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The Chair
Finance and Expenditure Committee
Parliament Buildings
Wellington

13 August 2018

Dear Sir

KPMG submission – Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill ('the Bill")

KPMG is pleased to make a submission on the Bill.

Individual Tax Management

Implementation

A major driver of modernising tax administration is to manage individual taxation better and in real time. The Bill provides enabling rules. Inland Revenue will be able to use information provided to it by income payers to determine the tax position of individuals, not just at year end but also during the year.

We agree with the objective. However, it raises important questions for Inland Revenue as administrator. We are concerned that implementation as early as 1 April 2019 will be "too much, too soon", for both individual taxpayers and Inland Revenue.

Our concerns are:

- **Taxpayer Knowledge.** Many individuals' only interaction with the tax system is through their employer or bank (or KiwiSaver provider). They do not understand how tax works. The new system will demand interaction. Inland Revenue will need to be ready to educate. This will need to be across a range of media, including social media.

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— **Taxpayer Behaviour**. The new system relies on individuals to respond. *MyIR* may help, but it is not an application that is regularly accessed. Further, anecdotally, correspondence from Inland Revenue is viewed as "bad news" and generally ignored. This creates risks that responses will not be timely. Inland Revenue's "advice" may be out of date when actioned and may create further errors.

— **Taxpayer Expectations**. Currently, Inland Revenue can require errors to be corrected. In the new model, Inland Revenue will exercise judgement, during the year, to recommend actions and, at year end, complete assessments. As an "advisor" to them, taxpayers will expect those judgements to be correct. If that is not the case, for example, a large tax bill results because of a recommended lowering in the tax deduction rate, they will expect Inland Revenue to stand behind its "advice". Inland Revenue and the Government need to be ready for that response.

— **Inland Revenue Resources**. We understand that there are 500,000 secondary tax codes issued. That provides an indication of the scale of potential contacts with individuals, which will trigger a response. Inland Revenue will have to be ready to manage those contacts.

— **Inland Revenue Correctness**. At an individual level, the tax system is still complicated. Getting the tax position right will not be simple for a sizable number. (For example, Inland Revenue will have to judge whether an individual is likely to have cash or other non-reported income.) However, given Inland Revenue's status, a notice from Inland Revenue is likely to be treated as correct. At the same time, Inland Revenue considers that it must get an assessment right. This means that its recommendations during the year may be corrected at year end, e.g. if circumstances change. Its judgments, including on which taxpayers can receive an automatic refund or bill, will be tested. This puts pressure on Inland Revenue's process for deciding when self-assessments are automatic. As far as we are aware, those processes have not been trialled.

— **Centrality of IRD Numbers**. The new model relies on income payers having the right IRD numbers for employees and investors. The system will work best when individuals supply their correct IRD numbers. We understand that investment income payers do not have every IRD number for the person. Further, Inland Revenue's system will, initially at least, only confirm that an IRD number is valid (i.e. that it is a possible IRD number) but not that it is the right IRD number. If income payers were able to confirm the IRD number is correct, the system is likely to operate more smoothly. However, we acknowledge this raises taxpayer secrecy concerns.

These concerns lead us to make the following **submissions**:

— The Committee should review particularly whether the timeline is realistic so that the risk of Inland Revenue making incorrect judgements is reduced.

— Inland Revenue should trial its new powers to test its processes and so that it identifies when it is likely to produce incorrect judgements. This should inform its communication to taxpayers so that taxpayers can appropriately check and confirm Inland Revenue's notifications. This should be done before the powers provided are widely used.

— Consideration should be given to allowing Inland Revenue to confirm IRD numbers with income payers, subject to appropriate safeguards.

Our experience with the implementation of the new investment income reporting rules in the Taxation (Annual Rates for 2017-18, Employment and Income and Remedial Matters) Act 2018 is answering these questions requires the involvement of Inland Revenue's customer services and technology development teams. In our view, it is important to have their evidence before the Committee.

Ability to reassess and penalties

We expect that corrections will need to be made. These may simply be a result of a taxpayer being unengaged, or because Inland Revenue does not have all of the information.

The Bill proposes modifications to the process for amending an assessment and to retain the application of penalties.

The existing amendment process is likely to be confusing for individuals without experience of the tax system. Further, in our view, they do not provide clear rights for taxpayers to correct the position. (For example, Inland Revenue can decline to exercise its ability to amend an assessment under section 113 of the Tax Administration Act 1994 despite, in our view, the clear incorrectness of the assessment.)

We consider the ability to make corrections in a subsequent period, which would be a simpler means to correct errors, should be expanded.

Also, a taxpayer is subject to penalties if an assessment is incorrect. For an expectedly large number of individuals, Inland Revenue will be making an assessment based on the information it has. In our view, taxpayers in that position should not be subject to penalties. (We acknowledge that if the information provided to a taxpayer in their pre-populated income tax account is clear and comprehensive there is a case for penalties being applied.)

We **submit** that:

— The modified amendment process should be reviewed to confirm it provides clear and easy amendments to correct automatic self-assessments.

— The thresholds for automatic subsequent correction of errors should be increased.

— Penalties should only apply to Inland Revenue generated assessments in more narrowly defined circumstances.

Further technical submissions

Our detailed technical submissions are included in the Appendix.

Care and Management

New discretionary powers

The Care and Management provisions are rewritten by the Bill. A specific ability to apply the Inland Revenue Acts on a policy basis rather than on a necessarily black letter approach is being added (to "correct legislative anomalies").

Correcting legislative anomalies is time limited. There are limitations and constraints on the ability to do so. The limited period allows for a legislative amendment to confirm the policy – otherwise the black letter approach will apply.

The existing Care and Management rules are not fundamentally changed (there are some drafting amendments only). This means that the Commissioner's existing interpretation statement is intended to continue to apply. The Commissioner's view is that she must correct an assessment if she considers it to be incorrect. However, she is able to decide not to direct resources to finding assessments to correct for a particular issue.

This raises the problem of particular taxpayers having to be assessed on the black letter law. Typically, problems with the legislation arise in specific situations (e.g. where Inland Revenue raises a question of a particular taxpayer), which allows discovery of the legislative anomaly.

By definition, if the new powers are exercised, this must mean the Commissioner considers past assessments to be incorrect. The new power can only be exercised prospectively. The Commissioner must, on her view, reassess past years. Other taxpayers, who are not in discussions with Inland Revenue, will not have their assessments amended (as the existing power can be exercised to not devote resources to find those incorrect assessments).

This is a known problem with the Commissioner's powers. However, it also appears fundamentally unfair.

We **submit** that the new power should be able to operate for all open years.

Detailed technical submissions

The Appendix contains our more detailed submissions.

Information Provision

The rewrite of the information collection and secrecy provisions attempt to strike a balance between Inland Revenue and the Government's need for information, and the privacy and confidentiality of that information.

We agree that a balance needs to be struck.

We agree the Commissioner needs to take care with the release of taxpayer information, while also being less fixated with secrecy processes when it is obvious that privacy and confidentiality are not at issue.

On the first, we note a recent release of a report on High Net Worth Individuals to the Tax Working Group that has subsequently been publicly released. Some of that report, particularly information contained in the tables, has been redacted on the basis that quantities if the data relates to less than five taxpayers, it could be reverse engineered to determine private details. However, the report's bar graph illustrations of that data have not been redacted. If the tables could be reverse engineered so could the bar graphs.

On the second, there is a lot of detail and, in some cases, specific, and what ought to be obvious, releases of information (for example, to the particular taxpayer of information concerning that taxpayer) are continued in the legislation. Although this provides comfort, because a specific rule can be identified, it may also encourage an excessive focus on the detail rather than on the principles.

We also **submit** that the opportunity should be taken to rewrite new schedule 8 of the Tax Administration Act so that it is easier to follow and apply.

Definitions

Unlike the Income Tax Act, the Tax Administration Act does not note whether a section includes a defined term. Given the addition of a significant number of definitions, it would aid interpretation if, at least, the amended sections to the Tax Administration Act noted defined terms.

We **submit** accordingly.

Status of the Commentary on the Bill

We have been hampered in developing our submissions to the Committee because of the uncertain status of the Commentary on the Bill.

We have reviewed the Officials' Report to the Committee on the Taxation (Neutralising Base Erosion and Profit Shifting) Bill (now Act). The Officials' Report refers to the Commentary as:

— "useful background, with no legal standing, intended solely as an aid to comprehension" (at page 14 of the Officials' Report).

but also:

> "This intent is also buttressed by the Commentary, which makes it clear that the parliamentary contemplation test is not to apply" (at page 153).
>
> "This has always been the stated intention of the rule (see the March 2017 Discussion Document on the rule and the Bill Commentary) (at page 166).
>
> "We note that the effect of the proposed measure is clearly spelled out under the heading "key features". In particular, the Commentary states"…" (at page 173).
>
> "However, the tax regimes affected can be identified from the Bill and, with more specificity, from the Commentary on the Bill" (at page 217).

These statements are contradictory. A Commentary on the Bill cannot be both "useful background" and authority for the policy intent. (We have not performed a textual analysis to resolve this contradiction. We consider that submitters should not have to do so.)

In our view, the Commentary should not, at least for Officials, change status depending on the submission being addressed.

The Select Committee's report on that Bill does not provide the Committee's view on this inconsistency and how it should be addressed.

We **submit** that the Committee should make clear its view on the status of Commentary on a Bill to assist submitters with how much regard they should have to the Commentary when interpreting the provisions.

Further information

KPMG would like to appear before the Committee in support of our submission.

Should the Committee have any questions on the matters raised in this letter please contact us, John Cantin on 04 816 4518, or Darshana Elwela on 09 367 5940.

Yours sincerely

John Cantin
Partner

Darshana Elwela
Partner

Individuals' income tax changes

Proactive actions

KPMG submission

We submit that the same approach should apply for investment income as is proposed for employment income, i.e. Inland Revenue should require consent from individuals who it considers are using an unsuitable tax rate to instruct a payer to change their withholding rate.

Comment

The proposed amendments will allow Inland Revenue to contact individuals who it considers are using an unsuitable tax rate and recommend they change it, but take no further action, in relation to employment income. However, for investment income, the proposed amendments will allow Inland Revenue to instruct payers to change an individual's withholding tax rate if the individual does not object or provides no response.

We consider that, instead of taking different approaches, the same approach should apply to both employment and investment income and the consent of the individual should be obtained. This is because, in both cases, the individual is best placed to understand their own circumstances. While the stated rationale for the different approach is that the amount of money involved is usually much smaller for investment income and there is less risk of over or under-withholding, we consider it is more principled to apply the same approach to investment income as to employment income.

The approach may also lead to incorrect withholding for joint accounts, where the account holders are on different marginal tax rates. Inland Revenue should make clear how it will treat such accounts.

The year-end income tax obligations of individuals

The Bill proposes that Inland Revenue will:

- Make a pre-populated (income tax) account available to each individual containing income information that Inland Revenue holds (i.e. has sourced from third parties, such as employers and investment income payers). This will replace the current tax return (IR 3) and personal tax summary process.
- Depending on whether the Commissioner is satisfied that the income information in the account is complete, automatically calculate and issue tax refunds or requests for tax to pay (Group A individuals).
- Require others (Group B and C individuals) to provide additional income information, subject to existing *de minimis* thresholds, or other information (such as deductible expenses or tax credits). This information will be included in a final account, which will be the individual's assessment.
- If information is not provided or the Commissioner considers it incorrect (for Groups B and C), the Commissioner can issue a default assessment.
- Individuals are provided with the ability amend the assessments.

We note that it would have been helpful to have a flowchart of the intended process to compare it to the Bill.

KPMG submission

While we support the proposed changes to year-end filing obligations for individuals, we have noted in our general comments our concerns with how these proposals could apply in practice, and the consequences for taxpayers (and the Commissioner) of "getting it wrong". We elaborate on some of these concerns below.

Comment

For Group A individuals, their pre-populated account will automatically become a self-assessment where Inland Revenue is satisfied that the information is complete and correct. This is without any taxpayer interaction. There is no guidance given, either in the Bill or the accompanying Commentary, on when the Commissioner will consider this to be the case, and the consequences if she is wrong. That is, how will the Commissioner be able to adequately discharge this responsibility, as she will effectively be deeming the individual's tax position to be correct (in effect this is a Commissioner assessment, not a self-assessment)?

KPMG submits that the process that will be followed by the Commissioner in determining whether an individual is in Group A should be clearly communicated, as well as the recourse available to the taxpayer if Inland Revenue makes an error.

Threshold for non-reportable income

The proposal under new section 22J (1) is that an individual will not have to provide information for a tax year if the individual derives total non-reportable income of less than $200. This is based on the current *de minimis* rule for non-filers.

KPMG submission

KPMG submits, that the *de minimis* threshold should be increased to a more realistic level (i.e. $500 or $1,000), as the current $200 *de minimis* has been in place for a significant period of time.

Amending for incorrect information

New section 22H applies to allow the Commissioner to correct an assessment (automatically) and to allow a taxpayer to request an amendment to an assessment (under section 113 of the Tax Administration Act or under the new section 113A if it applies). It requires incorrect information to have been provided to the Commissioner before an error can be corrected.

KPMG submission

The provision should allow amendments to be made if no information is provided.

The provision should also allow a taxpayer the automatic ability to correct an assessment.

The Commissioner should not be able to simply amend an assessment and should be required to apply the disputes rules before amending post-assessment.

Comment

It is likely that errors will arise because no information has been provided to the Commissioner. (See her ability to decide for Group A individuals for example.) New section 22H may technically limit her and a taxpayer's ability to correct assessments.

A taxpayer's ability to amend an assessment through the section 113 process is not absolute. The Commissioner considers that this provision provides her with a discretion to amend an assessment. She is not obliged to do so. Given the process that will be undertaken to issue an assessment, we consider that taxpayers should have an automatic right to have errors corrected.

The Commissioner is entitled, by new section 22H (3) to simply correct errors provided the individual is notified. In the absence of this provision, the Commissioner would be required to either have an agreed adjustment or issue a notice of proposed adjustment to commence the disputes process with a taxpayer. We can see no reason, if the Commissioner's process to issue an assessment based on information provided to her is robust, why the same requirements should not apply for individuals subject to the new process.

Legislative drafting

Proposed provision	Comment and KPMG's Submission
22D (3)	Section 22D (3) refers to "other income" as an amount of income "paid or payable to the individual … other than their reportable income". Other income will include amounts that are never paid or payable. The provision should be amended to reflect that "other income" may include fictional or deemed income, such as FIF income, which is not "paid or payable".
22D (6) (c)(iii)	Refers to the passage of time under section 22I (2 (c). Section 22I (2)(c) does not require the passage of time. Instead the Commissioner issues a default assessment. The provision should be amended to reflect the requirements of section 22I (2)(c).
Section 22 G and 22 I(3)	The Bill refers to an "assessment period", which is the period during which an assessment must be made by either the Commissioner or an individual. This period also covers the time during which an individual may be either required to confirm the information held by the Commissioner or provide further information. The period is better described as a "confirmation period" as that better describes the activity required. Consideration should also be given to including the definition of assessment period in section 22I (3) in section 22D as, in our view, it is a key term.
Section 22K(1)	The provision is stated to be applied "without limiting" the list of items of other income. Schedule 8, Table 1 Row 8 includes "Other income not otherwise included". The "without limiting" drafting is therefore confusing and unnecessary.
Section 22K (1)	The provision refers to "income other than reportable income". This is defined to be "other income" in section 22D (3). The inconsistent drafting suggests that "other income" may not be the right term to use. Otherwise, section 22K should use the defined term consistently.
Schedule 8, Table 1	Table 1 of Schedule 8 lists the categories of "other income" that must be included in an adjusted account. The drafting of the types of income listed do not reflect how those types of income are ordinarily referred to in the tax legislation. For example, Row 2 refers to "overseas income" which is not a defined term. The Income Tax Act does contain the term "foreign-sourced amount".

Proposed provision	Comment and KPMG's Submission
	The drafting should be aligned with defined terms. The table is specific and general at the same time. This may lead to confusion and errors being made. For example, Row 1 refers to New Zealand estate or trust income. This may be taken to mean that overseas estate or trust income does not need to be reported. (We acknowledge Row 2 and Row 8. We are simply pointing out the references may generate errors.) Specific items of income that can be expected to arise are not included. For example, financial arrangement income (which includes more than interest paid or payable) is not mentioned specifically. Row 8 includes a catch all "Other income ... which is not otherwise included in reportable income". "Other income" is defined to mean income that is not reportable income (subject to the drafting comment on section 22D (3)). This suggests that Rows 1 to 7 are redundant or that Row 8 should refer to simply "Income …".

Care and management

Our key submissions on these changes are included in our cover letter.

Legislative drafting

Proposed provision	Comment and KPMG's Submission
Section 6B (2)	We note that generally "taxpayer" has been replaced with "person" in the rewrite of these provisions. This includes section 6B (2). However, "persons" is qualified by "individual" in that provision. The new individual assessment rules also introduce an individual concept. We assume the section 6B (2) reference is not intended to be limited to individuals only. Section 6B (2) should refer to "specific" to ensure there is no confusion.
Section 6A (2) and 6C (1)	Refers to "in addition to the discharge of …". We assume this is intended to override the Commissioner's view that her section 6A (2) powers are limited to resourcing decisions when she has reached a view on the correct interpretation and application of a tax law. We further note that section 6A (2) is, itself, expressed as a "despite anything" provision. This circularity may mean the intention is not achieved (as if the Commissioner's view is that she can only make resourcing decisions, then she is unable to make the recommendations allowed by section 6C). "In addition to" does not appear to establish the correct relationship between sections 6A and 6C.
Section 6C (1)(b)	The Bill refers to "the Commissioner's approach to". This is an indirect reference to the relevant interpretation or application. It is not clear why this formulation is necessary. The reference to "approach" can be usefully deleted to aid interpretation.
Section 6D (c)	The provision refers to "is not inconsistent". This requirement would appear to be the same as "is consistent". It is not clear why a negative formulation is desirable or necessary. A positive formulation should be stated.
Section 6E (1)(c)	The provision refers to the Commissioner having applied section 6D. We expect that consultation should include whether section 6D would be satisfied. Otherwise, it would be pointless to consult on that point.

Information collection and secrecy

Our key submissions are included in our cover letter.

Ability to trace to original sections

New subpart 3A rewrites and brings together existing sections as well as including new provisions. The history note to these provisions should fully cross-reference the existing provisions.

Legislative drafting

Proposed provision	Comment and KPMG's Submission
Section 16B (6)	The Commissioner is entitled to require information to be provided to a particular office. Although this should be obvious, and with technology less of an issue than historically, the Commissioner should do this on a "reasonable in the circumstances" basis.
Section 17F (2)	Is unclear when information can be provided. The equivalent to the rewritten rule referred to establishing in the proceedings that a sufficient response was provided. We assume that is still what is intended.
Section 17F (3)	Is unclear as to its intended operation and its interaction with section 17F (2).
Section 17G	A "satisfactory response" is not defined nor is there a test of what is a satisfactory response. This should be a defined term. The provision assumes that the information requested is actually held by the recipient of the request. It should be made clear that a satisfactory response includes a response that the information requested does not exist.
Section 17H (6)	Does not include a reference to "tax advice documents". This reference should to be consistent with the policy of the tax advice document rules.
Section 17H (8)	It is unclear how information would not be in a document while still being able to be viewed and copied?
Section 17L (3)	Requires the Minister of Revenue to be satisfied that a consultation process has been undertaken. The factors that should be taken into account should include the reasonableness of the proposed Regulation including the frequency of provision of information to Inland Revenue.
Section 17L	Provides for a review of the operation of the section but does not provide for a review of the operation of the Regulations issued under the section. A review of the operation of the Regulations should also be required.

Rulings and correcting low value errors

Short process rulings

Issue 1

There is no legislated timeframe for a short process ruling.

KPMG submission

We support amendments to improve access for taxpayers to the binding ruling regime. More clarity should be provided regarding the time frame for a short process ruling to be issued.

Comment

We support the intention behind the new "short process" ruling regime to improve access by smaller taxpayers to the binding rulings regime. However, we consider that one of the aspects of the rulings regime that may discourage taxpayers from applying for a ruling is not addressed. This is the time that it takes for a draft ruling to be issued (up to three months). It should be clarified whether the timeframe for a short process ruling to be issued will be shorter or the same as for the full rulings process.

Issue 2

The application of income and tax thresholds where there is more than one applicant is not clear.

KPMG submission

Where there is more than one applicant for a short process ruling, it should be clarified whether the income and tax thresholds apply individually to each applicant or collectively.

Comment

New section 91EK allows a short process ruling if the annual gross income for the tax year before the application is made is $5 million or less and the matter for which the ruling is sought must involve tax of less than $1 million. The section states that two or more persons may make a joint application for a short process ruling. Where there is a joint application, it is unclear whether the income and tax thresholds apply to each person or collectively to the applicants. This should be clarified.

Extending the scope of binding rulings

The binding rulings regime will be expanded to include further matters which can be ruled upon.

KPMG submission

We support the proposed amendments to extend the scope of the binding rulings regime.

Comment

The amendments to extend the scope of the binding rulings regime, e.g. through broadening the matters on which a ruling can be made, are welcome. The proposed amendments should improve access to the regime and improve the ability for taxpayers to seek certainty as to the Commissioner's position.

Amending assessments

A limited ability to allow errors to be corrected in subsequent tax returns is to be included through new section 113A.

KPMG submission

We support making it easier for taxpayers to comply with their tax obligations by correcting errors in later tax returns. However, we consider new section 113A (1)(a) should:

— have significantly higher thresholds; and
— remove the reference to "minor".

Comment

By definition, a taxpayer correcting an error is paying the tax that is due. This should allow significantly higher thresholds to apply for correction in subsequent returns. For example, subsection (4) limits an individual's ability to amend an assessment to a maximum tax of $3,300 and this only applies if their taxable income is $100,000. At a taxable income of $50,000, the tax at stake is likely to be $300 (although it is noted that section 113A (1) may allow a correction provided the error does not exceed $1,000 of tax).

Further, given that the tax would be paid, the effect of allowing a correction in a subsequent tax return is no use-of-money interest is payable. A $1,001 correction of tax payable would give rise to about $90 of use-of-money interest, annually. The compliance costs to taxpayers and the administration costs to Inland Revenue of correcting an error of this magnitude would significantly outweigh the loss of the use-of-money interest.

Further, as we understand the Government's Budget forecasts assume that the tax laws are properly complied with. As a result, there should be no use-of-money interest included in the Budget projections. An increase in the allowable thresholds should have no fiscal impact.

We consider it is unnecessary to refer to "minor" errors in new section 113A (1)(a), when there is a clear threshold of $1,000 or less specified for automatically including an error in a subsequent return. This would also be consistent with the amendment in the Bill, which proposes to change the heading for new section 113A from referring to "minor errors" to referring to "certain errors".

Legislative drafting for rulings amendments

Proposed provision	Comment and KPMG's Submission
Section 91CB (1)(u)	Refers to residency and permanent establishment rulings for the purposes of a double tax treaty. Both of these concepts also apply for other purposes. Section 91CB (1)(u) should not be restricted to a double tax treaty purpose.

Securitisations

We strongly support the proposal to extend the current securitisation regime beyond financial institutions to include other corporate securitisations. The expanded (elective) regime will reduce compliance costs and tax disincentives that have previously discouraged the undertaking of securitisations.

In our view, it is a viable, commercial approach with positive economic benefits that will assist more taxpayers in diversifying financial risk and to obtain the benefits of balance sheet improvement and lower cost of funding.

Expansion of regime to include other corporates

It is proposed that the regime will be expanded to include other corporates (other than financial institutions). Based on the current drafting of the proposed legislation, corporates (the originator) will be able to elect into the regime by taking a position in the first tax return filed after the transfer of assets from the originator to a securitisation vehicle.

However, the current drafting does not allow existing securitisation vehicles to be included in the proposed, expanded regime.

KPMG submission

The regime should be applicable for both existing and newly established securitisation vehicles. This will require an additional section to be included (mirroring the proposed section HR10 that outlines "What happens when vehicle starts being a financial institution special purpose vehicle".

Extension to assets that are not financial arrangements

The current regime is limited to particular financial arrangements (being New Zealand residential mortgages or loans secured by such mortgages).

The proposed rules will remove this limitation to include assets that are not financial arrangements (e.g. trade receivables and operating leases).

KPMG submission

KPMG supports the inclusion of a broader range of assets in the securitisation regime as non-financial institution securitisations are likely to include a broader range of assets.

Consolidation requirement

The IFRS requirements are restrictive and require a financial institution to hold the securitised assets in their consolidated financial statements. It is proposed that the expanded securitisation regime will relax this requirement, and instead the consolidated requirement will be met if the securitised assets are recognised in the consolidated financial statements of the originator or another company in the same wholly-owned group.

KPMG submission

KPMG supports the proposed consolidation requirement.

Elective regime

It is proposed that the regime will be elective for both financial institutions and other corporates alike.

KPMG submission

KPMG supports the amendment to make the regime elective.

The securitisation regime, if applied, is likely to have an impact on thin capitalisation ratios and, therefore, giving taxpayers the option to elect into the regime (or not) removes the tax barrier for such taxpayers.

The new elective status may act as incentive for those who may benefit to consider this as an option.

PIE remedial amendments

We support the PIE remedial amendments included in the Bill. We outline below submissions for further simplifying and improving the operation of those rules.

Section HM 12 – Damages, insurance and other compensation received in relation to land

Under section HM 12(1)(b), 90% or more of the gross income for a PIE must be from one of the listed types in order for the entity to maintain its PIE status. This includes income under a lease of land (other than from an associate), under section HM 12(1)(b)(iv). However, this does not include amounts, which are taxable relating to damages, insurance proceeds and other compensation payments.

KPMG submission

Section HM 12(1)(b) should be extended to include amounts relating to taxable damages, insurance proceeds and compensation payments, where these amounts are derived by a PIE that derives income from a lease of land (under section HM 12(1)(b)(iv)).

Comment

Currently, the income types requirement in section HM 12 does not address ordinary commercial events where a PIE may receive either damages (e.g. where the PIE has commissioned the construction of a building for rental purposes, but the construction company or contractors defaults or there are delays, resulting in lost rental income and triggering damages, court-ordered compensation or settlements) or some other form of taxable compensation (e.g. insurance proceeds for loss of rent, insurance proceeds that are taxable under section CG 4 to the extent a deduction for repairs and maintenance is claimed, or insurance proceeds that require an adjustment under section EE 52).

As these payments are outside the control of the PIE, the 10% income tolerance provided under section HM 12 may be breached in a quarter, or consecutive quarters, resulting in a breach of PIE status. This is despite these payments being received in relation to the PIE's business of deriving income from the lease of land.

These payments should be explicitly included within the scope of section HM 12(1) as these amounts are replacement payments for lost rental income (i.e. income under a lease of land) and/or amounts the receipt of which is outside the control of the PIE.

Section HM 22 – exemption from meeting the minimum investors / maximum investor interests requirements for certain "public unit trusts"

Section HM 22 removes the need to meet the minimum 20 investor and maximum 20% investor interest requirements for a PIE that, if it were treated as a unit trust (or for an investment class of a PIE, if the investment class was treated as a unit trust), would meet the requirements of one or more of paragraph (a) and (c) to (e) of the public unit trust definition in section YA 1. Paragraph (e) of the definition is intended to allow entities that are for direct investment by widely-held entities to qualify as a public unit trust. However, the eligible investor types do not include other PIEs.

KPMG submission

The eligible investors under paragraph (e) of the definition of public unit trust should be extended to also include portfolio investment entities (PIEs).

Comment

Section HM 22 allows a PIE (or an investor class of that PIE) that, if it were a unit trust, would meet one or more of paragraphs (a) and (c) to (e) of the definition of "public unit trust", to not have to comply with the minimum 20 investor rule (section HM 14) or the 20% maximum investor interest requirement (section HM 15). This is designed to simplify some of the PIE eligibility requirements as a public unit trust will typically either be widely-held or have investors that are widely-held (other than in temporary or unusual circumstances).

Paragraph (e) of that definition applies to:

> *a unit trust that has less than 100 unit holders if it could reasonably be regarded as a vehicle mainly for investment by widely-held vehicles for direct investment that are 1 or more of the following:*
>
> *(i) unit trusts; or*
>
> *(ii) group investment funds; or*
>
> *(iii) life insurance companies; or*
>
> *(iv) superannuation funds*

This paragraph of the public unit trust definition is intended to qualify "wholesale" unit trusts or funds (i.e. where the investors are themselves widely-held investment vehicles for "retail" investment – i.e. investment by members of the public). However, currently, the list of eligible investors excludes PIEs. This is problematic where the PIE is not a unit trust, group investment fund, life insurer or a superannuation fund. For example, we note that a number of listed PIEs are legally companies and not unit trusts or superannuation funds, so this is a practical issue.

Where a wholesale fund has a listed PIE investor that is a company, for example, the listed PIE investor will not be able to own greater than 50% of the wholesale fund, due to the "mainly for investment" criterion in the paragraph (e) definition. This seems an absurd outcome as a PIE, by definition, must be widely-held, either directly or indirectly. (For completeness we note that this suggested change should also not dilute the effectiveness of the "public unit trust" definition for the notional single person shareholder continuity concession.)

Additions to Schedule 29 Part A (listed investors)

Under section HM 21(2), listed investors in Schedule 29 Part A of the Act are exempt from meeting the 20% maximum investor interest requirement for investment in a PIE (while the PIE also does not need to meet the minimum 20 investor requirement, if it has a listed investor).

The listed investors include Auckland Council and Quayside Holdings Limited (the investment arm of the Bay of Plenty Regional Council). The Bill proposes to add Northland Regional Council. However, no other local or regional councils or their investment owning subsidiaries are listed.

KPMG submission

Schedule 29 Part A should be amended to include all councils and their council-controlled organisations ("CCOs") as listed investors, rather than the current piecemeal approach of listing specific councils and/or CCOs.

Comment

Section HM 21(1) removes a PIE from the minimum 20 investor requirement, if one of their investors is an investor listed in Schedule 29 Part A. Such investors can also exceed the 20% maximum investor interest requirement (under section HM 21(2)).

Auckland Council and Quayside Holdings Limited are currently included in Schedule 29 Part A, while Northland Regional Council is being included as part of the Bill.

Our concern is that other councils and their subsidiaries are not allowed to hold greater than 20% interests in a PIE, or to be the sole investor in the PIE. This should be remedied by the inclusion of local and regional councils (and their council controlled organisations) generally, as defined in the Local Government Act 2002, as listed investors in Schedule 29 Part A. Simply put, these entities are widely held so they should be automatically treated as widely held.

This would preclude the need for individual councils / council entities to apply to be included on the list, which can be a time consuming process (and is not, in our view, an effective use of legislative resources).

Residential and main home exclusions

Proposed remedial amendments to the residential and main home exclusions from the land sale rules will ensure:

- the residential exclusion in section CB 17(2) applies whether or not the taxpayer has a family member living with them, and aligns the wording in the various residential exclusions; and
- the "regular pattern" carve outs from the residential exclusion in section CB 16 and the main home exclusion in section CB 16A operate as intended, so that a pattern of transactions will only prevent the exclusions being available if it involves buying and selling, or building and selling, houses that were the person's residence or main home.

KPMG submission

We welcome the proposed changes in the Bill to clarify the operation of the main home exclusion. However, we do not believe it goes far enough.

Sections CB 17(1), CB 17(2) and CB 18(1) should be further amended to make it explicit that the main home exclusion also applies if the main home is held in a family trust. This will provide consistency with the exclusions outlined in section CB 16A and CB 16, as well as providing much needed clarity for taxpayers.

Comment

Further amendments should be made to clarify that the main home exclusion also applies where the person is a trustee of a family trust.

The redrafted section still remains problematic where the person is the trustee of a trust.

That is, it could possibly be said in some cases that the trustee resides on the land, but not that the trustee's family resides on the land given trustee capacity.

Given these difficulties, a useful addition as part of the main home exclusion changes would be to include main homes held in trusts for the purposes of sections CB 17(1), CB 17(2) and CB 18(1). We note the exclusion for main homes is explicit for trusts in sections CB 16A and CB 16. However, this is not explicit for the main homes exemptions in sections CB 17(1), CB 17(2) and CB 18(1).

It can be common practice for an individual's main home be held in a family trust, as opposed to in the names of the individuals. Therefore, the uncertainty created by not explicitly excluding main homes held in trusts is problematic. A common example of the issues that the omission of a residential exemption for trusts causes is:

> A family trust acquires a land lot and constructs a home for the family to live in. Construction commences within 10 years of purchase of the lot. After residing on the land for five years the property is sold. The sale of the property is ordinarily taxable under section CB as the construction of a home on bare land entails development work that is more than minor in nature. If the family acquired the land in their personal capacity, the residential land exclusion in section CB 17(1) would apply. However, the residential land exclusion does not apply if the trust acquires the land.

To address this inequity and ambiguity in respect of residential property held in family trusts, we recommend that the trust residential land exclusion also be explicitly added to sections CB 17(1), CB 17(2) and CB 18(1). This change would be in line with the Government's objectives for the tax system, given that clarity, consistency and more certainty are key aspects of the government's initiative to modernise the tax system.

Accounting Income Method

Currently, taxpayers who are otherwise eligible to pay provisional tax under the accounting income method ("AIM") can only elect to use the AIM prior to their first payment date under that method. If the income year has commenced this may mean they will have to wait until the next income year to use the AIM. The Bill proposes to allow taxpayers who currently use another provisional tax method (other than the estimation method) to switch to the AIM at any time during an income year prior to the final payment due under the AIM for that person.

KPMG submission

We welcome the amendments. However, our key concern remains the overall user-friendliness of the AIM given the additional tax adjustments to accounting income that are required (particularly, given the more frequent tax payments required under the AIM). These tax adjustments, in our view, complicate what should be an otherwise straight-forward method for small taxpayers to calculate and pay their provisional tax. We would emphasise that AIM is designed to calculate an "interim" and not the final tax liability.

Comment

We welcome the proposed amendments to aid the take up of the AIM. However, we also note the various taxpayer concerns around the use of AIM, which include:

— The need for a number of tax adjustments to monthly accounting income, which moves the method away from the simple provisional tax on "cash flow" approach, originally envisaged to a detailed monthly tax calculation. In our view, this is excessive as provisional tax is an "interim" liability.

— The more frequent provisional tax payments under the AIM (up to six times a year versus three times under the standard and estimation methods).

— The need to provide two-monthly accounts under the AIM method to the Commissioner and the perception (rightly or wrongly) that this could be used to trigger "in-year" enforcement (i.e. audit action) even though the AIM is not the final tax position for the year.

While KPMG supports the AIM, the concerns above (coupled with the accompanying change that removed use-of-money interest on the first and second instalments if provisional tax is paid under the standard method) makes it difficult to recommend the AIM to businesses.

We believe a back-to-basics approach for the AIM is required, including reconsidering the need for a number of the prescribed tax adjustments to monthly accounting income, to simplify the method. Further, it would be helpful for the Commissioner to clearly articulate how information provided as part of the AIM will be used, to give clarity to taxpayers.

FIF cost method

The Cost Method for calculating FIF income is being amended to clarify that a person's ability to reset their "cost base" every five years through independent valuation is optional and not mandatory.

KPMG submission

We support the proposed clarification. However, our concern is that the "Cost Method" description for this FIF income calculation method is a misnomer. The method will require a taxpayer to source an independent valuation in most instances. We recommend that actual cost should be able to be used where a FIF interest is acquired for which a market value is not able to be obtained on a yearly basis.

Comment

The rules for determining the "opening value" for applying the Cost Method sets out a hierarchy. Actual cost is only an option if the FIF interest was acquired in the 2005-06 and 2006-07 income year (and was previously a so-called "grey list" investment). In other circumstances, the value of the FIF interest in the person's audited financial statements (which must be publicly available) or, if not, an independent valuation of the interest is required. This imposes significant compliance costs on taxpayers who hold or acquire minority interests in private companies offshore.

The inability to use actual cost in these circumstances should be reconsidered. As the Cost Method is only available for non-controlling interests (and in most cases will only be used where the interest held is less than 10%, as the attributable FIF method is available for interests of 10% or greater), the scope for the transaction value to be manipulated should be limited.

If the concern is that actual cost will not be a reasonable proxy at the time of the first FIF calculation (for the year following acquisition, as "opening value" is nil in the year of acquisition) this could be addressed by requiring the original cost to be uplifted by 5%.

Pre-consolidation imputation credits

The Bill introduces a savings provision for positions taken by taxpayers prior to amendments made to section OP 22 in the Taxation (Annual Rates for 2017–18, Employment and Investment Income and Remedial Matters) Act 2018.

Submission

We support the Bill's introduction of a savings provision. However, the protection offered should be extended to allow taxpayers to continue to rely on section OP 22 as it was prior to amendment until such time as a full review of the policy relating to pre-consolidation imputation credits can be undertaken.