D)	Removing redundant provision	1 April 2009
	173	142B(2)	Removing redundant provision	Day after date of Royal assent
	178	177B(7)	Correcting cross-reference	1 April 2009
	185(2)	Schedule 7, part C, clause 21(2)	Removing redundant provision	1 April 2009

Enactment	Clause	Section	Amendment	Effective date
Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022	187	YA 1 of the Income Tax Act 2007 (cryptocurrency, non-fungible token)	Correction of application and commencement dates	30 March 2022 (to ensure the definitions apply from 1 January 2009)