Draft question we've been asked PUB00311

What are the requirements for claiming tax deductions for payments to family members for services?

CA ANZ submission

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Dear Grant and Colleen

Draft question we've been asked – what are the requirements for claiming tax deductions for payments to family members for services? PUB00311

Thank you for the opportunity to comment on this exposure draft.

While we agree that the conclusions drawn in the exposure draft are technically correct, we recommend that the Commissioner review and modernise the deductibility rules for payments made to family members. A practical approach should be applied to achieve an outcome that reflects current commercial practice and principles.

Our submissions are:

- It is timely to amend the rules for claiming tax deductions for payments to family members for services provided.
- In the interim the Commissioner could consider limiting the resources allocated to enforce the rule under section DC 5 of the Income Tax Act 2007.
- It would be helpful if the exposure draft included guidance/comment on how the approval process will be initiated and actioned in START.
- An application date would be useful.
- Parts of the exposure draft could be clarified.

Amendment required

The rule in section DC 5 was first enacted in 1958 and has not been amended since. The requirement to obtain the Commissioner's approval before a deduction can be made for a payment to a family member for services provided is archaic, does not reflect self-assessment and is inconsistent with the direction of Inland Revenue's Business Transformation program. The exposure draft highlights that the rule needs amendment so that it aligns with and promotes the afore-mentioned principles. The matter should be referred to the Policy and Strategy (PAS) team for their action. As part of this review, PAS could consider granting the Commissioner the discretion to give retrospective approval for a deduction.

Interim measure

We acknowledge that it is not within the Commissioner's care and management powers to disregard the requirements for the lawful exercise of powers and discretions conferred by the Inland Revenue Acts; alter taxpayers' obligations and entitlements; or issue extra-statutory concessions. However, under the care and management provisions the Commissioner can make decisions about the allocation and management of her resources. On this basis the Commissioner could, in the interim, consider limiting the resources she allocates to strictly enforcing the rule under section DC 5 – in particular, the requirement to have the Commissioner's pre-approval for deduction.

Process in START

It would be helpful if the exposure draft included guidance and comment on how the approval process will be initiated and actioned in START. For example, will the process be digitalised in the future (the current process is manual)? Will approvals be streamlined with the pay-day filing process?

Application date

The exposure draft does not have an application date. Given that the finalised item will replace three earlier items published in 1994 and 1996, it would be helpful if the exposure draft confirmed how the item will be operationalised.

Parts to clarify

It would be useful if the following parts of the exposure draft are clarified:

- At first glance, the heading on page 3, "Commissioner's prior approval may be required" contradicts the first part of the first sentence in paragraph 8 of the exposure draft. To reduce the risk of misinterpretation, we suggest that the final three words in the heading be removed.

- Paragraph 10 of the exposure draft states that an application may be made for approval to deduct payments made to a family member during the year or for future payments. This statement does not match the statements made on Inland Revenue's website and on page 59 of the Employer's Guide IR335 (October 2018).

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- The website states: "You should apply for approval before you start paying wages to your spouse." https://www.ird.govt.nz/payroll-employers/employ-staff/spouse/emp-employ-spouse.html
- The Employer's Guide states: "It's a good idea to apply for approval before you start paying your spouse or partner wages."

We note that the exposure draft aligns with the wording of the legislation while the statements on the website and the Employer's Guide have been worded conservatively to ensure compliance with the rules (i.e. a 'belts and braces' approach). It would be helpful if this was highlighted in the exposure draft.

- It would be helpful if the conclusion in example 1 of the exposure draft clarified that a new approval was required in year 2 because Sam's wage increase was not a result of a general increase in wages; rather, it arose from an increase in duties performed.

- Example 3 in the exposure draft is helpful to illustrate a payment made to a family member of a shareholder of a company. For completeness the reason for the conclusion that the net profit credited to Soul will be treated as a dividend paid to her by Zeb Ltd should be explained (that reason being that it is a payment made to an associated person of a shareholder under section CD 6).

- We consider that example 4 in the exposure draft could be expanded to show what, if any, additional information the Commissioner would require for approval to be granted for a deduction for payments made to a family member who is not an employee (i.e. in the context of an independent contractor).

- We noticed two typographical errors on page 2 of the exposure draft:

    - The page reference to the December 1994 TIB item incorrectly refers to page 3. The correct page reference is 2 – 3.

    - The paragraph cross-reference in square brackets in paragraph 3 should read "[13]", not "[1313]".

We are happy to discuss our submission with you. Please contact Lindsay Ng in this regard.

Yours sincerely

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