

New Zealand Law Society

Submission on Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill

1. The Society sets out a number of comments on the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill, intended to enhance the workability of the legislation.

Cancellation of BETA debits from conduit-relieved dividends

Clause 30 – New heading and section OE 11B inserted

2. The insertion of new section OE 11B into the Income Tax Act 2007 (ITA 2007) would have the effect of retrospectively reversing conduit tax relief (CTR) available prior to the effective date of the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009 (the International Tax Act).

Explanation

3. The explanatory note states that the proposed new section OE 11B is intended to prevent the continuation of CTR by cancelling branch equivalent tax account (BETA) debits that arose from conduit-relieved dividends. This misstates the effect of the proposed amendment. In the situation contemplated by new section OE 11B, conduit relief will already have been claimed prior to the effective date of the repeal of conduit relief. By reversing the effect of the conduit relief, the amendment retrospectively pushes forward the effective date of the repeal of conduit relief.
4. The scheme of New Zealand's international tax regime prior to the International Tax Act amendments was to tax income derived offshore by controlled foreign companies and certain foreign investment funds, at the earlier of distribution to a New Zealand resident (which would trigger a foreign dividend payment (FDP) obligation) or attribution to the New Zealand resident under the CFC or FIF rules. This was reflected in the 1997 Government discussion document *Taxation of Conduit Investment*, issued prior to the introduction of CTR:

- 2.7 New Zealand's international tax regime taxes New Zealand companies in two ways on what is a single source of foreign

income. ... The net effect is that tax is imposed on the income stream (attributed income or dividend) that is derived earlier.

5. The CTR regime was then overlaid on the BETA regime; ie CTR was provided at the time the taxing point would otherwise have occurred under the BETA regime. The BETA regime was amended to ensure that BETA credits and debits would arise in respect of conduit-relieved attributed income, or conduit-relieved dividends, as if the tax or FDP on such amounts had actually been paid.

6. The way the BETA and CTR regimes interacted, therefore, ensured that:
 - (a) at the first stage - the taxing point (attribution of income not covered by BETA debits, or distribution of income not covered by BETA credits) - conduit relief would apply;
 - (b) at the second stage (distribution of income previously attributed, or attribution of income previously distributed), BETA relief would apply.

7. The situation contemplated by the proposed amendment is one in which the taxing point (distribution) has occurred, conduit relief has applied, and BETA debits have arisen. The amendment, by cancelling the BETA debit balance associated with conduit-relieved dividends, would deny BETA relief at the second stage. This in turn would have the effect of reversing conduit relief properly claimed at the taxing point. As that taxing point will have occurred prior to the effective date of the repeal of conduit relief, the amendment in the current Bill would give retrospective effect to the repeal of the conduit regime.

8. As a separate matter, the Society's submission in respect of the proposed amendment needs to be considered in the light of the process leading up to the latest proposed amendment. Proposals to allow the continued use of BETA debit balances were included in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill introduced on 2 July 2008, and it was signalled that such treatment would continue for a 2-year period (see the media statement "Tax reform to help NZ companies compete overseas" from the Ministers of Finance and Revenue, 2 July 2008, a copy of which is annexed). These proposals were then the subject of public consultation and consideration by the Finance and Expenditure Committee. Following that consultation, the proposals in respect of the continued use of BETA debits were refined, to better facilitate the continued use of BETA debits over the 2-year transitional period (see page 137, volume 4 of the Officials' Report on the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill).

9. Affected taxpayers could quite reasonably have proceeded on the basis that following that process, the transitional provisions in respect of BETA debit balances had been settled, and that taxpayers could make projections as to their future tax liabilities accordingly. The proposed new section OE 11B, if it proceeds, will undermine those expectations, and reverse the position reached following extensive consultation and consideration by the officials and the Finance and Expenditure Committee last year. Such a process is unlikely to be conducive either to taxpayers' confidence in the rule of law, or to their ability to make business decisions on the basis that decisions reached and communicated to taxpayers following consultation can be relied upon.
10. If the proposed new section OE 11B does proceed, its effect should be limited to BETA debits arising on or after 2 July 2008. The Bill proposes to cancel all BETA debits arising in respect of conduit-relieved dividends. If, contrary to the discussion above, it is determined that this proposal should proceed, the proposed new section OE 11B should be limited to BETA debits arising in respect of conduit-relieved dividends paid from 2 July 2008.
11. Any perceived risk to the tax base should exist only through CFCs (and FIFs where relevant) paying disproportionately large dividends to CTR companies, in order to accelerate the taxing point for such income to maximise the extent to which it qualifies for conduit relief. It is highly unlikely this could have occurred prior to the introduction of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill on 2 July 2008. Prior to that date, dividends can reasonably be expected to have been in a "business as usual" category, and not driven by any desire to create BETA debits that could provide a benefit following the repeal of the conduit regime.
12. If the proposed new section OE 11B does proceed, it needs to be redrafted so as to apply only to dividends for which CTR was provided, as it should not apply to BETA debits arising from FDP actually paid. As currently drafted, the proposed new section OE 11B would cancel all BETA debits in respect of both conduit-relieved dividends and dividends on which FDP was not reduced by CTR. If the proposed new section OE 11B is inserted into the ITA 2007, it should be redrafted to apply only to the extent dividends were in fact conduit-relieved.
13. The proposed new section OE 11B would cancel all BETA debits that "arose under section OE 12". Section OE 12 gave rise to BETA debits in respect of dividends received from CFCs, both in the situation where those dividends were conduit-relieved and where they were not. Therefore, the proposed new section OE 11B would have the effect of cancelling BETA debits that arose in respect of any dividend, including where FDP was paid in respect of the

dividend. According to the commentary on the Bill prepared by the Inland Revenue, BETA debits arising from FDP paid were not intended to be cancelled.

14. Should the proposal to insert the proposed new section OE 11B proceed, it should be redrafted to apply only to conduit-relieved dividends, and only to the extent that the FDP liability on such dividends was relieved by CTR. The proposed new section OE 11B therefore should not cancel BETA debits to the extent they arose from FDP actually paid.

Recommendations

15. That the proposed new section OE 11B not proceed.
16. That if the proposed new section OE 11B proceeds, the Committee give consideration to the matters raised in paragraphs 10 – 14. (In particular, as explained in paragraphs 12 - 14 above, the provision as drafted appears to contain a drafting error in that it would reverse all BETA debits, not just those arising from dividends for which FDP has been relieved by CTR.)

Trans-Tasman portability of retirement savings

Clause 80 – Schedule 1 - KiwiSaver scheme rules

17. Section MK 8 of the ITA 2007 should be amended to exclude explicitly any transfer under proposed clause 14B of schedule 1 of the KiwiSaver Act 2006 (the KiwiSaver scheme rules). This could be achieved, for example, by inserting the following after subsection MK 8(1):

When this section does not apply

- (1B) Nothing in this section applies to a transfer under schedule 1, clause 14B of the KiwiSaver Act 2006.

Explanation

18. Section MK 8 provides that where a member makes a withdrawal or transfer for permanent emigration under clause 14 of the KiwiSaver scheme rules “or an equivalent provision”, the fund provider must pay to the Commissioner the tax credit paid for the member and held by the fund provider (or the member’s accumulation, if this is lesser).
19. This could be read to include clause 14B as an equivalent provision to clause 14, as both clauses cover withdrawal or transfer after emigration. On a literal interpretation, this would mean that on a transfer under clause 14B, the fund provider would be required to pay the

amount of the member's tax credits to the Commissioner (under section MK 8) and to the member (under clause 14B).

Recommendation

20. That section MK 8 be amended to clarify that it does not apply to a transfer under proposed clause 14B of Schedule 1, of the KiwiSaver Act 2006 (the KiwiSaver scheme rules).

Clauses 32 and 72 - definition of Australian complying superannuation scheme

21. The proposed definition of "Australian complying superannuation scheme" in the ITA 2007 (clause 32(2) of the Bill) and KiwiSaver Act 2006 (clause 72(1)) should be amended to refer to "Division 2 of Part 5 of the Superannuation Industry (Supervision) Act 1993 (Aust) ..."
22. The Superannuation Industry (Supervision) Act 1993 (Aust) contains multiple divisions labelled "Division 2". The relevant Division 2 is in Part 5 of the Act.

Meaning of controlled foreign company

Clause 85 - Meaning of CFC

23. The savings provision in the proposed section 85(2)(b) should extend to the 2005-2006 income year. The provision in clause 85 restores the Income Tax Act 1994 definition of "controlled foreign company" in the Income Tax Act 2004 (ITA 2004). The savings provision in the proposed section 85(2)(b) protects taxpayers who have taken a tax position on the basis of the law as stated prior to the proposed amendment. Therefore, the proposed section 85(2)(b) should extend to any income year "that is the 2005-06 income year or any subsequent income year", rather than "after the 2005-06 income year" as currently drafted.

Explanation

24. The savings provision in the proposed new section 85(2)(b) is drafted to apply to income years after the 2005-2006 income year. However, the ITA 2004 applied for the 2005-2006 income year and later income years (and the amended definition is to apply for the 2005-2006 income year and later income years under the proposed section 85(2)(a)). Taxpayers who took a tax position for the 2005-2006 income year based on the definition of controlled foreign company as it currently stands in the ITA 2004 would not be covered by the savings provision. This is contrary to the intention stated on page 5 of the explanatory note that the savings provision is to protect such taxpayers.

Recommendation

25. That the savings provision in the proposed section 85(2)(b) be extended to include the 2005-2006 income year.

Binding rulings**Clauses 36 and 67 to 69 – interpretation and application of Commissioner’s official opinion**

26. The Society suggests that the proposed new safe harbour relating to reliance on the "Commissioner's official opinion" extend to written guidance published by the Commissioner, if applicable to the particular taxpayer and their particular circumstances.
27. The Committee should also give consideration to bringing forward the application date of this safe harbour, so that it may apply in respect of tax positions taken on or after the date of Royal assent, at least as regards opinions published as guidance for the general public or a particular group of taxpayers.

Explanation

28. The Bill proposes to introduce a safe harbour from use of money interest and shortfall penalties (other than for tax evasion) where taxpayers rely on certain advice from Inland Revenue. As currently drafted, advice contained in Inland Revenue guides and booklets (such as a *Tax Information Bulletin*) is excluded from this safe harbour. This creates problems of uncertainty for taxpayers, as the courts have held that the Commissioner is not bound by information contained in such guides.
29. For instance in *CIR v Ti Toki Cabarets (1989) Ltd* (2000) 19 NZTC 15,874 the taxpayers had attempted to rely on the Commissioner’s statement of policy in a *Tax Information Bulletin*. However, the Court of Appeal held that the taxpayers were not entitled to rely on such a stated policy if the Commissioner changes his position, and it transpires that the earlier stated policy does not reflect the correct legal position.
30. Views may differ about whether it is fair for a taxpayer, having relied on the Commissioner’s published interpretation, to subsequently find that the Commissioner has changed his interpretation, such that the taxpayer faces an unexpected tax impost. But what is unfair is that a taxpayer acting in reliance on such published advice could (as well as facing an

unexpected tax cost) be penalised, through the imposition of penalties as well as use of money interest at an above-market rate.

31. “The binding rulings system: legislative issues - an officials’ issues paper” (July 2009) at paragraph 7.4 states:
 “In whatever format the Commissioner provides advice, taxpayers should be able to rely on that advice.”
32. The Society agrees with this statement of principle, and sees no reason why the principle should exclude situations in which a taxpayer relies on the Commissioner’s published guidance. The amendment suggested (as paragraph (a)(ii) of the proposed definition of “Commissioner’s official opinion”) protects Inland Revenue’s interests by requiring that the guidance relate to an arrangement or circumstances not materially different from the taxpayer’s arrangement or circumstances. It is again emphasised, that reliance on the “Commissioner’s official opinion” will not relieve taxpayers from an underlying tax liability. It will relieve them only from the consequences of being penalised notwithstanding that they have followed the Commissioner’s published guidance.
33. As a separate matter, many interpretation statements published by the Commissioner are long-standing and are not regularly renewed. To restrict the application date to an opinion given by the Commissioner on or after the date of Royal Assent could be unduly restrictive, at least as regards opinions published as guidance for the general public or a particular group of taxpayers.

Recommendations

34. That paragraph (a) of the proposed new definition of the “Commissioner’s official opinion” in section 3(1) of the Tax Administration Act 1994 be amended as follows:

Commissioner’s official opinion –

- (a) means, for a taxpayer:
- (i) an opinion of the Commissioner concerning the tax affairs of the taxpayer, given by the Commissioner, either orally or in writing, after all information relevant to forming the opinion has been provided to the Commissioner, and that information is correct:
 - (ii) an opinion of the Commissioner published as guidance for the general public or a particular group of taxpayers (in which latter

case its application is restricted to members of that particular group) if that opinion relates to circumstances or to an arrangement not materially different from the circumstances or arrangement in respect of that taxpayer;

35. That consequential amendments be made to clause 67 of the Bill.
36. That at least as regards opinions published as guidance for the general public or a particular group of taxpayers (ie, subparagraph (ii) of the proposed definition of "Commissioner's official opinion"), consideration be given to the amendments applying to the taking of a tax position on or after the date of Royal assent, even if the opinion was issued prior to that date.

Clause 52 – Commissioner to make private rulings on request

Clause 58 – Commissioner may make product rulings

37. Sections 91E(3)(b) and 91F(3)(b) of the Tax Administration Act 1994 should not apply in respect of similar arrangements. Clause 52(1) of the Bill proposes to amend section 91E(3) of the Tax Administration Act 2004 to allow the Commissioner to decline to make a private ruling if:

[the] arrangement on which the ruling is sought, or a separately identifiable part of that arrangement, is substantially the same as an arrangement which is subject to an objection, challenge or appeal, whether in relation to the applicant or any other person.

38. Similar amendments are proposed to section 91F(3) in respect of product rulings (clause 58(1)). These amendments should not proceed; instead, sections 91E(3)(b) and 91F(3)(b) should be amended to apply where:

[the] arrangement on which the ruling is sought, or a separately identifiable part of that arrangement, is subject to an objection, challenge or appeal in relation to the applicant

Explanation

39. Sections 91E(3)(b) and 91F(3)(b) should be confined to situations in which the challenge proceedings concern the same arrangement and the particular tax laws on which the ruling is sought. The Commissioner should not be able to decline to rule in respect of a different

taxpayer and a separate arrangement (albeit one substantially similar to an arrangement the subject of challenge proceedings).

40. As a matter of principle, taxpayers should be entitled (upon paying the prescribed fees) to have the benefit, in binding form, of the Commissioner's view of the law. That the Commissioner's view may be the subject of a challenge in the Courts in relation to another arrangement or a different taxpayer, does not prevent the Commissioner from having a view and applying it in the context of the binding rulings process.

Recommendation

41. That the Committee consider adoption of the amendments set out in paragraph 38 above.

John Marshall QC
President
10.2.10