Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill

Chartered Accountants ANZ 28 February 2019

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General Position

In formulating its submissions, Chartered Accountants Australia and New Zealand takes a best practice, public policy perspective. That is, we endeavour to provide comment on a "what is best for New Zealand" basis.

We recognise Government's legitimate right to set tax policy direction. We comment on those policies, and also make comment on their practical implementation. Our public policy perspective means we endeavour to provide comment free from self-interest or sectorial bias.

Research confirms that in practice the best tax system is one with a broad tax base and low tax rates. Such an approach restricts the conditions that make tax avoidance attractive.

Our guiding principles in formulating this submission are that New Zealand's tax system must not impede New Zealand's international competitiveness; growth of the New Zealand economy; and innovation and entrepreneurship.

Recognising there are judgments and trade-offs, taxes should, as far as possible:

- be simple in their application;
- provide certainty in their application;
- be perceived as broadly fair;
- minimise the costs of compliance and administration;
- minimise distortions to the economic behaviour of individuals and businesses;
- utilise businesses' own accounting systems as the data source for calculation;
- align the obligations with the businesses' own cash flows; and
- be imposed at an overall rate which allows adequate retention of investment funds within businesses.

We believe one of the pillars of an effective and efficient tax system is taxpayer certainty. This will increase voluntary compliance, decrease administration costs, and deliver positive economic benefits. Tax legislation must be as clear in its policy intent and application. Further, any identified errors post-enactment should be corrected without delay.

In Chartered Accountants Australia and New Zealand's view tax legislation should not be retrospective unless it corrects an anomaly to ensure taxpayers pay no more tax than Parliament intended. Retrospective application dates undermine the principle of taxpayer certainty and the Generic Tax Policy Process.

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28 February 2018

The Chair
Finance and Expenditure Committee
Parliament
Wellington

Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill

Thank you for the opportunity to submit on the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill. Our principal comments in respect of the key proposals in the Bill are set out below. We have focused on key issues and have not undertaken a full review of every clause of the Bill.

GST and low value goods

Government has widely signalled its intention to introduce legislation to impose Goods and Services Tax (GST) on goods ordered over the internet. At present New Zealand consumers can purchase goods below the de minimis from an overseas supplier without paying GST.

The proposals were outlined in a Government Discussion Document (*GST on low-value imported goods – an offshore supplier registration system*, May 2018). The legislation as drafted is similar to the initial proposals, taking into account feedback received. We agree with the overall framework and direction of the proposals. We appreciate the time that officials have taken to consult and listen to feedback.

The proposed legislation brings New Zealand into line with other countries who have enacted overseas supplier registration regimes, including Australia. The proposed rules are similar to other countries', while acknowledging the framework of New Zealand's existing GST legislation.

The similarity with other countries – in particular Australia – will make it easier for overseas businesses to comply with their New Zealand tax obligations. It will also be important to ensure that the new rules are practically focused and workable. This includes ease of compliance for offshore suppliers and the ability for consumers to efficiently receive a refund when additional GST is charged in error.

The new rules depend on technology. Government must develop systems to administer and enforce these proposals, whilst recognising that this response is an interim domestic solution that will eventually be superseded by technology. Systems will eventually develop to allow governments to receive information about the flow of goods in real time and to impose tax accordingly.

Loss ring fencing

We would like to thank Government for undertaking consultation and listening to feedback.

However, we are concerned that the proposals will not achieve their desired effect and will have a greater impact on smaller investors.

The loss ring-fencing rules were initially proposed as a response to the rising cost of housing in New Zealand.

We doubt that these proposals will slow the growth in the housing market. Australia had introduced rules to achieve the same effect but they were not successful and the rules were repealed.

Taxpayers most affected by the rules will be those that have one rental property, held on capital account. These are likely to be smaller "mum-and-dad" investors. Larger property investors with an extensive portfolio will be able to offset deductions across properties and will be better placed to mitigate the effect of these rules. Taxpayers that have significant capital will not be affected by these rules as they are unlikely to require loss offsets. Dealers and developers will not be subject to the rules because they will hold their properties on revenue account. The smaller property investor cannot put mitigation measures in place.

Moreover, the proposed rules are extremely complex which we believe is unnecessary given those most affected by the rules. Government should seek to strike a balance between achieving its economic intent and encouraging voluntary compliance.

The proposed rules will be unnecessary if the Government decides to impose a tax on capital gains arising from the sale of residential rental property. In a CGT environment there will be no mismatch between deductions and income. The rules should be deferred until a decision on capital gains tax has been made.

We would like to appear before the Committee to discuss our submission.

Yours faithfully

John Cuthbertson, CA
NZ Tax and Financial Services Leader

Greg Haddon, FCA
Chair, CA ANZ Tax Advisory Group

Overview

The Bill proposes a supplier registration system to collect GST on low-value imported goods where GST is currently not collected at the border.

The key proposals include:

- A requirement for overseas suppliers to register for GST in New Zealand if they make supplies of more than $60,000;
- A requirement for a registered overseas supplier to charge GST on goods with a value of less than $1,000;
- A change to Customs regulations so that they will not collect GST on goods with a value of less than $1,000.

The proposals also include new rules for redeliverers, marketplaces and vouchers.

Offshore suppliers would be able to use a simplified “pay only” registration system to return GST if they do not have any GST on costs to claim back.

The Bill also proposes to introduce a regime for ring-fencing deductions on residential rental properties. The rules would:

- Require rental property owners to carry forward any excess deductions from residential rental activity; and
- Take the deductions only against residential rental income from future years, or from income on the sale of the land.

The rules could be applied on either a “portfolio” basis (including a number of properties), or on an individual property basis.

GST on low-value imported goods

Overall comments

Interim solution

As we have stated at the start of our submission, we see the proposed domestic regime as being an interim measure until advances in technology allow a global solution to be developed. Thus, the domestic solution proposed must have the requisite technology to allow it to operate on day one. The proposed rules should not be implemented if further systems development is required because the solution may be obsolete by the time the systems are developed.

Drafting

The proposed legislation has been drafted to fit into the existing structure of the Goods and Services Tax Act 1985 (GST Act).

The GST Act is nearly 35 years old. There have been many changes in GST during those years and this is now evident when reading and interpreting GST legislation. The section structure has become more uneven as different regimes have been incorporated into the Act. In our view, Government should consider a rewrite.

Customs' processes

The New Zealand Customs Service (Customs) systems and processes will be crucial to the new rules working well. Overseas suppliers and New Zealand consumers will need to know how to provide Customs with the information it needs, the form of the information and the process. The technology will also be crucial to the success of the regime.

Application date

The proposed rules are to apply from 1 October 2019. This is only a few months away and the rules are not yet finalised. Overseas companies are unlikely to undertake IT projects where the rules are not finalised and are not law. There may not be enough time after the rules are finalised for overseas suppliers to register for New Zealand GST and make the systems modifications necessary to charge New Zealand GST on goods sold.

We recommend that Government consult with the industry to determine whether there is sufficient time for overseas businesses to implement the changes necessary, or whether more time is needed. It may be that an application date of 1 April 2020 is more realistic, although we acknowledge that this will likely result in a revenue cost.

Monitoring of GST leakage

The proposal to increase the existing $400 de minimis to $1,000 may result in a reduction in GST collected for goods between $400 and $1,000 where the non-resident vendor is not required to or does not register for GST. This de minimis exemption has been increased on the assumption that most non-resident suppliers will be GST registered hence Inland Revenue (IR), as opposed to Customs, will collect the GST on imports less than $1,000. With the higher exemption level there is a theoretical possibility that New Zealand consumers will be able to import higher value goods with no GST at the border if they are able to find a non-GST registered non-resident supplier who delivers to New Zealand. It is unclear whether this will create a behavioral change and result in a significant loophole. We suggest that this be monitored.

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Supplies on low-value imported goods			
Clause 5(2)	2(1)	Definition of “entry value” and “entry value threshold”	
Clause 6	4B	Meaning of “distantly taxable goods”	See our Submission 1
Clause 9(1)	8(3)(a) and (ab)	Deemed supply in New Zealand by non-resident	
Clause 12(2)	10(7C)-(7E)	Value of supply	See our Submission 2 on the differing value provisions
Clause 13	10B and 10C	Value of goods for determining treatment as “distantly taxable goods” and election by supplier that higher value goods be “distantly taxable goods”.	See our Submission 3 on the differing value provisions
Clause 31	51	Registration	

Clause	Section	Description	Comment
Supplies to New Zealand GST-registered businesses			
Clause 8	5B	Supplies of certain imported services – amended to include goods	
Clause 9(2) to (6)	8(4B)	Deemed supply in New Zealand – amended to include goods	
Clause 11	8BB	Certain supplies by non-residents: determining whether recipient is a registered person	
Clause 14(1) and (4)	11(1)(fb) and 11(8E)	Zero rating of goods	
Clause 19(1) and (3) to (9)	20	Calculation of tax payable – provisions for remote services to also include “distantly taxable goods”	
Clause 23	24	Tax invoices	
Clause 25	24B	Records to be kept	
Clause 26(1) to (3) and (5)	25	Credit and debit notes	
Clause 27	25AA	Consequences of change in contract for imported services – provision for remote services to also include goods	

Clause	Section	Description	Comment
Preventing double taxation			
Clause 16	12	Inserts new section 12(1B)	See our Submission 4, Submission 5, Submission 6,
Clause 17	12B	Reimbursement by supplier if recipient charged tax on both supply and importation	See our Submission 8, Submission 9 and Submission 1o regarding the refund rules
Clause 19(2)	20(3)(dd)	Calculation of tax payable – supplier may adjust for consumption tax paid in another territory	
Clause 24	24BAB and BAC	Receipts for supplies; Information for importation of goods including distantly taxable goods	See our Submission 7 regarding making information available to Customs
Clause 26(4)	25(1)(abb)	Credit and debit notes	
Option to charge GST on supplies of high-value goods			
Clause 13	10B and 10C	Estimating value of goods in supply for treatment as distantly taxable goods; Election by supplier that supplies of higher-value goods be of distantly taxable goods	See our Submission 11 regarding the election to include higher value goods as distantly taxable goods
Marketplaces			
Clause 5(1), (3), (6)	2	Definition of "electronic marketplace", definition of "marketplace" – now to include supplies of goods as well as services; definition of "underlying supplier" – which refers to the party that would be the supplier of the goods in the absence of the marketplace rules	
Clause 12(2)	10(7C)–(7E)	Value of supply	See our Submission 12, Submission 13 and Submission 14 on the differing value provisions

Clause	Section	Description	Comment
Clause 14(3)	11(1)(jb)	Zero rating of goods supplied from an underlying supplier to the marketplace operator when the marketplace is treated as being the supplier to the New Zealand recipient	
Clause 30	26AA	Marketplace operators: bad debts for amounts of tax	
Clause 34(2) to (4)	60(1C), 60(1C)(a) and 60(1C)(b)	Agents of suppliers of remote services – amended to include goods	
Clause 35	60C	Electronic marketplaces	
Clause 36	60D	Approved marketplaces	

Redeliverers			
Clause 5(5)	2	Definition of "redeliverer"	
Clause 12(2)	10(7C)	Value of supply where a redeliverer makes a supply of distantly taxable goods to a recipient	
Clause 15(2)	11A(1D)	Zero rating of services does not include redelivery services	
Clause 37	60E, 60F, 60G	Where a redeliverer is a supplier of distantly taxable goods, Operator of marketplace or redlivered making return based on faulty information, Requirements for treatment of information by operator of marketplace or redeliverer	

Administering the offshore supplier registration system			
Clause 7(3) to (9)	5(27)	Discretion for the Commissioner to require a person to register and pay GST that should have been charged on a supply of distantly taxable goods	
Clause 18	15	Non-resident suppliers of distantly taxable goods would have calendar quarterly taxable periods	
Clause 32	51B	Supplier of distantly taxable goods treated as registered	
Clause 37	60E, 60F, 60G	Where a redeliverer is a supplier of distantly taxable goods, Operator of marketplace or redlivered making return based on faulty information, Requirements for treatment of information by operator of marketplace or redeliverer	
Clause 38(2)	75(3F)	Requirement for supplier of distantly taxable goods to keep records	

Clause	Section	Description	Comment
Clause 39	77(2)	Suppliers of distantly taxable goods may express the consideration in foreign currency	
Vouchers			
Clause 7(1) and (2)	5(11G)	Redemption of token, stamp or voucher	
Agency rule			
Clause 34(1)	60(1A)(b)	Agents acting for suppliers of distantly taxable goods may agree with the supplier to treat the agent (rather than the principal) as making the supply	

Supplies of low-value imported goods to consumers in New Zealand

(Clauses 5(2), 6, 9(1), 12(2), 13 and 31)

Proposal

To include a new definition for “distantly taxable goods”.

Submission 1

That a better acronym should be found.

Comment

The phrase “distantly taxable goods” is difficult to say and may be a difficult concept for consumers. Government should consider whether there is a phrase that is more accessible and more memorable. Although our submission may sound trivial, the accessibility of rules may be improved by using more user-friendly terminology (for example, the change to a PIE from a QCIV). We suggest “taxable overseas goods” TOGs).

Proposal

Proposed section 10(7E) states that the amount of consideration for a supply of distantly taxable goods includes additional amounts for services provided in connection with the goods.

Submission 2: clarify scope of services

The commentary or PAS special report accompanying the Bill should include a plain English explanation of the scope of proposed section 10(7E).

Comment

Proposed section 10(7E) states that certain services must be included in the value of the goods. The provision is complex. Our reading of the provision is that the “value” of the goods is intended to be the value for Customs purposes – so freight and insurance costs are included. We recommend that this is explained in an accompanying commentary or PAS Special Report.

Submission 3: communicate difference in value provisions

Any PAS special report, or other accompanying explanatory note, should explain the difference in the valuation provisions, when each is to be used and give examples for each.

Comment

The valuation of the goods is key to the new provisions: first, a supplier must determine whether the goods are "low value goods" and, second, must charge New Zealand GST based on the value of the goods. However, the valuation methods are different.

Overseas suppliers will be required to value the goods using the method outlined in proposed section 10B to determine if the goods are under the threshold. However, to determine the value of the goods for the purposes of charging GST, the supplier will be required to use the method in section 10, including proposed new sections 10(7C), (7D) and (7E).

It is important that overseas suppliers be made aware of the distinction. We recommend that a clear explanation is included in a PAS Special Report (or similar accompanying documentation) and in the information given to overseas businesses looking to register for GST. The documents should explain how to calculate the value of the goods:

- for the purposes of determining whether they are low value goods; and
- for the purposes of determining the taxable base for GST.

It should give examples of the calculation for each.

Preventing double taxation

Clauses 16,17, 19(2), 24 and 26(4)

Change to the customs de minimis

Exception to the collection of GST on importation

Proposal

Proposed section 12(1B) states that goods are treated as not having GST charged unless particular information is made available to the Customs, to show that GST has been charged.

Submission 4: inconsistent with self assessment

That proposed section 12(1B) is inconsistent with the principle of self-assessment.

Comment

Self-assessment is a fundamental principle in tax administration. Proposed section 12(1B) departs from this principle. Under the proposed section, Customs will assess and charge Customs GST (under section 12) unless it is provided with information in a specified form to show that GST has already been paid under section 8.

Submission 4: clarify meaning of “tax accounted for by the registered person”

The meaning of the phrase “tax accounted for by the registered person” is unclear and should be clarified.

Comment

The proposed rule requires that the supplier make information available to Customs to show that a registered person has accounted for tax on the supply of the item (proposed section 12(1B)(c)).

The meaning of “accounted for” is unclear. At the time of supply, it is unlikely that the overseas supplier will have filed the relevant GST return. They will probably not have made a payment to Inland Revenue.

Further, this is different to the drafting in the proposed section 12 (1) which refers to “tax charged”.

We consider that section 12 (1B) should be consistently drafted with section 12(1) and should use “tax charged” as this would remove timing questions as well as questions as to whether a different test is intended.

Submission 5: clarify meaning of “an item of goods in a consignment”

The proposed rules should apply to any imported good – whether imported individually or as part of a consignment.

Comment

The proposed section refers to “an item of goods in a consignment”. The rule should also apply to any good imported individually and not as part of a consignment. The wording of the section should be clarified.

Submission 6: Customs must implement data matching

Customs should put systems in place to process the information they will be receiving.

Comment

Proposed section 12(1B) requires that sufficient information be available to Customs, or Customs GST will be charged.

However, it is unlikely that Customs will physically inspect the relevant consignments of goods because the goods will have a value below the Customs de minimis.

Therefore, in theory, Customs should perform an information match between:

- the information given to Customs by overseas suppliers; and
- the goods coming into the country.

We are unaware whether Customs currently undertakes such data matching.

Customs will need processes in place to do the matching, and the technology to quickly and easily match data. The consignments of goods will by definition be below the Customs de minimis and it is unlikely that they will be physically checked by Customs. The Customs systems and processes will be crucial to the success of the new rules.

Information requirements

Submission 7: Customs to specify form of information and process for collecting it

Customs should specify the form of information to be made available and how they will collect it.

Comment

Proposed section 12(1B) requires that sufficient information be available to Customs, or Customs GST will be charged.

The form of the information is not clear. Customs will need to specify how the information may best be provided (e.g. import entry, receipt inside the package with the goods, daily electronic transmittal of all transactions). Customs should be capable of accepting all these forms of information delivery.

Information for the public on how Customs will collect and process the information required under section 12(1B) should also be made available to overseas suppliers and New Zealand taxpayers at the time of enactment. We suggest Government consider including the information on the Customs and IR websites. In addition, it would be useful to include on other government websites such as among the MBIE information on doing business in New Zealand (business.govt.nz).

Refunds when double taxation occurs

Proposal

To require a taxpayer to contact the supplier to claim a refund in the event of double taxation.

Submission 8: ease of refund for taxpayer

The easiest way for a consumer to claim a refund would be from Inland Revenue or Customs.

Comment

The easiest way for a consumer to claim back GST charged twice would be to apply to Inland Revenue or Customs for a refund. This approach is consistent across tax reform – for example, the withholding tax rules allow a taxpayer to claim a refund from Inland Revenue.

However, the proposed rules require the consumer to contact the supplier for a refund.

The Regulatory Impact Statement (*RIS: GST on low-value imported goods*, 5 September 2018) states that it would be too time consuming for IR or Customs to issue a refund. The RIS also notes that there is no refund process currently, so the consumer would not know how to obtain one. These provide limitations but in our view a process could be established if sufficient resource were allocated.

Submission 9:

Officials should consider allowing Customs or Inland Revenue to issue refunds in circumstances where the customer has incorrectly been charged GST and the supplier is not at fault.

Comment

It is our primary submission (above) that consumers should be able to seek a refund from Customs or Inland Revenue when they are overcharged GST. If our primary submission is not accepted, we believe consumers should be able to seek a refund from a New Zealand government agency where they have incorrectly been charged GST and the supplier is not at fault.

It is not logical for the consumer to seek a refund from the overseas vendor when the double taxation arises as a result of an error made by the freight forwarder.

For example, a New Zealand consumer imports a good valued at less than $200 and the supplier has charged GST. The Customs broker incorrectly values the good at $2,000. Customs notes the value and charges Customs GST. In that example, it would not make sense for the customer to seek a refund from the supplier (who has correctly charged GST). The refund should come from Customs.

The proposed rules do not consider the role of freight forwarders and Customs brokers in the process. Officials should consider allowing Customs to issue a refund in situations where the broker or freight forwarder is at fault.

Submission 10:

Officials should consider allowing Customs or Inland Revenue to issue a refund if the consumer has not been able to obtain a refund from the supplier after a certain time period.

Comment

It is our primary submission (above) that consumers should be able to seek a refund from Customs or Inland Revenue for overpaid or incorrectly charged GST. If our primary submission is not accepted, we believe that consumers should be able to obtain a refund from a New Zealand government agency if a consumer has attempted to obtain a refund from a supplier and has not been able to do so.

We suggest that the rule require that:

- the consumer has contacted the supplier;
- the supplier has not provided the refund; and
- a certain time period has elapsed.

In terms of time period, we suggest the end of the quarter because that would allow Inland Revenue or Customs to confirm that the GST has been paid to the New Zealand Government.

Option to charge GST on supplies of high-value goods

Clause 13

Proposal

To allow some suppliers to charge GST on high-value goods. The proposed rules provide for a self-assessed test and, for those who do not meet the threshold, a Commissioner's discretion to allow GST to be charged.

Submission 11: compliance history

That the compliance history of the taxpayer should be put into context.

Comment

Proposed section 10C(4) requires those below the 95% threshold to make an election if they wish to charge GST on high-value goods. The Commissioner has a discretion to allow the request.

Proposed section 10C(4)(a) requires the Commissioner to consider the compliance history of the registered person and any associated persons.

In our view, the compliance history must be taken in context. Other countries may have different tax laws and different tax regimes. Moreover, it may be necessary to give compliance with some regimes more weight than others – for example, in some jurisdictions the BEPS rules have been enacted in response to particular concerns so non-compliance may be as a result of the legislative framework at the time or commercial arrangements entered into prior to the law change.

Marketplaces

Clauses 5(1), (3), (6), 12(2), 14(3), 30, 34(2) to (4), 35 and 36

Discounts provided by marketplace operators

Proposal

Proposed section 10(7D) provides that the amount of consideration for a supply of distantly taxable goods by a marketplace operator does not include any discount given by the marketplace.

Submission 12: section needs to be clarified

The consideration for a supply should be the amount net of discount. The phrase “does not include” is ambiguous and the section should be clarified.

Comment

The amount of any consideration should take into account any discount offered. For example, if a widget is usually sold for $100 including GST, but is discounted by $20 by the marketplace operator, the consideration should be $80 (including GST).

The phrase “does not include” is ambiguous. Does it mean that the consideration for the widget should not take into account that there is a discount of $20, so the consideration is deemed to be $100? Or does it mean that the consideration should take into account the discount, so that the consideration is $80?

Even if the phrase “does not include” is clear to legislative drafters, the provision is not straightforward to interpret for taxpayers, even those who have experience in reading tax legislation.

The section should be clarified. The phrase “does not include” should be replaced. We suggest the phrase “net of any reduction provided”.

Submission 13: wording of the provision

"supply *for* the recipient", should be replaced with "supply *to* the recipient".

Comment

If the dependent clause is omitted, the relevant part of the provision reads "the consideration for the supply does not include the amount of a reduction…in the price of the supply for the recipient".

Supplies are made *to* recipients, rather than *for* recipients.

If "for" is intended to refer to the price, rather than the supply (i.e. "price…for the recipient"), then the phrase "for the recipient" is not needed. The price for the recipient will be the same as the price for the supplier.

Submission 14: Clear example needed

A clear example should be included in the PAS Special Report or other explanatory document accompanying the final legislation.

Comment

The example to explain this provision is the second example on page 50 of the Commentary. The example states that "there is a potential argument" that A Co has provided third party consideration.

The example should give clear facts and a clear answer as to the outcome. The equivocal nature of the example will be confusing to practitioners.

Ring-fencing

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Ring-fencing residential property deductions			
Clause 49	DB 18AC-18AK	Ring-fenced allocations	See our Submission15, Submission 16, Submission 17, Submission 18, Submission 19, Submission 20, Submission 21, Submission 22, Submission 23, Submission 24, Submission 25, Submission 26, Submission 27, Submission 28, Submission 29, Submission 30, Submission 31, Submission 32, Submission 33, Submission 34, Submission 35, Submission 36, Submission 37 concerning the proposals
Clause 65	YA 1	Definitions of “dispose”, “dwelling”, “principal settlor”, “residential land-rich entity” and “residential rental property”,	See our Submission 38

Ring-fencing residential property deductions

Clauses 49 and 65

Proposal

To allow deductions for residential land only to the extent that those deductions are matched by income.

Submission 15: Rules should be deferred

The rules will not be necessary in a capital gains tax environment.

Comment

Broadly speaking, the new regime is intended to match deductions against income. The aim is to ensure that taxpayers are not taking tax deductions over time when there will be no corresponding taxable income.

The Government's Tax Working Group released its report on 21 February and has recommended a tax on capital income, including on income from the sale of rental property. Under a capital gains tax, the gains on sale of the residential land will be taxed. The Tax Working Group also recommended the removal of loss ring fencing rules.

Thus, the regime would seem unnecessary.

We recommend that the regime be deferred until the Government has decided whether to introduce a tax on capital income on land sales. The decision of the Government is expected in April of this year, so the deferral should not result in a significant revenue loss.

If the Government decides to introduce a tax on capital gains, the loss ring-fencing regime would be redundant and would likely be repealed, resulting in uncertainty and complexity for taxpayers as they transition between regimes.

Submission 16: complexity

The loss ring fencing rules are complex and will be difficult to follow for many taxpayers and practitioners.

Comment

The proposed new legislation runs to 13 pages. The concept behind the rules is relatively simple (to allow deductions only to the extent of any corresponding income) and the Commentary on the rules is only eight pages. The rules themselves are complex. The different options – and the rules for combining or moving between the options – will be difficult to understand for many taxpayers and it is likely that most will need to seek professional advice.

Submission 17: contrary to New Zealand tax policy framework

That the proposed rules are contrary to New Zealand's tax policy framework

Comment

New Zealand tax policy should be made with regard to the frameworks underpinning our tax system. The concepts of gross income and global deductions are fundamental to the New Zealand tax system.

The proposed loss ring-fencing rules require that deductions are carried forward and may not be used until the taxpayer generates income of a particular type or from a particular source. This "schedular" approach is adopted in some other countries but has not been adopted in New Zealand to date, because of our "broad base, low rate" approach.

It is our view that departures from the fundamental frameworks should be considered carefully by Government before proceeding. If there are other alternatives to achieve the desired outcome these alternatives should be preferred. In the case of the loss ring-fencing rules, the same objective could arguably be achieved by introducing a tax on capital gains on the sale of land, as this would prevent the mismatch of deductions with no corresponding taxable income, because the corresponding income would be taxable.

Submission 18: application date

That the regime should not have retrospective effect.

Comment

Clause 2(12) of the Bill states that the legislation will come into force on 1 April 2019. However, clause 49(2) states that the legislation applies for the 2019-20 and later income years.

For an entity with a March balance date, the two are the same. For those with an early balance date, the rules will apply for a period prior to the legislation being passed and in some cases prior to it being introduced.

For example, an entity with a November balance date will have an 2019-20 income year of 1 December 2018 – 31 November 2019. They will have incurred deductions prior to the rules being introduced and which they would not have known would be ring fenced.

A proposal to introduce the rules had been outlined in an officials' paper. However, many taxpayers (including CA ANZ) were of the view that the rules would be unnecessary in a capital gains tax environment and were therefore unlikely to proceed.

If the rules are enacted as drafted, they should apply for the 2019-20 income year for standard and late balance date taxpayers, and should apply from the 2020-21 income year for early balance date taxpayers.

Property subject to the rules

Proposal

The rules apply to "residential land".

Submission 19:

That Government should clarify when the rules apply to mixed use land – either in the legislation or by way of commentary or Special Report.

Comment

"Residential land" includes land that has a dwelling on it. Difficulty arises where a property is used for both commercial and residential use. An example would be a two-storey building with a shop downstairs and a leased apartment upstairs.

There is nothing in the draft legislation that requires a separation of those activities or an apportionment between the two. We have assumed that the tests will be the same as those outlined in the Special Report on the brightline test, but this should be clarified – either in legislation or by way of Commentary or Special Report.

A similar issue arises when the use of the land changes. For example, a three storey commercial building where the top two floors are converted to residential use.

If the Government's intent is that any land with any dwelling on it, regardless of land area and length of time, falls within the proposed rules, this should be specifically legislated.

Proposal

The proposed rules will not apply to a "main home".

Submission 20:

That Government should clarify when the "main home" exemption applies to mixed use land – either in the legislation or by way of commentary or Special Report.

Comment

The proposed rules do not apply to "residential land" that is a "main home" of the owner or, if the owner is a trust, the beneficiary of the owner.

Two examples of properties where rental income is derived but which would seem to be excluded because of the "main home" requirement, are as follows:

- If a taxpayer has a home that also contains a small flat that is let to a third party, that rental income, and therefore associated deductions will not be caught by the ringfencing rules.
- If a taxpayer travels overseas for part of the year and leases their home to a third party during that time, the arrangement will not be caught so long as it is used as their private home for most of the year.

In the second case, we believe the outcome is appropriate. In the first case, the outcome is not as intuitive. As with our submission above, these should be clarified by way of Commentary or Special Report.

Proposal

To include land situated outside New Zealand

Submission 21: foreign exchange gains and losses should not be included

Taxpayers should have the ability to separate out foreign exchange losses on overseas land and treat them as deductible.

Comment

A lot of overseas land is owned by expatriates, who simply rent out their house to cover the mortgage while they are away. There is very little gain or loss and any tax to pay on the gain is usually covered by foreign tax credits. However, there can be gains or losses on foreign exchange. The overseas rent or mortgage are very rarely denominated in New Zealand dollars.

Foreign exchange gains or losses on other types of property are not ring fenced so it is not appropriate that they should be ring fenced when they relate to residential rental property.

Taxpayers should have the option to separate out foreign exchange movements pertaining to borrowings on overseas rental property and treat the movement as assessable or deductible.

Proposal

To exclude employee accommodation.

Submission 22: employee accommodation should be excluded

The exclusion for employee accommodation is sensible and logical.

Comment

We had previously submitted that employee accommodation should be excluded from the rules because the mischief the rules are seeking to address is not present. The proposed rules include an exclusion for employee accommodation where it is necessary to provide the accommodation due to the nature or remoteness of the business. We support this exclusion and would like to thank officials for listening to feedback.

Submission 23: Inland Revenue guidance

That Inland Revenue should provide guidance on the extent of the exclusion for employee accommodation.

Comment

Discerning whether the nature of the business requires employee accommodation to be provided will be a judgement call, and guidance will be required from Inland Revenue. In the past Inland Revenue has taken a narrow approach on the FBT/taxable allowance aspects of accommodation. The employer is best placed to make the decision about whether accommodation is required. This might be to not only attract staff to remote locations, but also to expensive locations where accommodation is hard to find.

Submission 24: employee accommodation where different entity is owner

The exclusion for employee accommodation should include accommodation owned by a related entity

Comment

There will be some corporate groups where one entity owns the fixed assets (including real property) and another entity owns the business and employs the staff. For example, it is common in farming for a trust to own the land and a company to run the business.

The proposed rule should allow employee accommodation where the employee is an employee of a related entity.

Portfolio basis by default with property-by-property application by election

Proposal

To allow taxpayers to account for their residential rental losses on a portfolio basis or on a property-by-property basis.

Submission 25:

The option to ring- fence losses on a property-by-property basis will give more flexibility to taxpayers.

Comment

The initial proposal for the ring-fencing rules (*Ring-fencing rental losses: An officials' issues paper* March 2018) required taxpayers to ring fence losses on a portfolio basis. Officials received feedback requesting that losses be able to be ring-fenced on an individual property basis. While we were happy with the portfolio basis, we understand that many taxpayers would prefer an individual property basis and we would like to thank officials for listening to feedback.

Submission 26: election method

That the election should be made by taking a position in the tax return.

Comment

The proposed default position is that the loss ring-fencing rules would apply on a portfolio basis. However, proposed section DB 18AG would allow taxpayers to elect to apply the rules on a property-by-property basis.

Proposed section DB 18AG(2) states that a person makes the election by notifying the Commissioner of it when the person files their return. This should be amended to "makes the election by taking the position in the tax return".

Submission 27: election in case of change of use

That the rules should specify that an election may be made on change of use.

Comment

As we have stated in our submission above, the legislation is silent on the consequences where the land has had a change of use from residential rental to some other use (such as commercial rental or main home).

For example, if a person converts a commercial property to residential use, after having owned it for some time, they would not be able to elect the property-by-property approach as that required the election to be made in the year the property was acquired (or the 2019-20 year if acquired before that time).

The proposed legislation should allow an election to be made for the year that the change in use occurred or at the time of acquisition.

Use of ring-fenced deductions

Submission 28: ordering of different classes of losses

If losses are to be used in a certain order, this should be stated in legislation.

Comment

The ring-fencing rules are likely to impact small individual investors and small businesses. The taxpayers affected may have losses from other activities, including in the current year. There is nothing in the proposed legislation that specifies the order in which different types of losses are to be used. For example, a taxpayer could make a loss in the current year that includes both a ring-fenced rental loss and a mixed-use asset loss.

At present, it is likely that a taxpayer would use a ring-fenced rental loss at the earliest opportunity because of its limited application. However, the extent to which that would be allowable is not clear. For example, a taxpayer may have an overall loss in the current year but have made a profit on the residential rental activity. Is that taxpayer able to utilise or recharacterise a portion of the quarantined brought forward losses against the residential rental profit?

In the above example, it should it be possible to use a ring-fenced loss against the residential rental income, thus increasing the unquarantined loss carried forward. A quarantined loss should be clearly available for use against rental profits before other losses are offset.

If the Government would prefer specific rules for the ordering of the use of losses, these should be legislated. One precedent for such a set of rules would be the Foreign Tax Credit regime which specifies the order in which the credits may be used against income. A similar set of rules could be developed for the above loss regimes, if required.

Submission 29: released losses

That the proposed rule to allow losses to be released in some circumstances and used against other income is fair.

Comment

The proposed rules would allow losses to be released and used against other income. Under the portfolio basis, the taxpayer must be taxed on the ultimate sale of every property in the portfolio and the entire portfolio must be sold. For the property-by-property basis, the property must have been sold and the sale must have been taxable. We would like to thank officials for responding to feedback.

Submission 30: use within wholly-owned group

That the proposed rules would allow ring-fenced deductions to be transferred within a wholly-owned group is fair and equitable.

Comment

The proposed rules would allow ring-fenced deductions to be transferred between companies in a wholly owned group, as the economic ownership is the same. We agree with the proposed rule and would like to thank officials for responding to feedback.

Submission 31: use within group of companies

That the proposed rules allow ring-fenced deductions to be transferred to other companies within a group of companies.

Comment

The proposed rules allow the ring-fenced deductions to be transferred within a group only where the group is wholly owned. This rule should be extended to allow the deductions to be transferred within a "group of companies" as defined in section IC 3 of the Income Tax Act.

Other losses may be transferred between group companies where they have the requisite commonality and continuity of ownership. It would be logical to allow the ring-fenced rental losses to be transferred also.

Submission 32: transfer of value for losses

That the transfer of ring-fenced deductions should allow the companies to pay for the losses.

Comment

As we have noted above, we recommend that ring-fenced deductions be able to be transferred between companies in a "group of companies" (as defined in section IC 3 of the Income Tax Act). However, a straight transfer of a loss from a loss company to a profit company may not be equitable for minority shareholders. The loss transfer rules in the Income Tax Act allow a payment between group companies for losses transferred. The loss ring-fencing rules should include the same rules and this should be done by way of reference to the existing loss offset rules in subpart IC of the Income Tax Act.

Submission 33: Status of losses on change of use

That the legislation should clarify the status of accumulated ring-fenced deductions when there the residential land has had a change of use, or partial change of use.

Comment

As we have stated in our submission above, the proposed legislation and accompanying Commentary are silent on the consequences where the land has had a change of use from residential rental to some other use (such as commercial rental or main home).

Where a residential rental which has ring-fenced excess deductions is converted to a commercial use, there appears to be no ability to offset any accumulated deductions against the future income from that property. Deductions can be offset only against income that relates to residential rental property (nor does the conversion trigger a deemed disposal of the property, which would allow excess deductions to be used against the deemed taxable gain).

In our view, these ring-fenced deductions should be available to be used against the property while it remains within the definition of residential property (that is, where it has been used as a dwelling for more than half the time).

However, we note that this will cause complexity as the taxpayer is required to keep applying the test to determine the point at which the property becomes predominantly commercial. The better answer may be to apply the test annually rather than over the life of the property.

Submission 34: status of losses on land disposal

That the "tainting" apply only to the portion of the losses that relates to the tainted property.

Comment

If the portfolio or property has been tainted by way of using excess deductions from previously held properties (where those properties were not taxable on sale), the ring-fenced amount retains its nature and is available to be carried forward by the taxpayer and used against future residential property income. However, this will "taint" the remainder of the portfolio.

So if, for example, a taxpayer owns a property (Property A) which has $10 of ring-fenced excess deductions and is sold with the deductions remaining ring-fenced. Ten years later the taxpayer purchases a new property (Property B) for $150,000, which is subsequently sold for $100,000. Thus, the taxpayer has made a loss of $50,000 on property B.

If the requirements to release the $50,000 loss are met, the $50,000 loss should be released. However, it would seem that proposed section DB 18AC(5)(d) would prevent the loss on Property B being released because of the $10 of "tainted" deductions from Property A.

It would seem more appropriate that the tainting apply only to a portion of the loss with the balance released. In the above example, the $50,000 should be released and the $10 remain ring-fenced.

Interposed entities

Submission 35: use of ring fenced amounts

That the legislation should specify how ring-fenced losses can be used when the ring-fencing has arisen because of the "interposed entity" rules.

Comment

The Commentary explains the "interposed entity" rules would:

"…apply for interest on borrowings to acquire an interest in an entity, if for a particular income year the entity is a "residential land-rich entity" – which would be where over fifty percent of the entity's assets are residential properties."

The example on page 82 of the Commentary explains the calculations in the legislative provisions. In the example, $2,858 is non-deductible and must be carried forward. It is not clear how Alex can use the ring-fenced loss in future years.

Alex will not receive "residential rental property income" as defined. She may receive dividends from Company X. Otherwise, the only corresponding "income" will be a gain on sale of the shares in Company X, which may be held on capital account.

The legislation should go a step further and explain how the ring-fenced losses can be used when they have arisen out of an interposed entity. The rules should then be explained further by extending the example in the Commentary.

Submission 36: application to trusts – commentary should be clarified

That the Commentary should be expanded to clarify that the “interposed entity” rule is intended to apply to the beneficiary of a fixed trust (that is not a unit trust) where the beneficiary borrows to acquire the interest in the trust.

Comment

The Commentary also mentions that the rules regarding interposed entities would apply to trusts (page 81). We were not clear as to how this would operate, but understand the rule is intended to apply where the land is held in a fixed trust that is not a unit trust, and the beneficiary borrows to acquire the interest in the trust.

We agree that this scenario is possible; however, question how common this would be in practice.

The Commentary should be expanded to clarify the scenario and should note that it is not likely to occur often.

Submission 37: application to trusts – use of ring-fenced amounts

As with the company example above, the legislation should specify how ring-fenced losses can be used when the loss has arisen because of the “interposed entity” rules.

Comment

The Commentary also mentions that the rules regarding interposed entities would apply to trusts.

As with the example on page 82 of the Commentary, the legislation does not say how the beneficiary is able to use the loss in future years. The beneficiary will not have “residential rental property income” as defined. She may have distributions from the trust. She may also make a gain on sale of the interest in the trust. However, this could be a capital gain and not subject to tax.

The legislation should go a step further and explain how the ring-fenced losses can be used when they have arisen from borrowing to acquire an interest in a trust. As with the Company example above, the rules should also be explained further by extending the example in the Commentary.

Submission 38: application to Look Through Companies

That the interposed entity rules should not apply to Look Through Companies (LTCs).

Comment

Proposed section DB 18AJ(7) states that a "residential land-rich entity" means "a company, partnership or Look Through Company…"

However, an LTC is a transparent entity. Any excess deduction in an LTC should belong to the shareholder and be available to put into a "portfolio" owned by the shareholder and used to offset rental profits of the shareholder.

The extent to which an LTC is transparent has been raised by CA ANZ with the Committee and with officials. This issue has never been resolved. In our view the inclusion of LTCs as interposed entities suggests that an LTC is not fully transparent. Clarity in this area is needed and should be a priority.

Social policy matters

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Definition of income for student loans and Working for Families			
Clause 57	MB 12B	Family scheme income from trusts	
Clause 93	5A	Excluded income	

Day count test amended			
Clauses 84 and 85	Sections 22 and 23 Student Loan Scheme Act 2011	Reinstates a tie breaker provision which ensures a borrower continues to be treated as New Zealand based and not overseas based. Applies from 1 April 2012.	

Other policy matters

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Securitised pre-1990 forest land emissions units			
Clauses 44, 45, 47, 48, 52, 53	CX 54, new CX 54B, new DB 17B,, new EW 5(11C). new EW 52B	The sale and compulsory buy back of pre-1990 forest land emissions units will, in effect, be treated as loans.	See Submission 39 and Submission 40 for editorial errors.
Keeping tax records in te reo Maori			
Clauses 38(1), (3) to (5), 68-71	GST Act: 75; Tax Administration Act: 22, 22A, 22B, 26	Codification of GST Act and Tax Administration Act of Inland Revenue's operational practice allowing taxpayers to hold tax records in te reo Maori (taxpayers will not be required to seek the approval of the Commissioner of Inland Revenue).	See Submission 41 regarding practical implications/possible compliance costs.
PAYE and employee share schemes			
Clause 61	Section RD 7	Allows an employer to make an irrevocable election to withhold PAYE in relation to a grant made under an ESS.	A pragmatic solution to overcome the accounting consequences and will help minimise compliance and administration costs.
Beneficiaries as settlors			
Clause 56	HC27	The legislation will specifically provide that if the trustees of a trust owe an amount to a beneficiary that beneficiary will not be a settlor of the trust solely by virtue of being owed the amount if: the trustee pays interest to the beneficiary at an interest rate equal to or greater than the prescribed rate of interest; or the amount owing at the end of the income year is not more than $25,000.	Refer Submission 42 regarding transition/operationalisation.

Clause	Section	Description	Comment
Co-operative companies: non-deductible cash contributions			
Clause 51	DV 18	Statutory producer boards and co-operative companies	
Clause 58 to 60	OB 78B, OB 82, OZ 15	Co-operative companies attaching imputation credits to cash distributions to groups	The amendment will have the intended effect if tax on pool profits is always borne solely by members of the pool.
Clarification of the application of the Common Reporting Standard			
Clause 73 and 74	Section 185O; Schedule 2 Tax Administration Act	Clarifies that an entity does not have to be remunerated directly for its activities to be considered a financial institution for the purposes of the Common Reporting Standard.	
Loss of earnings insurance			
Clause 42	CG 5B	Receipts from insurance, indemnity or compensation for interruption or impairment of business activities	
Taxation of life insurance; remedial change to the tax transition rules			
Clause 54	EY 30	Transitional adjustments: life risk	See our Submission 43 regarding the implications for level premium policies.

Securitised pre-1990 forest land emissions units

Clauses 44 and 47

Proposal

The headings in sections CX 54 and DB 16 will be amended to include the proposed amendments to the tax treatment of sale and compulsory buy back arrangements of pre-1990 forest land emissions units.

Submission 39: correct section references

The section references in clauses 44 and 47 incorrectly refer to section CX 54 and section DB 15 respectively.

Comment

Clauses 44 and 47 should refer to section CX 54 and section DB 16 respectively.

Submission 40: amendment to body of sections

The body of section CX 54 and section DB 15 should be amended to also refer to “excepted financial arrangements”.

Comment

Clauses 44 and 47 amend only the headings in section CX 54 and section DB 16. These provisions currently do not refer to “excepted financial arrangements”. Amending the heading without amending the substantive provision would cause confusion.

Keeping tax records in te reo Maori

Clauses 38(1), (3) to (5) and 68 to 71

Proposal

The law will be amended to codify Inland Revenue's long-standing practice allowing taxpayers to hold tax records in te reo Maori.

Submission 41: recipients not to be disadvantaged or required to incur compliance costs

Non-te reo Maori speaking taxpayers should be assured that they will not be disadvantaged or required to incur additional compliance costs if they receive a tax record in te reo Maori.

Comment

Notwithstanding our support of the proposed amendments we consider it appropriate that non-te reo speaking taxpayers are assured that they will not be required to incur additional compliance costs if they receive a tax record in te reo Maori. For example, a person should not be required to incur the cost of an interpreter/have the tax record translated in order to meet their own tax requirements.

Beneficiaries as settlors

Clause 56

Proposal

The legislation will specifically provide that if the trustees of a trust owe an amount to a beneficiary, that beneficiary will not be a settlor of the trust solely by virtue of being owed the amount if:

- the trustee pays interest to the beneficiary at an interest rate equal to or greater than the prescribed rate of interest; or
- the amount owing at the end of the income year is not more than $25,000.

Submission 42: savings provision

The amendment should include a savings provision.

Comment

We thank Officials for their engagement with CA ANZ on this issue (which began in 2012).

While we support the proposed clarification in the law, we consider the amendment should include a savings provision.

During our engagement it became apparent that practitioners held varying views on the issue of whether a beneficiary owed an amount by trustees upon which no interest is paid could be a settlor. It was also acknowledged that concluding in the affirmative would not reflect the long-standing approach adopted by many practitioners (especially if the amounts owed to the beneficiary were unpaid beneficiary income distributions).

The proposed amendment (and Commentary and Explanatory note to the Bill) confirms the policy intent of the provision which, as stated above, will be contrary to the tax positions adopted by many taxpayers. (We note that such a policy intent was not made clear when the trust rules were amended in the 1980s. The comprehensive TIB, completed contemporaneously, makes no mention of this result. It could be said that this result was obvious so did not need to be mentioned. Equally, the detailed nature of the TIB indicates that a such clearly intended effect would have been identified).

We consider that a savings provision should be included so that taxpayers who have adopted a different tax position are protected. In any case, in our view, it would be inequitable for the Commissioner to direct her limited resources to this issue.

Taxation of life insurance, remedial change to the tax transition rules

Clause 54(2)

Proposal

The proposed Clause 54(2) of the Bill is a remedial provision. It amends section EY 30(5)(b) to ensure that the legislation relating to the grandparenting period for level premium policies operated as it was intended when introduced in 2010.

Submission 43: “continuous rate period”

We recommend that the words “continuous rate period” in section EY 30(5BA)(b) be replaced with “cover review period” to correctly reflect the general industry practice and to preserve the intended outcome.

Comment

The proposed amendments to section EY 30 do not achieve the intended outcome with respect to level premium life insurance policies.

The industry standard for level premium policies permits cover increases to a fixed percentage per annum. It is clear that such increases were intended to be grandfathered.

The proposed section EY 30(5BA)(b) allows an increase in the life insurance cover under a policy during the “continuous rate period” of up to the greater of 3% and the percentage change in the consumer price index. The “continuous rate period” however as defined means up to the entire term for a level premium policy.

The change, if introduced, would remove the transitional deduction for some policies that already satisfy the test, and would not be in accordance with the intended outcome.

Remedials and maintenance items

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Clause 27	20H	Input tax on capital raising costs	