New Zealand Law Society
Te Kāhui Ture o Aotearoa

Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill

13/07/2023

Submission on the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill 2023

1 Introduction

1.1 The New Zealand Law Society Te Kāhui Ture o Aoteoroa (**Law Society**) welcomes the opportunity to comment on the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill (**Bill**).

1.2 This submission focuses on the following aspects of the Bill:

a. incorporation of the Global Anti-Base Erosion (GloBE) rules.

b. the proposed 39% trustee tax rate.

c. ACC and MSD lump sum backdated payments.

1.3 The Law Society **wishes to be heard**.

2 Global Anti-Base Erosion rules

Greater transparency of officials' and Government's role in Inclusive Framework required

2.1 It is a fundamental tenet of New Zealand's constitution that the levying of taxes may only be undertaken under the auspices of an Act of Parliament.[1] The Bill proposes that amendments to the GloBE rules will apply under New Zealand law without further public consultation or Act of Parliament; it adopts an ambulatory, rather than static, approach to incorporation. In its submission on Inland Revenue's consultation on the GloBE rules in 2022, the Law Society submitted that a static approach to future amendments of the GloBE rules was most appropriate,[2] in order to retain ongoing Parliamentary oversight and endorsement of subsequent amendments. This remains the Law Society's preferred approach.

2.2 While the automatic adoption of future amendments to the GloBE rules may arguably be justified in this particular case, the Law Society is concerned that the public has no visibility or input into the development of rules under the Inclusive Framework. Given that the public will not be given an opportunity to submit on further changes to the GloBE rules, the Law Society recommends that Inland Revenue publish information on who represents New Zealand as part of the Inclusive Framework, how those persons are accountable to the New Zealand public and the consultation process undertaken when determining New Zealand's position when negotiating changes to the GloBE rules.

2.3 Clauses 44 and 77 of the Bill may be intended to operate so that there is the ability to readily 'opt-out' or not apply future amendments to the GloBE rules, should the Government so decide. However, the Bill could be improved by including a provision that more clearly and expressly addresses the question of future amendments to the GloBE Rules and Commentary. Such a provision could provide that future amendments apply <u>unless</u> specific

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[1] Section 22(a) Constitution Act 1986. See also LDAC Legislation Guidelines, Chapter 17, http://www.ldac.org.nz/guidelines/legislation-guidelines-2021-edition/issues-particularly-relevant-to-empowering-secondary-legislation-2/chapter-17/

[2] https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/IR-OECD-Pillar-2-GloBE-rules-27-6-22.pdf, at page 2.

steps have been taken to declare that they do not apply (e.g., declaration by Order in Council). The Law Society considers this would be a more transparent means of addressing future changes to the GloBE Rules, and would ensure a more appropriate level of domestic control over taxation.

Gateway criteria should be in New Zealand legislation

2.4 The Law Society understands that very few New Zealand taxpayers are expected to be subject to the GloBE rules. However, under proposed Subpart HP a taxpayer (who would bear the onus of proof in any dispute with Inland Revenue) is required to access and apply the GloBE rules (as set out in the relevant OECD documentation) to determine whether or not the GloBE rules apply to it. The Law Society is concerned this places an undue burden on taxpayers.

2.5 The Law Society recommends that gateway criteria for the application of the GloBE rules are expressly set out in the Income Tax Act 2007, to allow taxpayers to determine whether the GloBE rules do not apply to them without the need to access and understand the OECD documentation.

Double tax agreement override not justified

2.6 Subject to limited specific exceptions, New Zealand's network of double tax agreements (**DTAs**) overrides the Income Tax Act 2007. As explained on Inland Revenue's tax policy website "*DTAs reduce tax impediments to cross-border trade and investment*".[3] DTAs are important bi-lateral agreements between New Zealand and other jurisdictions that should be respected, and not unilaterally disregarded unless there is a sound and well-articulated rationale.

2.7 The Commentary to the Bill[4] states that "*The OECD has stated that the IIR and UTPR [ie, the new taxes imposed by the GloBE rules] are both compatible with OECD model-based tax treaties, such as New Zealand's*". However, despite the OECD's stated position the Bill proposes that GloBE rules override New Zealand's DTAs.

2.8 The Law Society is concerned that the Bill seeks to override New Zealand's DTAs without New Zealand first consulting each of its DTA treaty partners (including those who may not adopt the GloBE rules). This approach may unduly harm the value of New Zealand's DTA network, including undermining New Zealand's ability to resist its DTA treaty partners themselves unilaterally overriding DTAs.

2.9 The Law Society recommends that the amendments to section BH 1 be removed from the Bill and that officials consider how New Zealand's DTA treaty partners are approaching the interaction between DTAs and the GloBE rules in order to adopt a consistent approach.

Effective date

2.10 The Bill provides that the implementation date of each component of the GloBE rules will be set by Order in Council, with each "component" potentially having a different implementation date. Proposed section HP 4(3) sets some time constraints on the

3 https://www.taxpolicy.ird.govt.nz/tax-treaties.

4 Page 17.

implementation date but otherwise provides no criteria or limits on when the Government may decide to implement the GloBE rules (i.e., impose new taxes).

2.11 The Commentary to the Bill[5] states:

> *The design of the rules means this intention can be achieved even if many, or indeed most, countries do not adopt the rules,* ***provided a critical mass of countries implement the GloBE rules*** *(that is, enough adopt the rules that domestic MNEs cannot escape the tax by earning income only in countries that do not adopt them)*" [Emphasis added].

2.12 The Commentary[6] then further states that "*The application date for the Applied GloBE rules will be set by Order in Council* ***once the Government determines that a critical mass of countries has adopted the GloBE rules."*** [Emphasis added]

2.13 The imposition of new taxes should not be undertaken lightly. The Law Society recommends that if the GloBE rules require "a critical mass" of countries to adopt the rules, then that criterion should be reflected in the *power* allowing the Government to select the implementation date. Including that criterion would provide a standard against which a New Zealand court may test the Government's exercise of its power under section HP 4.

Rules should be available from New Zealand Government sources

2.14 The Law Society considers it critical for the rule of law that New Zealand's statutes be readily and freely available to the New Zealand public. Taxpayers must be able to access and determine their legal obligations. As such, the Law Society recommends that the copies of the Model Rules, Commentary and Agreed Administrative Guidance (and any other documents adopted into New Zealand law by Act of Parliament) should be available electronically and for purchase from the New Zealand legislation website.

3 Increasing the trustee tax rate to 39%

Disregard for the Generic Tax Policy Process is concerning and inefficient

3.1 The Generic Tax Policy Process (**GTPP**) has been in place since 1994. It is designed to *"ensure better, more effective tax policy development through early consideration of all aspects –and likely impacts –of proposals, and increased opportunities for public consultation*," and ensure that "*tax initiatives are subject to public scrutiny at all stages of their development.*"[7] It is intended to ensure early and informed consultation, which promotes effective and workable laws, and reduces the need for subsequent remedial reforms. As noted on Inland Revenue's website:[8]

> *The GTPP is widely accepted as the way to make tax policy, and tax professionals and professional associations expect it to be used. It leads to cooperation, assistance and frank dialogue.*

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5 At page 11.

6 At pages 12 and 17.

7 https://www.taxpolicy.ird.govt.nz/publications/2017/2017-other-regulatory-stewardship/5-gttp

8 *Ibid.*

3.2 The proposals related to the amendment of the trustee tax rate were not developed in accordance with the GTPP. While the Law Society accepts that certain elements of tax policy are the prerogative of the Government of the day, the fact that the change in the trustee tax rate requires additional rules to address under-taxation and over-taxation resulting from the change in rate (e.g., proposed sections HC 8B, HC 38 and HC 39) illustrates that changing the trustee tax rate involves more than simply changing a number.

3.3 The use of trusts in New Zealand is widespread and is driven by many factors, most of which are not tax related. The Law Society is concerned that proposals affecting many New Zealanders were not subject to public consultation in accordance with the GTPP. It now falls on the Finance and Expenditure Committee to address as many of the deficiencies in the proposals as possible. The Law Society expects that this approach to tax policy will require future remedial amendments and, for that reason, is inherently inefficient.

Rationale for taxing beneficiary income derived by certain corporate beneficiaries as trustee income at the rate of 39% is unclear

3.4 The Bill proposes taxing beneficiary income derived by certain close companies as trustee income (i.e., at the proposed 39% trustee tax rate) from the beginning of the 2024/25 income year (1 April 2024 for most trusts). The Commentary to the Bill[9] indicates that it is inappropriate to tax such distributions at the corporate tax rate of 28%, as the "real beneficiary" of such a distribution is the ultimate shareholder of the corporate beneficiary. The Commentary to the Bill[10] also states that where the shareholder of the corporate beneficiary is a trust, it is inappropriate to tax such distributions at the rate of 28% as the income effectively remains within the trust.

3.5 These comments are at odds with, or disregard, New Zealand's comprehensive and robust dividend rules. The Law Society does not agree with the rationale for taxing such distributions as trustee income at the 39% trustee tax rate, as the 28% corporate tax rate still applies where there is a transfer of funds within a corporate structure (e.g. where there is a transfer of funds from a company to a corporate shareholder, or a transfer of funds from a company to another company, whether or not the recipient is in the same wholly-owned group).

3.6 It is therefore unclear why transfers of funds from a company to another company via a trust are being singled out for taxation at the proposed 39% trustee tax rate. The Law Society also notes that PIE investments can be taxed at the corporate tax rate of 28% as a final tax, even though the person benefiting from that PIE investment may be subject to income tax at the 39% tax rate.

3.7 The Law Society recommends proposed section HC 38 be removed from the Bill, pending further consultation and consideration of the tax policy underlying the accumulation of profits in corporate structures and the taxation of PIE investments.

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9 https://www.taxpolicy.ird.govt.nz/publications/2023/2023-commentary-multinational-tax-bill, at page 69.

10 At page 69.

Requirement for the settlor of the trust to have natural love and affection for a direct or indirect shareholder of the corporate beneficiary is defective

3.8 The proposed anti-avoidance rule concerning distributions of beneficiary income derived by certain close companies uses the term "natural love and affection" to distinguish between those corporate beneficiaries to which the rule will apply and those to which the rule will not apply. The Commentary to the Bill[11] notes that limiting the anti-avoidance rule to close companies where a settlor of the trust has natural love and affection for a (direct or indirect) shareholder of the company should ensure that the proposal is targeted towards family trusts and would not affect the commercial use of trusts in large corporate groups.

3.9 However, given the manner in which the "natural love and affection" requirement has been drafted, it does not appear to apply in a situation where the corporate beneficiary is owned by a trust (as it is not possible to have natural love and affection for a trust), and may not apply where the only settlor of the trust owns all of the shares in the corporate beneficiary (as it is not clear whether a person can have natural love and affection for themselves).

3.10 The Law Society recommends that, if proposed section HC 38 is not removed from the Bill, this drafting issue is addressed by providing that where the shareholder of a corporate beneficiary is a trust, then the anti-avoidance rule would apply if a settlor of the trust making the distribution of beneficiary income has "natural love and affection" for the main beneficiaries of the trust which is the shareholder of the corporate beneficiary.

Distributions of amounts derived by corporate beneficiaries of a trust to shareholders that are deemed to be trustee income should be treated as exempt dividends rather than 'available capital distribution amounts'

3.11 The proposed anti-avoidance rule concerning distributions of beneficiary income derived by certain close companies provides that affected corporate beneficiaries are credited with an "available capital distribution amount" equal to the amount of the dividend, so that the distribution from the trust can subsequently be distributed by the company to its shareholders tax free. The Law Society notes that "available capital distribution amounts" can only be distributed tax-free when the company is liquidated, and such amounts should be able to be distributed by the corporate beneficiary to its shareholders tax-free at any time, given the amount has already been taxed at 39%.

3.12 The Law Society submits that affected companies should be able to maintain a tracking account in respect of distributions taxed at the rate of 39% under the proposed anti-avoidance rule, and that distributions made by affected companies to their shareholders should be tax-free to the extent that the distribution does not exceed the credit balance of the tracking account.

Proposed rules for taxation of deceased estates require executors to prepare past-year accounts, which entails unnecessary compliance costs

3.13 The Bill proposes allowing trustees of a deceased estate to elect for income derived by the deceased estate within 12 months of the deceased person's date of death to be taxed at the personal tax rate of the deceased person.

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[11] At page 70.

3.14 This 12-month period is somewhat less than the three-year period that applies to deceased estates in Australia. The Law Society notes that deceased estates making the election will need to prepare part-year accounts for the income year after the date of death of the deceased person, as some of the income in that income year will be taxed at the personal tax rates, and some of that income will be taxed at the 39% trustee tax rate (to the extent that income has not been distributed to the beneficiaries of the estate as beneficiary income, which gives rise to tracing issues).This would impose unnecessary compliance costs.

3.15 The Law Society recommends that the period for which income derived by a deceased estate is taxed at the personal tax rates is increased so that it applies for a full income year (or for two or three full income years, if the time period is extended to match the three-year time period that applies to deceased estates in Australia) following the date of death of the deceased person, so that executors will not be required to prepare part-year accounts, or trace distributions made from income derived in the income year following the date of death.

Trust rules remedial

3.16 Section 78(1) of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 replaced "New Zealand resident trustee" with "resident trustee of a foreign trust" in the opening words of section HC 26. This amendment appears to narrow the scope of the exemption for foreign sourced amounts in section HC 26 such that it applies to foreign trusts only. This could mean, for example, that section HC 26 would no longer apply where a settlor is a transitional resident (despite transitional residents being expressly referred to in section HC 26(1)(a)). Similarly, the trusts referred to in examples 41 and 43 in the Commentary to Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) would no longer be able to rely on the exemption in section HC 26 (which would be inconsistent with those examples).

3.17 The Law Society had understood the intention of the changes in the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Act 2023 was to expand the foreign trust disclosure rules to apply to trusts that were not foreign trusts but that also utilised the exemption in section HC 26; not limit the application of section HC 26. The Law Society recommends that the amendments effected by section 78(1) of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 be reversed.

Inland Revenue Guidance

3.18 The following comments relate to two areas of uncertainty arising from the Bill, for which guidance will be necessary well in advance of the increased trustee tax rate taking effect. The Law Society recommends Inland Revenue engages with relevant stakeholders throughout the preparation of this guidance.

Distributions of retained earnings by companies owned by trusts in anticipation of the increase in the trustee tax rate

3.19 When the top individual tax rate increased to 39% effective from the 2021/22 income year (1 April 2021 for most taxpayers), many companies owned by individuals subject to the 39% individual tax rate distributed retained earnings prior to 1 April 2021 to mitigate the impact

of the increase in the top individual tax rate. The Law Society expects that many companies owned by trusts will also seek to mitigate the impact of the proposed increase in the trustee tax rate to 39% by distributing retained earnings prior to 1 April 2024.

3.20 The Law Society is aware Inland Revenue reviewed the payment of large dividends paid by some companies prior to the increase in the top individual tax rate and, in some cases, intimated (contrary to previous guidance) that crediting such dividends to the shareholders' current accounts in circumstances in which the company did not have available cash to pay the dividend meant that the dividend was not properly made.

3.21 To avoid a repeat of this issue in relation to the proposed increase in the trustee tax rate to 39%, the Law Society recommends that Inland Revenue engages with stakeholders on this issue, and issues clear guidance on the circumstances in which the payment of a dividend in anticipation of the increase in the trustee tax rate might constitute a tax avoidance arrangement, well in advance of 1 April 2024 (when the proposed 39% trustee tax rate applies to most trusts).

Mitigating over-taxation by making distributions of beneficiary income to beneficiaries on lower marginal tax rates

3.22 The Commentary to the Bill[12] and the Fact Sheet[13] accompanying the introduction of the Bill note that trust income can be distributed to beneficiaries on lower tax rates as beneficiary income to mitigate over-taxation arising from the proposed 39% trustee tax rate. The revised Fact Sheet notes that a previous version of the Fact Sheet included the example of a beneficiary settling beneficiary income back on the trust, but this has been removed as there is some uncertainty under existing law about the tax treatment of such a settlement.

3.23 The Law Society recommends Inland Revenue engages with stakeholders on this issue and issues clear guidance on the circumstances in which the distribution of beneficiary income might constitute a tax avoidance arrangement, well in advance of 1 April 2024 (when the proposed 39% trustee tax rate applies to most trusts).

4 Taxation of ACC and MSD backdated lump sum payments

4.1 The Law Society supports the amendments contained in clause 57, which address the tax treatment of backdated ACC and MSD lump sum payments. Having advocated for the tax treatment of such payments to be addressed, we are pleased to see the Bill will remedy the unfair, and likely unintended, impacts of the current law.

4.2 We note, however, that the Bill only seeks to address the tax treatment of earnings-related lump sum payments. The current tax treatment of backdated lump sum payments also affects backdated attendant care payments (i.e., backdated payments made by ACC to caregivers who provide personal care to ACC claimants). We understand ACC often makes these payments directly to the caregiver (particularly where the caregiver is also a family

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12 At page 70.

13 https://www.taxpolicy.ird.govt.nz/publications/2023/2023-other-fact-sheet-increasing-trustee-tax-rate

member or a guardian of the ACC claimant). These payments then form part of the caregiver's income, and are taxed on a cash basis.

4.3 We therefore invite the select committee to consider whether it is possible to also address the tax treatment of backdated lump sum payments for attendant care, to reduce the inequities which affect those who provide care for ACC claimants.

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13 July 2023