NEW ZEALAND LAW SOCIETY

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Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill

15/08/2018

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Introduction

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill (Bill).

2. The Law Society does not seek to be heard but is happy to discuss its submission with the Committee or officials if that would be of assistance.

3. The headings in this submission correspond to the relevant headings of the Minister of Revenue's *Commentary on the Bill* (Commentary). All statutory references in this submission are to the Income Tax Act 2007 (Income Tax Act), the Goods and Services Tax Act 1985 (GST Act) or the Tax Administration Act 1994 (TAA).

Not-For-Profits Remedials (Commentary, page 143)

Application of the charitable business income exemption (clause 125)

Charities Act registration

4. Clause 125(1) of the Bill proposes that the charitable income tax exemption for business income in section CW 42(1) of the Income Tax Act will apply only if the entity carrying on the business is registered as a charitable entity under the Charities Act 2005 (Charities Act) at the time the relevant business income is derived.

5. The Commentary justifies this change on the basis that "[a] small but increasing number of businesses are seeking to take advantage of the business income exemption without being registered charities themselves" and that "[t]his risks undermining public trust and confidence in the charitable sector". The Commentary also suggests that the Department of Internal Affairs (Charities Services), rather than Inland Revenue, should oversee and regulate such businesses.

6. The Law Society notes there are a variety of reasons why businesses affected by the proposed amendment – i.e. entities carrying on business for, or for the benefit of, registered charitable entities – are not themselves registered as charitable entities under the Charities Act. Such reasons include:

   (a) ineligibility to register (e.g. where not all business activities carried on by that entity are for, or for the benefit of, a registered charity, although in such cases provision for registration of a trustee deriving income in trust for charitable purposes may apply); and

   (b) unwillingness to make commercially sensitive information available to competitors (noting that Charities Services currently takes a narrow approach to granting exemptions from public disclosure of registered charities' financial information on the Charities Register).

7. It would seem appropriate for Inland Revenue, rather than Charities Services, to oversee and regulate such businesses, under revenue legislation that includes appropriate protection of commercially sensitive information from public disclosure. This would reflect the situation that applies to various other tax-exempt entities.

8. In addition, the Law Society notes that section CW 42(1) of the Income Tax Act already requires the beneficiary of tax-exempt business income to be a charitable entity registered under the Charities Act. As such, the entity benefiting from the tax-exempt business income is already subject to Inland Revenue, Charities Services and general public reporting and scrutiny, including reporting and

scrutiny in relation to whether its funds are being applied to charitable purposes in accordance with its rules.

9. The Law Society considers that the current legislative framework – Inland Revenue having oversight over the business entity's operations (with appropriate protection of commercially sensitive information from public disclosure in this context), and Charities Services (as well as Inland Revenue) having oversight over the beneficiary charity's use of its funds, including any business income – is appropriate. Accordingly, Charities Act non-registration of businesses carried on for, or for the benefit of, registered charities is unlikely to undermine public trust and confidence in the charitable sector.

10. The Commentary states that the proposed amendment to section CW 42(1) of the Income Tax Act will apply from the date of enactment. However, clause 2(22) provides that the proposed amendment will come into force on 1 April 2019, and clause 125(2) states that it will apply from the 2019-2020 income year (which will typically commence 1 April 2019, as tax-exempt entities generally will not have approval of a non-standard income year even if they otherwise use a non-standard balance date).

Application date

11. The Law Society considers that if the proposed amendment to section CW 42(1) does proceed, the application date will need to be reviewed, and deferred. Entities carrying on business for, or for the benefit of, a registered charity are unlikely to have sufficient time following the enactment of the Bill to register as charitable entities under the Charities Act before the start of their 2019-2020 income year. The Charities Act registration process can often take between 3 and 6 months, and although registration can be backdated in certain circumstances (if ultimately approved), entities need certainty regarding their registration position before the amendment applies. Changes to an entity's constitution and/or restructuring may also be required.

12. It would also be inappropriate for business entities that qualify for registration but fail to register as charitable entities prior to the start of their 2020 income year, to be required to prepare part-year accounts (which will require calculation of opening tax book values of tax base property) for the period from 1 April 2019 until they become registered charities.

13. The Law Society notes the contrasting position in relation to the proposed amendment under clause 176(2) that would require charitable organisations to register under the Charities Act in order to retain donee status, effective April 2020. It is not clear why entities carrying on business for, or for the benefit of, registered charities should be treated less favourably in this respect than charitable organisations that wish to retain their donee status, which will have until 1 April 2020 to register as charitable entities under the Charities Act.

Recommendations

14. The proposed amendment to section CW 42(1) is unnecessary and should not proceed. (Affected business entities are subject to Inland Revenue oversight and regulation and the section already requires the beneficiary of the business income to be registered as a charitable entity under the Charities Act. Accordingly, there already is public accountability and public scrutiny of the use of that tax-exempt business income.)

15. If, contrary to the above recommendation, the proposed amendment to section CW 42(1) proceeds, then:

(a) The amendment should not come into effect until 1 April 2020 at the earliest (consistent with the proposed changes requiring charitable organisations that wish to retain their donee status to register as charitable entities), to ensure that entities carrying on business for, or for the benefit of, charitable entities have sufficient time after the Bill is enacted to either apply for registration as a charitable entity (which may require changes to that entity's constitution) or to restructure their affairs (which may involve a transfer of the entity's business operations to the registered charity); and

(b) The issue of commercially sensitive information being publicly accessible on the Charities Register, rather than only being accessible to Charities Services and other authorities for oversight/regulation purposes, needs to be addressed before the proposed amendment comes into effect. (The review of the Charities Act announced in May 2018 would provide an opportunity to do this, but only if the application date for the proposed amendment is deferred.)

Approval/listing to qualify for donee status (clauses 176(1) and 42(5) – (6))

16. Clause 176(1) proposes to amend section LD 3(1)(a) of the Income Tax Act to require entities to attain the Commissioner's approval and listing, in addition to meeting other existing requirements for donee status, in order to qualify for donee status under section LD 3(2)(a), (ab), (b), (c) or (d) of the Income Tax Act (so that monetary donations to such entities are eligible for donation tax incentives, including the charitable donation tax credit under section LD 1 of the Income Tax Act or a deduction under section DB 41 of the Income Tax Act). Clause 42(5) proposes related changes to the donation tax credit administrative provisions in section 41A of the TAA. (Clause 2(22) provides for clauses 42 and 176(1) to come into force on 1 April 2019, and clause 42(6) provides that clause 42(5) will apply from the 2018-2019 income year.)

17. In practice, it is already the case that donee organisations are typically approved by Inland Revenue and listed on Inland Revenue's website. The approval and listing are attained in order to be able to provide donors with confirmation that an entity has donee status, and to ensure that donors' donation tax credit or deduction claims, and payroll giving credit claims, will be processed by Inland Revenue.

18. Although the proposed amendments simply provide a formal legislative framework for the existing approval/listing process, the proposed amendments confer upon the Commissioner inappropriately broad powers in relation to determining whether or not an entity will qualify for donee status. There are also various other issues with the current drafting:

a. It is not appropriate for the Commissioner to have discretion to include entities on the list based on what the Commissioner "*considers appropriate*" (as referred to in proposed section 41A(16)(b) of the TAA). Listing should be expressly based on an entity having satisfied the Commissioner that the applicable requirements for donee status under section LD 3(2)(a), (ab), (b), (c) or (d) of the Income Tax Act are met.

b. The provision for the Commissioner to prescribe information that needs to be provided by an entity requesting approval/listing (under proposed section 41A(18) of the TAA) should expressly refer to information that is relevant to determining whether the entity meets the requirements for donee status under section LD 3(2)(a), (ab), (b), (c) or (d) of the Income Tax Act, as applicable.

c. In relation to the above matters, in respect of charitable entities that are already registered under the Charities Act, consistent with current Inland Revenue practice such entities should not be required to satisfy the Commissioner that their purposes are charitable, or to provide information relating to this issue. Donee status approval/listing should only involve the Commissioner's assessment of any additional donee status requirements that need to be met by the entity, such as the application of funds wholly or mainly to purposes within New Zealand (under section LD 3(2)(a) of the Income Tax Act).

d. A decision by the Commissioner not to list an entity under the proposed new provisions must be a decision that can be disputed by the entity. The same would apply in relation to any decision by the Commissioner to withdraw approval/listing, and there should be a process for dealing with any proposed decision to withdraw an entity's approval/listing.

e. Timing issues also need to be addressed, because there will inevitably be circumstances that arise where gifts are made to entities that meet the requirements for donee status under section LD 3(2)(a), (b), (c) or (d) of the Income Tax Act, and should qualify for donation tax incentives, in circumstances where it is not possible or practicable to attain prior listing (for example, because the entity is a new entity). Time delays in relation to the Commissioner's approval of donee status listings may exacerbate this issue. There should be express provision for listing to be backdated, for example to the beginning of the year in which a request for listing is made or possibly to any earlier date. Further flexibility may also be achieved by providing for the Commissioner to accept donation tax incentive claims even though the recipient entity was not listed at the time of the gift (but met the other requirements for donee status).

f. The proposed application date for the changes also needs to reviewed, and most likely deferred, unless the timing issues noted above are addressed in a manner that ensures that the proposed 1 April 2019 application date will not be problematic. As in the case of the proposed amendment under clause 176(2) of the Bill, the application date could be deferred to 1 April 2020.

g. Consideration should also be given to providing for donors to be able to rely on the Commissioner's published approval/listing of an entity as a donee organisation in relation to making any donation tax incentive claims, unless a donor knows or has reason to believe that the entity does not qualify for donee status.

Recommendations

19. The Law Society recommends that the issues discussed at paragraph 18 be reviewed.

20. If the proposed amendments proceed, the Law Society recommends that Inland Revenue's Operational Statement OS 06/02 is updated or replaced to provide clear guidance regarding the Commissioner's approach to approval/listing.

21. The Law Society notes that as an alternative to the proposed amendments, the extension of the more formal registration regime under the Charities Act to donee organisations could be considered. The exclusion of donee organisations from such a regime was a deliberate decision that was made when the Charities Act was first enacted. The first version of the Charities Bill provided for the registration of donee organisations, alongside the registration of charitable entities, but provision for the registration of donee organisations was subsequently removed from the Charities Bill. This option

could, however, potentially be revisited as part of the Charities Act review announced in May 2018, rather than legislating for a separate but largely overlapping approval/listing regime administered by Inland Revenue as proposed under the current Bill.

22. As in the case of entities carrying on businesses for or for the benefit of registered charities, however, it may be considered more appropriate for oversight and regulation of donee status to remain with Inland Revenue.

Application of donee status to organisations with charitable purposes (clause 176(2))

23. Clause 176(2) proposes to amend section LD 3 of the Income Tax Act to require an entity which, in the Commissioner's opinion, is eligible to be registered as a charitable entity under the Charities Act, to be registered under that Act in order to qualify for donee status under section LD 3(2)(a), (b), (c) or (d) of the Income Tax Act (so that monetary donations to such entities are eligible for donation tax incentives, including the charitable donation tax credit under section LD 1, or a deduction under section DB 41, of the Income Tax Act). Clause 2(24) provides that this requirement will apply from 1 April 2020.

24. The Law Society understands that at times the Commissioner's opinion as to whether an entity is eligible to register as a charitable entity under the Charities Act 2005 differs from the Charities Registration Board's opinion, and that the Charities Registration Board and Charities Services have taken a different approach from the Commissioner with respect to eligibility to register in some cases.

25. Indeed, many Charities Act deregistration decisions to date relate to entities previously granted tax-exempt status by Inland Revenue. Examples include the Canterbury Development Corporation and the Canterbury Economic Development Fund (see *Canterbury Development Corporation v Charities Commission* [2010] NZHC 331).

26. The risk of conflicting approaches to the question of eligibility could create uncertainty for taxpayers. The intent and drafting of the proposed amendment need to be reviewed:

    a. Arguably, if the Commissioner's opinion is that an entity is eligible to register under the Charities Act (and the entity meets other applicable requirements for donee status), but Charities Services and the Charities Registration Board consider that the entity is not eligible to register under the Charities Act, the entity should still qualify for donee status.

    b. If, however, the intention of the proposed amendment is that any entity with exclusively charitable purposes (rather than, for example, an entity with non-charitable benevolent, philanthropic or cultural purposes, or with those purposes plus some charitable purposes) must be registered under the Charities Act in order to qualify for donee status, then the drafting should be amended to reflect this.

    c. The latter approach would, however, mean that there is a somewhat unsatisfactory two-tier regime for donee organisations, with exclusively charitable entities being subject to both Charities Act registration and compliance and the Commissioner approval/listing requirements, and other entities that apply their funds for charitable, benevolent,

philanthropic or cultural purposes, but are not exclusively charitable, being subject only to the Commissioner approval/listing requirements.

Recommendations

27. The Law Society recommends that the intent and drafting of proposed clause 176(2) be reviewed (as discussed at paragraph 26).

28. If clause 176(2) as currently drafted is enacted, the Law Society also recommends that Inland Revenue's Operational Statement OS 06/02[1] is updated to provide clear guidance regarding the Commissioner's approach to the amendment. If the amendment proceeds as currently drafted, this should include confirmation that the Commissioner's opinion on whether an entity is eligible to be registered as a charitable entity under the Charities Act, for the purpose of section LD 3 of the Income Tax Act, will be consistent with guidance provided by Charities Services and decisions made by the Charities Registration Board.

Arrangements involving tax credits for charitable or other public benefit gifts (clause 157)

29. Clause 157 proposes the enactment of a new anti-avoidance provision (new section GB 54)[2] relating to tax credits for charitable or other public benefit gifts. The proposed anti-avoidance provision will apply where a person enters into an arrangement and a purpose of the arrangement is that the person receives a greater tax credit than if the arrangement had not been entered into. If the proposed anti-avoidance provision applies, then the charitable donation tax credit is reduced to the amount that the Commissioner considers would have arisen if the arrangement had not been entered into.

30. Clause 2(22) provides that the proposed provision would come into force on 1 April 2019. The Law Society notes that it is already the case that a donation tax credit under section LD 1 of the Income Tax Act is only available if a person's payment constitutes a "charitable or other public benefit gift", as defined in section LD 3(1)(a) of the Income Tax Act. A payment will only fall within the principal limb of this definition if it is a monetary "gift" of $5 or more to a donee organisation. The term "gift" used in this context regulates the type of payments that qualify for a donation tax credit. That is, there needs to be a voluntary transfer of property to the donee organisation, without consideration.

31. In addition, although the Commentary on the Bill appears to suggest that existing avoidance provisions would not apply in relation to donation tax credit claims, the Law Society doubts that this is the case. The general anti-avoidance provision in section BG 1 of the Income Tax Act, and associated definitions, would appear to be wide enough to cover donation tax credit claims, so that this also regulates the type of payments that can qualify for a donation tax credit. (The Law Society also notes, however, that the circumstances in which a payment is a "gift" to a donee organisation but section BG 1 applies to deny a donation tax credit, would be expected to be rare.)

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1 OS 06/02 *Interaction of tax and charities rules, covering tax exemption and donee status (Dec 2006)*

2 The Bill's section numbering will need revision: the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 has already brought in a new section GB 54 as an anti-avoidance measure relating to permanent establishments, so the proposed introduction of a new section GB 54 in the Bill is potentially confusing.

32. Consequently, the Law Society considers that these aspects of the existing rules already adequately regulate the type of payments that qualify for a donation tax credit and there is no need for the proposed new anti-avoidance provision.

33. The Law Society is also concerned about the breadth of the proposed anti-avoidance rule, which effectively only requires the existence of an "arrangement" to obtain a tax credit. Taken literally, and given that the courts have confirmed that "arrangement" means almost anything,[3] the proposed anti-avoidance provision could apply whenever a person gives money to a donee organisation (which is an arrangement) for purposes that include the (objective) purpose of receiving a tax credit. In particular, it could apply to *any* donation fundraising by a donee organisation where the organisation might have tried to raise funds in some other way.

34. The proposed anti-avoidance rule could be interpreted by officials in such a way as to deny tax credits in situations which are not in the nature of tax avoidance. Examples may include where an individual is able to donate a high proportion of their income to donee organisations by living off capital receipts (e.g. inheritance, insurance proceeds or loan repayments). The Law Society understands that Inland Revenue is already taking this type of approach with some donors, despite section LD 1 of the Income Tax Act providing a clear entitlement to a tax credit in such situations.

35. This concern is reinforced by the fact that Inland Revenue officials can take such an approach with donors without any fiscal consequences, because the Commissioner is not required to pay interest on any delayed payment of donation tax credit refunds to which donors are entitled (which is to be affirmed by a proposed amendment to the interest provisions under the TAA, under clause 77 of the Bill).

36. In short, the Law Society considers that the anti-avoidance rule in proposed section GB 54 is not necessary and does not sufficiently set out the circumstances in which an arrangement involving donation tax credits should be treated as tax avoidance. The Commissioner should continue to apply the existing "charitable or other public benefit gift" provisions, and if necessary apply the general anti-avoidance provision under section BG 1 of the Income Tax Act where an arrangement is entered into that is contrary to the purpose of the donation tax credit provisions in section LD 1.

Recommendation

37. The Law Society recommends that the anti-avoidance rule in proposed section GB 54 is not enacted.

Land Sales – Associated Persons (Commentary, page 149)

Proposed amendment to section CB 15(1) of the Income Tax Act (clause 108)

38. Clause 108(1) proposes to delete the words "under whichever is applicable of sections CB 6 to CB 14" from section CB 15(1) of the Income Tax Act. The effect of this proposed change is to make section CB 15(1) an independent charging provision. This means that the exclusions set out in sections CB 16A to CB 23 of the Income Tax Act will no longer apply to a transferee where land held on revenue account is transferred to the transferee from an associated transferor.

39. The Law Society does not agree that this is a rewrite remedial. Further, the Law Society does not agree with the Commentary that section CB 15(1) of the Income Tax Act is an "anti-avoidance rule" (it is not included in subpart GA or GB of the Income Tax Act), nor the inference in the Commentary

[3] IS 13/01 *Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007 (June 2013)*

that the rule was intended to apply in all instances where a property developer transfers land acquired for the purpose of their business to an associated person. On the contrary, the Law Society considers that Parliament intended that the disposal of land would not be taxable if an exclusion applies, and that the application of the various exclusions should turn on the actual use of the land by its owner. For example, where a natural person transferee uses the property as their own home, the subsequent disposal of that property should not be taxable (provided the criteria set out in that residential land exclusion is satisfied), irrespective of who the land was acquired from.

40. The proposed changes to section CB 15(1) of the Income Tax Act will apply retrospectively from the beginning of the 2008/2009 income year (see clause 108(4), and clause 2(6) which provides that clauses 108(1), (3) and (4) are treated as coming into force on 1 April 2008).

41. The Law Society considers that any proposed change to section CB 15(1) should not be retrospective (as it is not a rewrite remedial), and that any such change (if made at all) should only be effective from the date of enactment. The proposed retrospective amendment to section CB 15(1) would undermine historic tax positions taken based on the existing wording of section CB 15(1). It would also adversely impact on structuring decisions (e.g. the sale of a section earmarked as a future residence by a property developer to their family trust) made in good faith in reliance on the existing wording of section CB 15(1).

42. The Commentary states that "a savings provision is proposed to protect tax positions taken on the basis of the existing law [the existing wording of section CB 15(1)] prior to introduction of the Bill". However, the Bill does not include any such savings provision. On the contrary, clause 108(4) provides that the proposed changes to section CB 15(1) of the Income Tax Act will apply from the beginning of the 2008/2009 income year, and clause 2(6) provides that clause 108(1) will be treated as coming into force on 1 April 2008. Presumably, the absence of a savings provision in the Bill is an oversight.

Recommendations

43. The Law Society recommends that the proposed amendment to section CB 15(1) of the Income Tax Act is not enacted, as it is not a re-write remedial and the proposed amendment will, in many instances, mean that taxpayers will be subject to income tax on the sale of their own home, even if the criteria set out in the relevant residential exclusion are satisfied.

44. If, contrary to the above recommendation, the proposed amendment to section CB 15(1) proceeds in its current form, then that amendment should apply only to dispositions of land between associated persons from the date of enactment. Given that the proposed amendment to section CB 15(1) will mean that exclusions (including the exclusions that apply to a taxpayer's own home) will no longer apply, any such change should only apply prospectively. The Law Society notes that if the proposed amendment applies to the disposal of land by the associated transferee from the date of enactment (rather than to dispositions of land between associated persons from the date of enactment) then the proposed amendment will still have a retrospective effect.

45. If, contrary to the above recommendations, the proposed amendment to section CB 15(1) proceeds in its current form from the 2008/2009 income year, then a savings provision should be included to protect tax positions taken based on the existing wording of section CB 15(1). The Commentary notes that such a savings provision is proposed, but the Bill does not appear to include such a savings provision; presumably this is an oversight.

Rulings and Amending Assessments (Commentary, page 55)

Extending the scope of binding rulings (in particular, clause 55)

46. The Law Society supports the binding rulings simplification measures in the Bill. Clause 55 proposes a new section 91CB of the TAA to provide that the Commissioner may make a private or short-process ruling on whether a person meets specific requirements of the Income Tax Act, such as whether the person is or is not a New Zealand resident or an associated person. The Law Society welcomes this proposal but submits that there are also similar "status" issues in the GST Act which should be included – such as whether a person is or is not GST resident, an associated person, a non-profit body, a public authority, or an absentee.

Recommendation

47. The Law Society recommends that proposed section 91CB of the TAA be extended, to permit private or short-process rulings on "status" issues in the GST Act.

GST Remedial Amendments (Commentary, page 126)

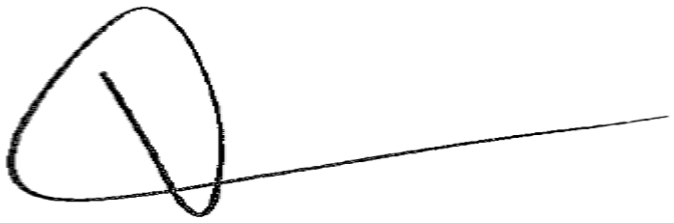
Outdated references to principal purpose test in rules for GST groups (clause 228)

48. Clause 228 proposes amendments to the rules for GST groups under section 55(7) of the GST Act to remove references to "principal purpose". The Law Society has three comments on clause 228 of the Bill:

    a. First, proposed new section 55(7)(db) does not address the situation where the goods and services were acquired, produced or applied for a non-taxable use by an entity before becoming a member of the group and are subsequently applied for a taxable use. The Commentary states that the amendment is intended to cover this situation, not just the situation where the new member previously acquired the goods or services for a taxable use.

    b. Second, if the proposed collapsing of section 55(7)(dc) and (db) into a new section 55(7)(db) proceeds, the reference in section 55(7)(c) to 55(7)(dc) would need to be omitted.

    c. Third, the Law Society notes there are other apparently outdated references to "principal purpose" in the GST Act in sections 5(13A), 10(3A) and 20A(4) which could be updated. The use of the term in section 21HB(1) may need to be retained as it is, in part, dealing with the position prior to 1 April 2011.



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