NEW ZEALAND LAW SOCIETY

NZLS EST 1869

Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill

14/09/2016

Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill

1 Introduction

1.1 The Law Society appreciates the opportunity to comment on the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (the Bill). All section references are to the Tax Administration Act 1994 (TAA) or Income Tax Act 2007 (ITA), unless otherwise specified.

1.2 The Law Society's comments address the following matters in the Bill:

- Automatic Exchange of Information (Part 1)
- Foreign Trust Disclosure Rules (Part 1)
- AIM provisional tax method (Part 2)
- Provisional Tax Attribution (Part 3)

1.3 A Supplementary Order Paper (no. 190) to the Bill (SOP) was introduced on 16 August 2016, and the Law Society received an invitation from officials on 25 August 2016 to comment on the SOP. The Law Society intends to provide a supplementary written submission on the SOP shortly.

2 Automatic exchange of information (Part 1)

Definitions (clauses 8 and 24)

2.1 For the most part, definitions included in the Common Reporting Standard (CRS) applied standard will be incorporated into domestic law by reference back to the CRS applied standard (rather than being incorporated by replication or translation). This is achieved by proposed new section 185O(4). Several new domestic law definitions are still required to ensure the workability of the new provisions in the Tax Administration Act 1994 (TAA). These will be inserted into section 3 of the TAA.

2.2 The Law Society broadly agrees with this approach, but has identified some possible improvements to the following definitions proposed in the Bill:

- "CRS standard" (clause 8(2));
- "FATCA agreement" (clause 8(3)); and
- "Passive income (clause 8(7)).

Definition of "CRS standard"

2.3 As currently drafted, the definition of "CRS standard" refers to "financial accounts as defined". It is assumed that the phrase "as defined" is included as a reference back to the relevant definition of "financial accounts" in the CRS standard.

2.4 This reference may be confusing to a reader as it suggests that there is a definition of "financial accounts" within the TAA itself. The confusion is exacerbated by the absence of a similar reference back in relation to other terms used in the TAA that are defined in the CRS applied standard.

Recommendation

2.5 That the words "as defined" be removed from clause 8(2)(a).

Definition of "FATCA agreement"

2.6 The definition of "FATCA agreement" refers to the full title of this agreement. While this is technically correct, the FATCA agreement is commonly known as the "intergovernmental agreement". The relevant link to this document on Inland Revenue's website also uses the title "intergovernmental agreement".

2.7 It would assist a reader's understanding of the provisions in the TAA, and a reader's ability to locate the relevant document, if the phrase "intergovernmental agreement" were incorporated into the TAA. This is particularly important given that obligations under the FATCA agreement are imported into domestic law by reference back to the FATCA agreement (rather than by replication or translation) meaning that financial institutions need to be able to easily locate the text of the FATCA agreement.

Recommendation

2.8 That the definition of "FATCA agreement" incorporate the following phrase (or a similar phrase):

> *"commonly known as the Intergovernmental Agreement with the United States in relation to FATCA"*

Definition of "passive income"

2.9 The Law Society welcomes the inclusion of a definition of "passive income" in the TAA. This will facilitate consistent interpretation and application of the CRS applied standard in New Zealand.

2.10 The proposed definition of "passive income" in clause 8(7) of the Bill is drawn from the meaning of "passive income" provided at paragraph 126 of the OECD Commentary on the Common Reporting Standard, Section VIII (OECD Commentary).[1] However, rather than the Bill replicating the OECD Commentary, the language used by the OECD has been reworded.

2.11 The Law Society submits that rewording the list of income types provided in the OECD Commentary creates potential gaps between the OECD and domestic law meanings of passive income. This is contrary to the Commentary on the Bill which provides (at page 98) that the full meaning of "passive income" as set out in the OECD Commentary, will apply in New Zealand.

2.12 Replicating the meaning of "passive income" provided in the OECD Commentary would better ensure that this term is given the full meaning provided by the OECD, that any risk of inadvertent gaps is minimised and that any subsequent guidance issued by the OECD (in relation to the meaning of "passive income") can be directly applied in New Zealand.

Recommendation

2.13 That the definition of "passive income" be amended so that it is consistent with the OECD Commentary, as follows (proposed additions in bold and underlined):

> *"**Passive income**, in the application of the FATCA agreement or the CRS applied standard to a person ~~or entity for a period~~, means an amount ~~that is not income from a transaction entered into in the ordinary course of the business of a dealer in financial assets and that is~~ **of gross income that consists of** –*
>
> *(a) a dividend:*

[1] See Part B of *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (OECD 2014)

(b) interest:

(c) income equivalent to interest:

*(d) rent or a royalty, other than rent or a royalty derived in the active conduct of a business conducted, **at least in part** ~~partly or wholly~~, by employees of the **NFE** ~~person or entity~~:*

(e) an annuity:

*(f) **the excess of gains over losses from the sale or exchange of** ~~for~~ financial assets that give rise to ~~amounts~~ **passive income described in** ~~included under~~ **paragraphs (a) to (e)**~~, the amount by which gains from the sales or exchanges of the financial assets in the period exceed losses from the sales or exchanges:~~*

*(g) the **excess of gains over losses from transactions (including futures, forwards, options, and similar transactions) in any financial assets** ~~amount by which gains from the transactions in financial assets in the period exceed losses from the transactions~~:*

*(h) the **excess of foreign currency gains over foreign currency losses** ~~amount by which gains from the foreign currency transactions in the period exceed losses from the transactions~~:*

*(i) ~~the amount by which gains from the swaps in the period exceed losses from the~~ **net income from** swaps:*

(j) an amount received under a cash value insurance contract:

but, notwithstanding the foregoing, passive income will not include, in the case of a NFE that regularly acts as a dealer in financial assets, any income from any transaction entered into in the ordinary course of such dealer's business as such a dealer."

Record-keeping obligations (clause 9)

2.14 Record-keeping obligations are intended to assist Inland Revenue when verifying a financial institution's compliance with the CRS and addressing any non-compliance. In practice, retained records may also support a financial institution's defence to an allegation of non-compliance.

2.15 To ensure that these purposes are achieved, the record-keeping obligations ought to cover all documents that are material to a financial institution's CRS compliance. This may include documents other than self-certifications (for example, documentary evidence establishing an account holder's tax residence).

Recommendation

2.16 That clause 9(3) of the Bill be amended as follows:

> *"a failure by a person to obtain* **information, or** *a self-certification as required by the CRS applied standard; and"*

Determinations and regulatory powers (clauses 12 and 25)

2.17 The proposed amendments provide a framework for establishing and amending New Zealand's lists of participating jurisdictions, reportable jurisdictions, non-reporting financial institutions and excluded accounts. This framework is set out in proposed new sections 91AAU, 91AAV, 91AAW and 226D.

2.18 The Law Society considers that these sections are adequate and achieve the intended outcome. However, aspects of these sections could be drafted more clearly. In particular, the word "determination" is used in sections 91AAU, 91AAV and 91AAW as if it were a defined term (when, in

fact, no definition is provided). The Commentary to the Bill also capitalises the word "Determinations", further suggesting that this is a defined term. This drafting may cause confusion.

2.19 For example, and to further illustrate this point, the wording of proposed section 91AAU suggests that subsection (3) should be read as a continuation of subsection (1) (where the phrase "the determination" first appears). This is not the intended meaning. Instead, subsection (1) and subsection (3) provide for two different forms of determination: determinations that name a new participating jurisdiction and determinations that amend the list of current participating jurisdictions.

2.20 Proposed sections 91AAU, 91AAV, 91AAW and 226D are also inconsistent as to whether or not a determination or regulation (as appropriate) needs to set out the period for which it is to apply. Subsection (2) of proposed sections 91AAU, 91AAW and 226D, states that the determination or regulation (as appropriate) *may* set out the period for which it is to apply. In comparison, subsection (2) of proposed section 91AAV, states that the determination *must* set out the period for which it is to apply.

2.21 The Law Society considers that every determination or regulation made under proposed sections 91AAU, 91AAV, 91AAW and 226D should state the period for which it is to apply. This will ensure that financial institutions have all necessary information to enable complete and full compliance with their obligations under Part 11B and the CRS applied standard. For example, New Zealand's list of participating jurisdictions will be important for a financial institution when undertaking due diligence as the CRS due diligence procedures require financial institutions to treat certain investment entities that are not resident in participating jurisdictions as passive NFEs – a point noted at page 105 of the Bill Commentary.

Recommendations

2.22 That the drafting of proposed sections 91AAU, 91AAV and 91AW be reconsidered, in relation to defining the term "determination".

2.23 That the term "may" be replaced with "must" in subsection (2) of proposed sections 91AAU, 91AAW and 226D.

Enforcement (clauses 13, 14 and 15)

2.24 The Law Society supports the inclusion of a transitional "reasonable efforts" defence in respect of any failure by a financial institution to meet its obligations under Part 11B and the CRS applied standard prior to 1 April 2019 (as set out in subsections (2) and (4) of proposed new section 142H). However, guidance should be provided as to how this defence will apply in practice. This guidance should address:

- what will constitute "reasonable efforts" to comply;
- what will constitute "reasonable efforts" to correct a failure to comply;
- at what point a financial institution will be treated as having become "aware of the failure"; and
- what constitutes a "reasonable period" for correction of the failure.

2.25 Given the significant penalty in proposed section 142H(5), the Law Society recommends that guidance also be provided as to when a financial institution will be considered to have taken "reasonable care" to meet its obligations under Part 11B and the CRS applied standard. Ideally, this guidance would include specific examples of steps that a financial institution can take to ensure that it has taken reasonable care in meeting its requirements under the CRS applied standard.

2.26 The Law Society recommends that guidance also be provided in relation to section 142I. In particular, this ought to cover:

- what constitutes a "reasonable time" under proposed section 142I(2)(e)-(i);
- what constitutes a "material change"; and
- when an information provider will be able to rely on the "no fault" defence under section 142I(3) or the "reasonable efforts" defence under section 142I(4).

2.27 Persons potentially subject to penalties under proposed new section 142I ought to be made fully aware of their obligations, and the possible application of a $1000 penalty. This will necessarily involve education of the wider public. The Law Society considers that Inland Revenue is the best-resourced agency to carry out this education exercise (as opposed to financial institutions, who are already tasked with significant compliance obligations). It is also preferable that Inland Revenue take the lead in relation to public education to ensure that the message provided to account holders is consistent, clear and complete.

2.28 The Law Society also notes that section 143A(2) and proposed section 143A(1)(ac) apply only in respect of a failure to provide a self-certification to another person. Elsewhere in the Bill, a person's obligations are in respect of "information or a self-certification". It is not clear whether or not this narrower liability in respect of knowledge offences is intended.

Recommendations

2.29 That comprehensive guidance on the enforcement regime be provided, including in relation to the availability of defences to liability.

2.30 That Inland Revenue be tasked with educating account holders and persons associated with financial accounts about their obligations under Part 11B, and the potential for penalties to be imposed in respect of non-compliance (including in respect of a failure to notify a financial institution of any material change to information or a self-certification previously provided).

Requirements for financial institutions (clause 24)

2.31 Proposed section 185N summarises the requirements for a financial institution under the CRS standard. The Law Society observes that the current drafting goes further than what is strictly necessary to incorporate the CRS standard into domestic law by reference (as was the policy intent). This creates opportunity for inadvertent gaps and interpretive errors. The Law Society recommends that proposed section 185N be pared back and refer more heavily to the CRS applied standard (similar to the approach taken to FATCA).

2.32 In the event that this submission is not accepted, and that proposed section 185N is retained in its current form, the Law Society suggests a number of drafting changes be made to that section to assist with clarity of meaning and ensure consistency with the CRS standard.

Recommendations

2.33 That proposed section 185N be pared back, similar to sections 185H and 185I of the TAA relating to FATCA. For example:

> *(1) A financial institution, as described in the CRS applied standard, is required to apply the relevant due diligence procedures described or contemplated in the CRS applied standard.*

(2) A financial institution, as described in the CRS applied standard, must obtain and provide information to the Commissioner if that information and its providing and obtaining is described or contemplated in the CRS applied standard.

(3) Information described in subsection (1) must be obtained and provided in accordance with –

(a) the CRS applied standard; and

(b) this Part 11B.

2.34 Alternatively, that proposed section 185N be enacted in its current form but with the amendments shown below:

185N Requirements for financial institution

(1) A financial institution must comply with this section for a period in which the financial institution is—

(a) resident in New Zealand under the CRS applied standard:

(b) a branch located in New Zealand under the CRS applied standard.

*(2) For the purposes of **subsection (1)**, the requirements for a financial institution that is resident in New Zealand do not include requirements for a branch of the financial institution that is not located in New Zealand.*

(3) The financial institution must, for each reporting period —

(a) perform the due diligence procedures required by the CRS applied standard for each financial account that is maintained by the financial institution in the reporting period; and

*(b) obtain the ~~documents and~~ information **and self-certification(s)**, for each financial account, that the CRS applied standard requires the financial institution to obtain; and*

*(c) obtain, as part of the due diligence procedures for each new financial account, for each account holder or controlling person identified by the financial institution as being a resident of a foreign jurisdiction **upon application of the due diligence procedures set out in Sections V, VI and VII of the CRS applied standard**, —*

i. the date of birth for an individual; and

*ii. the taxpayer identification number (**TIN**), if the foreign jurisdiction issues a TIN and has domestic law requiring that the TIN be collected; and*

*(d) give to the Commissioner a report of the information **that the CRA applied standard** ~~this Part~~ requires the financial institution to provide to the competent authority.*

*(4) The report by the financial institution **under subsection (3)(d)** for a reporting period must be given to the Commissioner by the 30 June following the 31 March that is the end of the reporting period, except as given by **subsection (5)**.*

(5) The first report by the financial institution for information with respect to a financial account that is maintained by a financial institution in a reportable period must be given to the Commissioner by—

(a) 30 June 2018, if the financial account is identified before that date as a reportable account that is a pre-existing individual account and a high value account:

(b) 30 June 2019, if the financial account is identified before that date as a reportable account that is a pre-existing entity account or that is a pre-existing individual account and a lower value account.

(6) In determining the aggregate balance or value of financial accounts, the financial institution must apply the rules in Section VII, subparagraph C(1) to (3) of the CRS applied standard.

(7) The financial institution may choose that the reporting requirements given by the CRS applied standard for financial accounts held or controlled by a resident of a reportable jurisdiction apply to all financial accounts maintained by the financial institution and ***identified as being*** *held or controlled by a resident of a foreign jurisdiction* ***upon application of the due diligence procedures set out in Sections V, VI and VII of the CRS applied standard****.*

(8) A financial institution that makes the election referred to in ***subsection (7)*** *must make reports* ***to the Commissioner*** *that are consistent with the* ***financial institution's*** *chosen* ***application of the*** *reporting requirements.*

(9) A financial institution that chooses to review all pre-existing entity accounts must complete the review by the date given in Section V, subparagraph D(1) of the CRS applied standard ~~for completion of the review of pre-existing entity accounts with the specified aggregate account balance or value~~.

(10) A financial institution that chooses to treat a discretionary beneficiary of a trust as not being a controlling person for the trust until the beneficiary receives a distribution must have reasonable safeguards and procedures for identifying when a distribution is made to the beneficiary.

(11) The financial institution is not permitted to choose for a report ***under subsection (3)(d)****—*

(a) to use a reporting period other than a period ending ~~with a~~ ***at*** *31 March:*

(b) to give the average balance of a financial account for a reporting period as being the balance for the financial account for the reporting period.

(12) The report ***by a financial institution under subsection (3)(d)*** *must be* ***provided to the Commissioner*** *in the prescribed electronic format.*

Application of the Common Reporting Standard (clause 24)

2.35 Proposed section 185O sets out a number of provisions for the application of the CRS standard under the Inland Revenue Acts. The matters covered in proposed section 185O are essential to understanding the provisions pertaining to the CRS standard. For this reason, the Law Society

recommends that proposed section 185O be placed at the beginning of the provisions relating to the CRS standard.

Recommendation

2.36 That the order in which proposed sections 185N and 185O appear in the Bill be reversed.

2.37 The Law Society also recommends a minor amendment to subsection (5) of proposed section 185O as follows:

> *"A person or entity may make an election that is expressed as being available to a person or entity **under the CRS applied standard**, if the election is not contrary to this Act and not otherwise contrary to the law of New Zealand."*

Requirements for persons to provide information to financial institution

2.38 Proposed section 185P places an obligation on account holders and other persons associated with a financial account in relation to the CRS applied standard. The information provision requirements apply to:

(a) institution contacts, at the request of a financial institution; and

(b) secondary contacts, at the request of an institution contact or other person or entity.

2.39 The Law Society considers that the inclusion of the phrase "or other person or entity" unnecessarily widens a secondary contact's obligation to provide information in relation to the CRS applied standard. This language introduces the possibility of a person being compelled to provide information other than at the request of an institution contact or at the request of a financial institution (in which event, the person would themselves be an institution contact).

Recommendation

2.40 That section 185P(3) be amended as follows:

> *"When a person or entity associated with the financial account (the **secondary contact**) is asked by an institution contact **that is acting in accordance with the institution contact's obligations under subsection (2)(b)** ~~or other person or entity~~ (the **requesting person**) to provide information or self-certifications related to the financial account ~~and referred to in subsection (2)(b),~~ the secondary contact must…"*

Schedule 2 (Schedule 1 of the Bill)

2.41 The Law Society broadly agrees with the inclusion of a new Schedule 2 to modify the CRS standard for New Zealand. In reviewing proposed new Schedule 2, the Law Society has identified a number of minor improvements that could be made (as set out below).

Recommendations

2.42 For item 10 of new Schedule 2, that the reference to "31 December" on line 4 of Section V, subparagraph D(2) be replaced with "31 March". This is consistent with the approach taken in relation to the review of pre-existing entity accounts under FATCA (as stated at paragraph 94 of Inland Revenue's FATCA due diligence guidance notes).

2.43 For items 13 and 22 of new Schedule 2, that a cross reference to the relevant sections that provide for the Commissioner's power to make such determination be included.

2.44 For item 20 of new Schedule 2, that the second reference to "31 December" on line 3 of Section VIII, subparagraph C(15) be replaced with "31 March". This is consistent with the approach taken in relation to the review of high-value accounts under FATCA (as stated at paragraph 67 of Inland Revenue's FATCA due diligence guidance notes)

Miscellaneous (suggested additions to clause 8)

Definition of "Tax return"

2.45 The Law Society considers that the definition of "tax return" in section 3 of the TAA ought to be amended to omit a return required under the CRS applied standard. Returns filed under the FATCA agreement were carved out from the definition of "tax return" for the reasons provided on page 59 of the Commentary to the Taxation (Annual Rates, Employee Allowances and Remedial Matters) Bill (no 176-3).

2.46 The Law Society considers that the reasons for excluding returns filed under the FATCA agreement from the definition of "tax return" are equally applicable to returns filed under the CRS applied standard. In particular, if a return under the CRS applied standard was a "tax return", provisions in the TAA relating to late filing penalties could apply. It is not necessary to impose late filing penalties in respect of returns required under the CRS applied standard, as this will be addressed by the general sanctions for non-compliance (proposed new section 142H).

Recommendation

2.47 That returns filed under the CRS applied standard be explicitly excluded from the definition of "tax return" in section 3 of the TAA.

"Financial institution"

2.48 The use of the term "financial institution" in the Bill, in relation to the CRS applied standard, is inconsistent with the approach taken in relation to the FATCA agreement. The sections of the TAA that relate to implementation of the FATCA agreement place obligations on a "person" (rather than a "financial institution").

2.49 The Law Society observes that including reference to "financial institutions" is preferable (rather than simply referring to "a person") as it creates a distinction between obligations placed on financial institutions and obligations placed on account holders (referred to in proposed section 185P as a "person or entity").

2.50 The Law Society also submits that it would be beneficial to include a definition of "financial institution" in section 3 of the TAA. This would assist a reader's understanding of the TAA.

Recommendation

2.51 That provisions in the TAA relating to obligations under the FATCA agreement be amended to refer to a "financial institution" (rather than a "person") where appropriate.

2.52 That a definition of "financial institution" be added to section 3 of the TAA. For example:

> ***Financial institution*** *means, in relation to the CRS applied standard or the FATCA agreement, a financial institution as defined in the CRS applied standard or the FATCA agreement (as appropriate).*

3 Foreign Trust Disclosure Rules (Part 1)

Proposed amendments to section HC 26 of the ITA (clause 5)

3.1 Clause 5 proposes to amend section HC 26(1) of the Income Tax Act 2007 so that an additional requirement must be satisfied before a foreign-sourced amount derived by a New Zealand resident foreign trustee in an income year is exempt income. The additional requirement is that the foreign trust is registered before the income is derived. This clause is intended to take effect on the date the amending Act receives the Royal assent. However, clause 10 of the Bill provides that a new foreign trust must register within 30 days and a trust existing prior to the date of enactment of the amending Act has until 30 June 2017 to register.

3.2 Presumably the intention to treat foreign-sourced income as being liable to tax in New Zealand for failure to register relates only to income derived for that income year and not, if a trust is belatedly registered, for every year thereafter. In other words, the Law Society assumes the intention is that the criteria under section HC 26 are to be applied on a year by year basis, so that for:

(a) a new trust that fails to register within 30 days, or

(b) an existing trust that fails to register before 30 June 2017,

foreign sourced income will still be eligible for a tax exemption under section HC 26.

3.3 Presumably a failure to register within the required timeframe does not mean that the failure cannot be rectified for a later period, so as to bring the trust within the rules, however this ought to be made clear.

Recommendation

3.4 That section HC 26 be amended:

(i) to permit income derived before registration to be exempt if registration occurs within the prescribed time limit (and the other requirements for income exemption are met); and

(ii) to clarify the intended position with regard to rectification of a failure to register within the required timeframe.

Proposed new section 59B of the TAA (clause 10)

3.5 Clause 10 contains a number of references to "*resident trustee*" (as does the heading to clause 5). This term is not defined. However, the term "*resident foreign trustee*" is already defined by section 3(1) of the Tax Administration Act 1994. This defined term should replace references in clause 10 to "*resident trustee*", and the reference to "*trustee*" in proposed section 59B(3).

3.6 The words "*all that is relevant to the trust of*" in the opening line of proposed section 59B(3) are redundant, given the detailed list of items that must be disclosed which follow those words.

3.7 The words "*other identifying particulars*" in proposed section 59B(3)(a) are vague and, given the liability for inadequate disclosure, unhelpful. Proposed section 59B(3) requires the name of the trust and a copy of the trust deed to be provided, so it is not clear what other particulars are required to identify the trust. If it is desirable for the date of establishment of the trust to be expressly disclosed, for example, then that should be specified.

3.8 Proposed section 59B(3)(b) requires the "*date and detail of each settlement*" to be disclosed. It is not clear what details are required, for example, the value of the settlement, the nature of the property

settled, the location (if any) of the property settled, and/or the identity of the settlor of each settlement.

3.9 Proposed section 59B(3)(c) requires the "*residential address*" of each person listed in (c) to be disclosed. Since, for instance, a trustee or settlor may not be an individual, clarification is needed as to what address, if any, is required for non-individuals, (e.g., a registered office). This provision also refers to the "*country of tax residence*". This would be better expressed as "*country, territory or jurisdiction of tax residence*".

3.10 Proposed section 59B(3)(c)(ii) requires disclosure of "each person with a power under the trust deed to control the dismissal or appointment of a trustee, to amend the trust deed, or to add or remove a beneficiary". This drafting does not appear to encompass a person with a power to control the amendment of the trust deed or to control the appointment or removal of a beneficiary, nor is it clear that a person to control the dismissal or appointment of a trustee encompasses a person with the power to appoint and remove a trustee. The drafting is also problematic as it requires the requisite power to stem from the trust deed. The Law Society recommends this be redrafted as:

> "*each person with a power (whether under the trust deed or otherwise) to dismiss or appoint a trustee, to amend the trust deed, or to add or remove a beneficiary and each person with a power (whether under the trust deed or otherwise) to consent, veto or otherwise control the exercise of a power to dismiss or appoint a trustee, to amend the trust deed, or to add or remove a beneficiary*".

3.11 It is not clear what is added by the words "*when a distribution is made under the trust or when rights apparently vested under the trust are exercised*" in proposed section 59B(3)(d). The Law Society recognises that such phrasing was suggested in the Shewan report,[2] but the provision would appear to be effective if it simply read:

> *"for a discretionary trust, details of each class of beneficiary sufficient for the Commissioner to determine whether a person is a member of the class".*

3.12 Proposed section 59B(3)(e) requires that the trust deed be provided. The Law Society recommends that this state expressly that both a copy of the trust deed and any document amending or that must be read together with the trust deed (such as, for instance, any document by which a person is appointed as protector), must be provided.

Recommendation

3.13 That proposed section 59B be amended to address the matters specified at paragraphs 3.5 to 3.12 above.

Proposed new sections 59C and 59D of the TAA (clause 10)

3.14 Proposed section 59C(2) includes the words "*except if subsection (3) applies*." If a change to particulars provided on registration must be supplied within 30 days of the trustee becoming aware of the change (a requirement queried below in the comment on proposed section 59D(2)), it is not clear why that 30 day requirement does not apply to an individual trustee who meets the requirements of subsection (3). If such person has registered the trust, it is not evident why the remainder of any grace period provided by subsection (3) should apply to the provision of a change in particulars.

---

2 *Government Inquiry into Foreign Trust Disclosure Rules: Report,* 27 June 2016.

3.15 The reference in proposed section 59C(3)(b) to the trustee becoming NZ resident "on or after 1 October 2006" appears redundant, given that the grace period runs from the time that residence is acquired and ends 2 years and 30 days after that date if the grace period ends after the date otherwise provided for in subsection (1) or (2). Since section 59C(1) refers to a date of 30 June 2017, it seems that a grace period must begin no earlier than 31 March 2015. Accordingly, if a trustee becomes NZ resident before 31 March 2015, section 59C(3)(b) could not apply.

3.16 Following on from the comment above about proposed section 59C(2), the reference in section 59C(3) to section 59C(2) also appears redundant, since section 59C(2) concerns an alteration to particulars given previously. The Law Society considers that the reference should be to section 59C(1) only, which prescribes the different dates by which registration is required for existing and new trusts.

3.17 Proposed section 59D(1)(b)(ii) acknowledges the possibility of a foreign trust not preparing financial statements. If a foreign trust has not done so, it is not clear whether it is intended under proposed section 59D(2)(b) that financial statements are to be provided only if they are prepared, or whether the intention is for every registered foreign trust to prepare financial statements, even if they would not otherwise be prepared.

3.18 Proposed section 59D(2) requires the annual return to include "each change during the year to information that is required to be provided when the trust is registered". In addition, proposed section 59C(2) requires any alteration to information given on registration to be supplied by the trustee to the Commissioner within 30 days of becoming aware of the alteration. This means that the same information is required to be provided twice. This is unnecessary duplication. The Law Society considers that the change to any particular should be required to be provided only in the annual return, to prevent the need for minor changes to be notified on a 30-day basis.

3.19 In addition, in some cases there are very likely to be beneficiaries (e.g., children) that do not have email addresses and/or tax numbers. The Law Society considers that a provision should be included allowing the contact details of a guardian or parent to be provided where the beneficiary is a minor.

3.20 Proposed section 59D(3) requires the annual return and fee to be provided within three months of any balance date for which the foreign trust prepares financial statements or otherwise within three months of the end of the "year". The official Commentary on the Bill indicates that "year" is to be construed as "tax year", but this is not made clear in the Bill. Three months is a very short timeframe. By contrast, the annual return for a charitable trust must be filed within six months of balance date. Moreover, if the majority of income is derived in other jurisdictions which have different balance dates, then there may not be complete information available within three months of the end of the New Zealand tax year. Six months after balance date or six months after the end of the tax year (as applicable) would be a more reasonable timeframe.

3.21 Proposed section 59D(2)(e) requires the date and amount of each distribution to be provided in the annual return. It is not clear whether the required amount is the total of distributions made on a particular date or the amount of a distribution on a particular date to a particular beneficiary. If the latter is intended, then that should be clarified. If so, it is also unclear whether the identity of the particular beneficiary is also required to be provided under (e), which would seem useful, in which case the requirements in proposed (f) could be transferred to (e) instead. In addition, it should be noted that distributions can include items that are otherwise of money or assets (for example, the use of a property by a beneficiary for no consideration). It is not clear whether it is intended that these types of distributions be identified and valued.

Recommendations

3.22 That the words *"except if subsection (3) applies"* be deleted from proposed section 59C(2).

3.23 That proposed section 59C(3)(b) be deleted.

3.24 That the words "or (2)" be deleted from proposed section 59C(3).

3.25 That proposed section 59D(2)(b) be amended to clarify the position regarding the requirement to prepare financial statements, as discussed at paragraph 3.17 above.

3.26 That proposed section 59C(2) be deleted.

3.27 That proposed section 59D(2) be amended to allow the contact details of the parent/guardian of a beneficiary who is a minor to be provided.

3.28 That proposed section 59D(3) be amended to clarify that "year" means "tax year".

3.29 That consideration be given to deleting the words "3 months" from proposed section 59D(3)(a) and replacing them with "6 months".

3.30 That proposed section 59D(2)(e) be amended to clarify the position on the matters discussed at paragraph 3.21 above.

4 AIM provisional tax method (Part 2)

Income requirement to use AIM-capable accounting system (clause 31)

4.1 Clause 31 of the Bill inserts a new subsection (5B) into section RC 5 of the ITA. This section would govern a taxpayer's eligibility to use the AIM provisional tax method. Paragraph (c) contains requirements relating to a person's level of gross income.

4.2 The Bill does not adequately address the circumstances of businesses with high gross income (in excess of $5 million), but low margins and therefore low net (taxable) income. Such a business may well use the same off-the-shelf accounting package as a business with gross income of less than $5 million (which therefore qualifies for the AIM method) but that has the same or higher taxable income. As such, a criterion based on **gross** income does not necessarily reflect a logical threshold at which a taxpayer should be entitled to use an AIM-capable accounting system. Proposed section RC 5(5B)(c)(ii) partly addresses this issue by catering for taxpayers whose gross income is $5 million or less in the first year for which they use the AIM method, but that will not assist existing businesses whose annual gross income already exceeds $5 million.

Recommendation

4.3 That an additional limb be added to paragraph (c) which would permit a taxpayer to use the AIM method with an AIM-capable accounting system where that taxpayer's net income falls under a certain level, provided their annual gross income is less than (say) $10 million.

Statutory declarations as to future actions (clause 44)

4.4 Clause 44 of the Bill inserts a proposed new section into the Tax Administration Act 1994, section 15U. This proposed section sets out the circumstances in which the Commissioner may approve a person as an approved AIM Provider.

4.5 One of the requirements for the applicant under proposed section 15U is that the person makes a statutory declaration in relation to certain matters. One of the matters that an applicant is required

to declare is that "the product is updated regularly, to reflect changes in tax law or Commissioner's requirements ..." (proposed section 15U(b)).

4.6 While the form of the statutory declaration to be signed by the applicants has not yet been published (the Commentary to the Bill states that the details of the declaration will be clearly outlined in a technical determination issued under proposed section 91AAX), the Law Society is concerned that the Bill may impose an obligation to give a declaration as to future actions.

Recommendation

4.7 That the form of any statutory declaration required to be signed by the applicants is worded so that the applicant makes a declaration as to an existing state of affairs, rather than a declaration as to future actions, thus ensuring that the accuracy of the declaration can be determined on the date it is made.

"Failed instalment" definition (clause 48)

4.8 Clause 48 of the Bill inserts a proposed new section 120KBC into the TAA. This proposed section is intended to set out the use of money interest consequences for persons who elect to use the AIM provisional tax method.

4.9 The Law Society notes that proposed section 120KBC(3) defines a term, "a failed instalment" which is not subsequently used in this section, and is therefore redundant.

Recommendation

4.10 That the defined term "a failed instalment" be removed from proposed section 120KBC(3).

5 Provisional Tax Attribution (Part 3)

Withholding tax rates for schedular payments (clause 98)

5.1 Clause 98 proposes replacing section 24L(2) of the TAA. There is a risk that the proposed wording could be read as requiring all payees of schedular payments to give notice of elected withholding tax rates or of rates prescribed by the Commissioner.

Recommendation

5.2 That proposed section 24L(2) be reworded to make clear that it applies only if a taxpayer has elected a withholding tax rate or if the Commissioner has prescribed a withholding tax rate. For example, section 24L(2) could be worded as follows:

> *"Before the person (the payee) receives the schedular payment, the payee must give the person making the payment a notice that states* ***the applicable tax rate*** *–*
>
> *(a)* ~~*the tax rate that*~~ ***if*** *the payee has elected under section 24LB* ***for that rate*** *to be applied to the schedular payment; or*
>
> *(b) if the Commissioner has notified the payee* ~~*that*~~ ***of*** *a* ~~*different*~~ *tax rate* ~~*applies*~~ *for the schedular payment* ~~*as provided by*~~ ***prescribed under*** *section 24LC,* ~~*that different tax rate.*~~*"*

Standard Method Associates (clause 109)

Requirement for all "standard method associates" to apply GST ratio or standard uplift methods (proposed section 120KKB(1))

5.3 As part of allowing concessionary use of money interest (UOMI) treatment for most standard method provisional taxpayers, clause 109 inserts a proposed new section 120KBB into the TAA. The concessionary UOMI treatment will not be available unless all "standard method associates" who are liable to pay provisional tax, use either the GST ratio method[3] or the standard uplift method.[4]

5.4 If one person makes a fair and reasonable estimate (for example, because taxable profits have significantly reduced and there are cash flow restrictions), none of the other standard method associates would be entitled to the concessionary UOMI treatment. Given the wide application of "standard method associate", the Law Society considers that there should be no restriction on the availability of the concessionary UOMI treatment for other standard method associates, even though the person making the estimate is not entitled to the concessionary UOMI treatment (under proposed section 120KBB(1)(b)). Any concerns regarding the switching of income between taxpayers are more than adequately addressed by the general anti-avoidance provision (section BG 1 of the ITA and the specific anti-avoidance provision in proposed section 120KBB(1)(d)).

5.5 From an administration perspective proposed section 120KBB(1), as currently worded, could be difficult for Inland Revenue and taxpayers to monitor. For example, in practice, beneficiaries will not necessarily have the same tax agents or advisers and meeting their return and provisional tax obligations will not be carried out alongside those of the trust as part of the same "package deal". Thus, it could be difficult to track who is a "standard method associate" in Inland Revenue's systems and the UOMI impact for a provisional taxpayer if another (indirect) standard method associate files an estimate unbeknown to the other provisional taxpayers. The Law Society considers that proposed section 120KBB(1)(b) ought to be drafted so that each provisional taxpayer can determine (based on their own actions) whether they are entitled to concessionary UOMI treatment.

Recommendations

5.6 That the concessionary UOMI tax treatment apply where a standard method associate uses the estimation method.[5]

5.7 That proposed section 120KBB(1)(c) be deleted.

5.8 That consideration be given to amending proposed section 120KBB(1)(b) as set out in paragraph 5.5 above.

Definition of "standard method associates" (proposed section 120KBB(4))

5.9 The Law Society considers that the proposed definition of "standard method associate" in proposed section 120KBB(4)(b) is too widely defined. Proposed section 120KBB(4)(b)(ii) could apply to a much broader range of taxpayers than a company's direct and indirect shareholders because of the aggregation rule in section YB 3(3) of the ITA. Relatives of two degrees (who may not have any direct dependence on the income or remuneration of the provisional taxpayer) may be beneficiaries or associates under sections YB 4 to YB 14 of the ITA, and thus could also fall within the proposed definition of "standard method associate".

---

3 Under section RC 5(6) of the Income Tax Act 2007.
4 Under section RC 5(2) or (3) of the Income Tax Act 2007.
5 Under section RC 5(5) and RC 7, ITA 2007.

5.10 Similar issues arise under proposed section 120KBB(4)(b)(iii) for taxpayers other than companies when applying the tripartite rule in section YB 14.

Recommendations

5.11 That the definition of "standard method associates" be restricted to associated parties who are directly interdependent for any given tax year.

5.12 That, for the purposes of proposed section 120KBB(4)(b)(ii), only shareholders with at least 50% direct voting interests or market value interests should be treated as "standard method associates".

5.13 That, for the purposes of proposed section 120KBB(4)(b)(iii), any limitation should be restricted in scope to the trustees and beneficiaries of those trusts.

6 Conclusion

6.1 The Law Society does not wish to be heard, but is available to meet with officials advising on the Bill if the Committee considers that this would be of assistance.

Kathryn Beck
President
14 September 2016