New Zealand Law Society
Te Kāhui Ture o Aotearoa

Taxation (Annual Rates for 2024-25, Emergency Response, and Remedial Matters) Bill

Submission of the New Zealand Law Society Te Kāhui Ture o Aotearoa

9 October 2024

1 Introduction

1.1 The New Zealand Law Society Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on the Taxation (Annual Rates for 2024-25, Emergency Response, and Remedial Matters) Bill (**Bill**).

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

(a) Retrospective registration of securities for the approved issuer levy (AIL).

(b) Increase in thresholds for exempt employee share shares.

(c) Changes to the limitations applying to second-hand goods credits for supplies between associated persons.

(d) Application of the associated persons rules to limited partnership (LPs) and look-through companies (LTCs).

(e) Land rules remedials, including changes to the bright-line test and the rollover relief provision.

(f) Eligibility criteria for debt funding special purpose vehicles.

1.3 This submission has been prepared with assistance from the Law Society's Tax Law Committee.

1.4 The Law Society **wished to be heard** in relation to this submission.

2 Other policy items

Retrospective registration of securities for AIL (clause 199)

2.1 The Law Society is in favour of allowing retrospective registration of securities for AIL. However, the Law Society submits that the proposals in the Bill are too restrictive and effectively allow NRWT to continue to apply as an excessive penalty in situations where AIL could apply.

2.2 While as a matter of law NRWT generally applies as the default position, in practice, utilisation of the AIL regime (where available) is almost always the intended tax position. Imposition of NRWT at 10% or 15% in such situations (where a person would expect AIL to apply at 2%) is unnecessarily punitive. The Law Society submits that where retrospective AIL registration is requested by a person, that retrospective registration for AIL should be automatic (as it is for current applications) and not subject to any application window, albeit subject to a one-off fixed amount penalty akin to a late filing penalty. Such a late filing penalty or, in this case, a late application penalty should create the necessary incentives for taxpayers to comply with the AIL regime.

2.3 It also seems that retrospective AIL registration should be available not only where the delay in making the application for registration is as a result of an oversight, but also where the failure to deduct and pay non-resident withholding tax (NRWT) was caused by an oversight. There may also be situations where a person was unaware of an obligation to deduct and pay NRWT, and retrospective AIL registration should also be available in this situation.

2.4 The Law Society also has concerns about how Inland Revenue intends to exercise its discretion regarding retrospective registration. The Commentary to the Bill (at page 69) indicates that where the relevant Borrower has a poor compliance history (either with AIL and NRWT, or tax obligations generally) Inland Revenue "would be less inclined to regard the cause of the delay leading to retrospective registration as an oversight". If anything, a poor compliance history would suggest failing to register was a mistake rather than point to an intentional decision (in relation to AIL). As noted above, the Law Society is of the view that retrospective registration should be granted in such circumstances.

2.5 In the alternative, if a time limit for applications for seeking retrospective registration is required, the Law Society considers that a longer period is appropriate. The Law Society submits that the time period in which a taxpayer may apply for retrospective registration should align with the time period that generally applies to Inland Revenue's enforcement activities (ie, the time-bar). That is, the Law Society submits that applications for retrospective registration should be permitted until 4 years have passed from the end of the period in which the first interest payment was made.

Increase in thresholds for exempt employee share schemes (clause 21)

2.6 The Law Society supports increasing the thresholds used for exempt employee shares schemes. However, in order for the legislation to achieve its intended purpose, the Law Society submits that the increases should be higher (say, double the current thresholds) and other changes should be made in order for tax exempt share schemes under section CW 26C ITA to be more widely used.

2.7 The Commentary to the Bill (at page 75) states that the proposed increases to the thresholds recognise the impact of inflation since the last change in 2018 and to provide a buffer against future inflation. The Commentary to the Bill also states that the changes to the thresholds are "intended to make it easier for companies in the start-up and tech sectors to attract and retain talent through the use of employee share schemes". The Law Society has received feedback that this change is unlikely to mean that start-up companies are more likely to use these types of share schemes and that more meaningful increases to the thresholds are required to meet that stated intention along with a loosening of the criteria in section CW 26C ITA section (2) to (9).

2.8 We would welcome the opportunity to present to the select committee on these changes.

3 GST remedials

Second-hand goods credits and associated persons (clause 156)

3.1 The Law Society notes that proposed section 3A(3BB) does not result in a "tax fraction", but an input tax amount. The wording of proposed section 3A(3)(a)(i) in clause 156(1) of the Bill should be amended to replace "the tax fraction given" with "the amount of input tax given".

3.2 The Law Society considers the words "for the recipient" in proposed section 3A(3BB) are unnecessary and should be deleted.

3.3 The Law Society notes there may be circumstances where a good has been supplied between several associated persons, and one of those associated persons was registered for GST but was not subject to GST on the supply of the entire good. The Law Society submits that proposed section 3A(3BB)(b) should be amended so that the input tax amount is only limited to the GST paid by the associated registered supplier to the extent that the supply of the good by that supplier was subject to GST. This issue is illustrated by the following example:

(a) Person A is purchasing a farm property from Person B. Person A and Person B are associated persons. Person A is registered for GST. Person B is not registered for GST. Person A intends to use the entire farm property to make taxable supplies.

(b) Person B acquired the property from Person C. Person B and Person C are associated persons. Person C was not registered for GST when Person C supplied the property to Person B.

(c) Person C acquired the property from Person D. Person C and Person D are associated persons. Person D was registered for GST when Person D supplied the property to Person C.

(d) When Person D sold the farm property to Person C, the farmhouse on the property was Person D's principal place of residence. The supply of the farmhouse was treated as a separate supply under section 5(15) of the Goods and Services Tax Act 1985, and that separate supply was not subject to GST.

(e) When Person B sells the farm property to Person A, the farmhouse is not a principal place of residence. As such, the supply of the farm property is treated as a single supply for GST purposes.

(f) In this situation, under proposed section 3A(3BB)(b), Person A's input tax amount would be limited to the amount of GST Person D paid on the supply of the farmland to Person C. Person A would not be entitled to claim GST on the farmhouse portion of the farm property. This is not the correct policy outcome.

3.4 If the examples in the Bill commentary are to be used in the Special Report or a Tax information Bulletin relating to these changes, the Law Society recommends that Example 23 specifically states that Landbank is not registered for GST.

4 Partnership remedials

Application of associated persons rules to certain structures involving LPs (clause 111)

4.1 The Law Society notes that while proposed section YB 16B deals with 'underreach' where there is a chain of entities that includes one or more LPs, it does not deal with 'overreach' that arises where a person holds an interest in both an LP and a company. This is illustrated by the following example:

(a) A person ("X") holds a 25% voting interest in a company ("Company A") and a 25% interest as a limited partner in an LP ("Limited Partnership B").

(b) Because LPs are treated as companies for the purpose of the tripartite test of association (section YB 14(4)), Company A and Limited Partnership B are not associated persons under the tripartite test of association (because of the anti-daisy chaining rule in section YB 14(1)). This is the correct policy outcome.

(c) However, because LPs are not treated as companies for the purpose of the company-based tests of association (except where proposed section YB 16B applies, which is not the case here), Company A and Limited Partnership B will be treated as associated persons under the company/person test of association in section YB 3. This is because Limited Partnership B will be treated as holding X's interest in Company A under the interest aggregation rule, as X and Limited Partnership B are associated persons under the limited partner / limited partnership test of association in section YB 12(2).

4.2 In the above example, Company A and Limited Partnership B will be associated under the company/person test of association, even though there seems to be a clear policy intent (as evidenced by the retrospective amendment in 2013 to section YB 14, which inserted section YB 14(4)), that "daisy-chaining" through a combination of companies and limited partnerships should not occur.

4.3 To prevent overreach in this situation, the following amendments are recommended:

(a) the interest aggregation rules in sections YB 2(4), YB 2(5), YB 3(3) and YB 3(4) are amended to exclude section YB 12 (other than section YB 12(1) and proposed section YB 12(1B)),

(b) section YB 12(3) is amended to refer to "sections YB 4 to YB 11 and YB 14", and

(c) the interest aggregation rule in section YB 12(4) is amended to delete references to sections YB 2 and YB 3.

Clarifying the application of the LP and LTC aggregation rules (clauses 109 and 110)

4.4 The Law Society agrees with these changes.

5 Land rules remedials

Bright-line start date when land partitioned or subdivided (clause 16)

5.1 The Law Society supports the proposal to ensure the bright-line start date for co-owners after a partition/subdivision is completed is the start date for the co-owners when they originally acquired the undivided land.

5.2 The Law Society notes, however, that proposed subsection CW 3C(9) introduces the terms "transferee" and "transferor", which are not otherwise used in section CW 3C, and recommends consistency in the terms used.

5.3 The Law Society also notes that proposed subsection CW 3C(9) is not limited to apply only to the extent that the co-owner's proportional interest in the property does not change (or is within the 5% tolerance allowed in section CW 3C). The Law Society submits that proposed section CW 3C(9) would address the position in respect of land acquired by the co-owner, and remain consistent with the policy intent, if it incorporated

the formula in subsection CB 15E(2). Alternatively, section CW 3C could be amended to provide there is no disposal to the extent the criteria in section CW 3C(1) is satisfied, rather than that income arising as a result of the partitioning arrangement is exempt. The Law Society notes that section CB 6A(3) would apply to the extent that the co-owner acquired land which was outside the 5% margin of tolerance allowed in section CW 3C.

5.4 The commentary to the Bill states that section CB 15B of the Income Tax Act 2007 confirms that the date of acquisition for the purpose of most of the land sale rules is the date that the person first has an estate or interest in the land, and "[i]n a partition…transaction, this will be the date the undivided land was acquired".

5.5 The Law Society notes that in a partitioning transaction, each co-owner disposes of their interest in the part of the land which is allocated to other co-owners on the completion of the subdivision, and acquires the other co-owners' interest in the part of the land which is allocated to them. The Law Society submits that if it is intended that each co-owner is treated as acquiring their entire subdivided title (i.e. both the interest in the land they held from the outset, and the interest that they acquired from their co-owners when the subdivision was completed) on the date that they acquired their first interest in the undivided land, section CW 3C or section CB 15B should be amended to clarify that.

Inherited land and bright-line test (clauses 5 and 47)

5.6 The Law Society notes that clause 47 corrects a cross-referencing error in section FC 9(2). In addition, the words "including any intervening transfer to an executor or administrator" in section FC 9(2) should be deleted as they are unnecessary: section FC 9(1) states that the section applies when land is transferred on a person's death in the circumstances described in section FC 1(1)(a), which is the transfer of a person's estate to an executor or administrator on the death the person.

Proposed changes to rollover relief from the bright-line test (clause 48)

5.7 The Law Society supports the proposed amendment in clause 48(2) to ensure that rollover relief from the bright-line test applies where residential land is transferred to a trustee of a trust which includes a beneficiary who entered a civil union with, or became a de facto partner of, the transferor within two years of the date of transfer.

5.8 The Law Society considers, however, that the following further amendments should be made to section FD 1 of the Income Tax Act 2007 to ensure it applies as intended:

(a) The opening words of section FD 1(1) state that the section applies for the purposes of sections CB 6A, CB 16A and Part D. However, section FD 1 also applies for the purpose of section FC 9(4) of the Income Tax Act 2007 (which provides that the bright-line test does not apply to the disposal of residential land by a person who acquired that land from a beneficiary of an estate where rollover relief in subpart FD applies to the transfer from the beneficiary to that person). The Law Society considers that section FD 1(1) should also include a reference to section FC 9(4).

(b) The opening words of section FD 1(1) state that the section applies only when residential land is transferred "within the bright-line period". In draft Interpretation Statement *Income tax – Look-through companies and the bright-*

line test (PUB00455) (and in the Examples in draft Questions We've Been Asked *How do the bright-line rollover relief provisions apply to transfers of residential land between associated persons?* (PUB00489)), Inland Revenue considers that the words "within the bright-line period" do not restrict the application of rollover relief to transfers of residential land by the transferor within the two-year bright-line period. This is because Inland Revenue considers that all transfers of residential land must necessarily be "within the bright-line period" (i.e. the period from the bright-line start date to the bright-line end date), so these words do not have any meaning at all.

The Law Society has concerns with Inland Revenue's interpretation of the term "within the bright-line period", as that interpretation disregards the wording that Parliament specifically included when enacting section FD 1. It is arguable that under Inland Revenue's interpretation, very few transfers (being the transfer of the legal title to the land) will occur "within the bright-line end date", given that the trigger for the "bright-line end date" is the entry into an agreement to sell the residential land, and the land will generally be transferred after that date.

While the Law Society agrees that rollover relief in section FD 1 should apply whether or not the residential land is transferred within the two-year bright-line period, the Law Society is concerned that the inclusion of the words "within the bright-line period" creates some uncertainty in this regard. The Law Society considers that, rather than Inland Revenue relying on a strained interpretation of section FD 1, which attributes no meaning to the words "within the bright-line period", section FD 1(1) should be amended to delete the words "within the bright-line period". To that end, the Law Society notes that the wording of section FB 3A of the Income Tax Act 2007 (the equivalent rollover relief provision that applies to relationship transfers) does not include these words.

Sale of subdivided land acquired from co-owner

5.9 The Law Society considers that the scope of section CB 15E should be further extended so that co-owners do not derive income on a subsequent sale of their land as a result of the partitioning arrangement, to the extent that the criteria in subsection CB 15E(2) is satisfied.

5.10 Given the policy intent that income does not arise to the co-owners as a result of a partitioning arrangement if there is no substantive change of ownership, the Law Society submits that in addition to sections CB 10 and CB 15, the exemption in section CB 15E should be further extended to also apply to income arising, as a result of the partitioning arrangement, under sections CB 6, CB 9, CB 11, CB 12 and CB 14.

5.11 The Law Society notes that the application of some of these provisions would be addressed if the legislation is amended to clarify that the co-owners are treated, for the purpose of the land provisions, as acquiring their entire interest in the subdivided parcel which is allocated to them under the partitioning arrangement on the date they acquired their interest in the unsubdivided land (refer paragraph 5.4 above).

Disposals of land to the Crown – repeal of income spreading rule

5.12 The Law Society notes that the proposal to repeal the income spreading rule which applies to income derived on disposing of land to the Crown is not in the nature of a remedial change. Further, the Law Society does not agree that there is no longer sufficient reason to depart from the standard income timing rules, at least where the land is compulsorily acquired by the Crown. New Zealand still has a progressive tax system, which has recently become more progressive. Where land is compulsorily acquired, the landowner is not able to choose whether, or when, to dispose of their land, taking into account the applicable tax rates and the other income they will derive in that income year. The Law Society recommends that section EI 8 of the Income Tax Act 2007 is retained, at least for disposals of land that is compulsorily acquired by the Crown.

6 Other remedials

Eligibility criteria for debt funding special purpose vehicles

6.1 The Law Society supports the expansion of the eligibility criteria for debt funding special purpose vehicles. However, the Law Society recommends the following drafting changes are made to clarify and assist with the readability of the proposed amendments:

(a) In proposed section HR 9(4) the words "For the purposes of calculating the income tax liability of the special purpose vehicle and an originator for an income year," should be deleted. The opening words of proposed subsection (4) are redundant and inconsistent with the drafting of subsections (1) and (3). Given the scope of section HR 9 is set out in subsection (1), the wording of subsection (4) can simply follow the form used in subsection (3).

(b) In proposed section HR 9BAA(2)(b) the word "them" should be replaced with "the person". Proposed subsection (2) applies only to a single company and therefore the use of the pronoun "them" is confusing.

(c) The proposed amendments to the statutory provisions relating to debt funding special purpose vehicles have adopted a drafting style that refers to "special purpose vehicle" as shorthand for "debt funding special purpose vehicle". The Law Society submits that such shorthand is inappropriate given "debt funding special purpose vehicle" is a defined term whereas "special purpose vehicle" is not. For example, section HR 10 contains paragraphs that provide for a tax treatment to apply from when "the vehicle stops being a debt funding special purpose vehicle". The proposal is that the relevant paragraphs read "the vehicle stops being a special purpose vehicle". The securitisation vehicle by its nature will always be a "special purpose vehicle" in ordinary parlance. The Law Society recommends that if a shorthand term for "debt funding special purpose vehicle" is required for readability, then:

(i) the abbreviation of "DFSPV" should be adopted; and

(ii) the opening words of the "debt funding special purpose vehicle" definition in section YA 1 be amended to read "**debt funding special purpose vehicle** or **DFSPV**…". This will ensure that the operative

provisions continue to use a defined term (while being shorter and easier to read).

6.2 The definition of "securitisation trust" was enacted by the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024. Paragraph (e) of that definition requires that a trust (in order to be a securitisation trust) be "… a New Zealand resident". There is no statutory test for when a trust is tax resident. Rather, the relevant statutory test is to look to the tax residence of the trustee. The Law Society recommends that paragraph (e) of the definition of "securitisation trust" is amended to read "… has a trustee that is a New Zealand resident". Given the remedial nature of this change, the Law Society submits that the change should be retrospective from the enactment of the "securitisation trust" definition.

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