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WEEKLY COMMENT: FRIDAY 6 SEPTEMBER 2013

1. This week I go through the remedial income tax changes in the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* (the "Assets Expenditure Tax Act"). As far as the major changes in the Assets Expenditure Tax Act are concerned, I note that:

   (a) I discussed the Mixed-use Assets amendments as introduced in the original version of the Assets Expenditure Tax Bill in *Weekly Comment* 21 September 2012. Since then those rules have been substantially overhauled following deliberation by the Finance and Expenditure Committee, and the revised rules as enacted will be the subject of a separate *Weekly Comment* in the near future.

   (b) The changes relating to lease inducements and lease surrender payments were discussed in *Weekly Comment* 22 March 2013. The rules have been enacted in essentially the same form, with the principal change relating to limiting the residential exemption to natural persons.

   (c) I discussed the changes relating to short-term charge facilities and excepted financial arrangements in *Weekly Comment* 5 April 2013. These rules have been changed slightly following review by the Finance and Expenditure Committee:

      (i) The proposed new compliance obligation for an employer who provides a short-term charge facility to provide a statement to relevant employees was rejected by the Finance and Expenditure Committee.

      (ii) Taxpayers can no longer treat the excepted financial arrangements described in s. EW 5(21) to (25) as financial arrangements. An exception has been made for financiers who purchase debt for collection, who can continue to be able to treat the debt under the financial arrangements rules. Taxpayers may, however, value foreign currency amounts at their values in their financial statements.

2. The changes I discuss this week are as follows:

   (a) Changes to the bonus issue definition: share splits are not dividends;

   (b) Issues to shareholders of rights to subscribe for or sell back shares are not dividends;

   (c) Deductibility of repairs and maintenance on commercial fit-out;

   (d) Capital contributions for farming and aquaculture business;

   (e) FIF changes: taxed FIF connection, changing methods, and BE losses brought forward;

   (f) Foreign tax credits for CFCs that are foreign hybrids and foreign CFC-type taxes;

   (g) Family scheme income from employment benefits;

(h) Limitation of time limit for tax refunds;

(i) Trustee associated with a person with a power of appointment;

(j) Time period for applying for a tax credit for a charitable donation.

Changes to the bonus issue definition: share splits are not dividends

3. An amendment has been made to the definition of "bonus issue" so that share splits that involve a subdivision of shares (that takes place under the *Companies Act 1993*) are excluded from the dividend definition. Previously, only a bonus issue that involved the issue of new shares could be excluded from the tax definition of "dividend". However, a subdivision of shares does not necessarily involve the issue of new shares.

4. Officials stated in the *Commentary to the Assets Expenditure Tax Bill* that from a policy perspective, a share split should not be treated as a taxable dividend because the company does not give up anything of value. Moreover, with a share split, the shareholder is generally not involved in a transaction with the company. Officials stated that the change does not involve a change in policy, but merely clarifies the policy intent. The New Zealand Law Society submitted that the approach of treating a share split as a bonus issue preserves a company's ability to treat a share split as a dividend, by virtue of it being a taxable bonus issue.

5. The amendment applies from the 2005-06 income year. Following the introduction of the rules on profit distribution plans from 1 October 2012, the definition of 'bonus issue' has been replaced with "bonus issue means:

   (a) The issue or subdivision of shares in a company, or the giving of credit for or forgiveness of an amount unpaid on any shares in a company, if the company receives no consideration for the issue, subdivision, crediting, or forgiveness other than the shareholder choosing not to receive an amount as an alternative to the issue or subdivision;

   (b) The issue of shares under a profit distribution plan."

Issues to shareholders of rights to subscribe for or sell back shares are not dividends

6. Companies can offer shareholders rights to buy new shares, generally at a discount to the market value. A rights issue does not result in a company giving up anything of value to its shareholders. (Some submissions raised the question of whether rights issues could give rise to income under ordinary concepts as was held in Commissioner of Taxation v McNeil [2007] HCA 5, but officials noted that Australian case law is not binding on New Zealand and declined any further clarification in this regard.) Legislative amendments have clarified that:

   (a) The discounted amount is not a taxable dividend for those shareholders that exercise the right; and

   (b) The right itself (which has a value and may in some cases be traded or renounced) is not a taxable dividend; and

   (c) Premiums paid under a bookbuild following a rights issue are not taxable dividends.

7. A bookbuild involves the rights of non-participating shareholders (who chose not to participate or were not entitled to participate) being offered to other investors who pay a premium for them. The original shareholder is paid all or part of this premium for giving up

their rights. Officials stated that from a policy perspective, a bookbuild is not a dividend because, like a rights issue, the company does not give up anything of value.

8. Section 8 of the Assets Expenditure Tax Act inserts a new s. CD 29B into the *Income Tax Act 2007* ("the Act") as part of the section of the Act on "What is not a dividend?", applying from the 2008-09 tax year onwards. The following is not a dividend:

   (a) The *issue by a company to a shareholder of a right* to:

   (i) Subscribe for a share; or

   (ii) Sell a share in the company to the company.

   (b) *The issue by a company, under a right to subscribe for shares, of a share to a person for a consideration less than market value*, immediately before the issue, of a share in the same class of shares, if:

   (i) The person subscribes for the share under a "subscription right" issued by the company to a shareholder holding shares before the issue of the subscription right; and

   (ii) The company does not, as part of the issue of the subscription right, give the person a right to dispose of the share to the company.

   (c) A *distribution by a company to a shareholder of a premium from the issue of rights to subscribe for shares*, if all the following conditions are met:

   (i) The company issues to the shareholder a "shareholder right" to subscribe for, or dispose of to the company, a share in the company at a "shareholder price"; and

   (ii) The shareholder fails or is ineligible to exercise the shareholder right; and

   (iii) Another person pays the company an amount for the shareholder right exceeding the shareholder price, for the issue of a share under the shareholder right; and

   (iv) The distribution is from the portion of the payment that does not increase the company's available subscribed capital (i.e. from the portion of the "premium" for the share issue paid by the other person that does not give rise to available subscribed capital).

Deductibility of repairs and maintenance on commercial fit-out

9. New s. DA 5, inserted by s. 23 of the Assets Expenditure Tax Act, states that expenditure relating to a building's commercial fit-out will be treated as commercial fit-out expenditure, and not as building expenditure, when applying the capital limitation to expenditure.

10. This means that the capital/revenue distinction will be applied in relation to the item of commercial fit-out. This removes the ability to treat capital expenditure on commercial fit-out as revenue expenditure relating to the building. The amendment applies from 1 April 2011.

Capital contributions for farming and aquaculture business

11. From the 2011-12 income year onwards, a revised definition of "capital contribution property", in s. 98(10) of the Assets Expenditure Tax Act, includes:

(a) An improvement for which expenditure is or would be deductible for the recipient under section DO 4, DO 11, DO 12, or DO 13 (which relate to farming, horticultural, aquacultural, and forestry improvements);

(b) A listed horticultural plant or land for which expenditure is or would be deductible for the recipient under section DO 5 or DO 6 (which relate to horticultural expenditure on land);

(c) A listed horticultural plant or land to the extent to which some but not all expenditure for replacement plants is deductible under section DO 6.

12. Under s. 29 of the Assets Expenditure Tax Act, a revised s. DB 64 provides that where a person would be allowed a deduction for the relevant capital contribution property under subpart DO the relevant expenditure otherwise deductible under subpart DO is reduced by the amount of the capital contribution.

FIF changes: taxed FIF connection, changing methods, and BE losses brought forward

13. Section EX 50(4C) sets out the requirements under which foreign company payments to a FIF will not result in attributable income. The first requirement in s. EX 50(4C)(a) is that the person must use the attributable FIF income method for the foreign company. Section 52 of the Assets Expenditure Tax Act alters this requirement so as to include foreign company payments from foreign companies that are Australian resident FIFs exempt from the FIF regime under s. EX 35.

14. Section EX 63 sets out the consequences of changing FIF calculation methods. An amendment in s. 53 of the Assets Expenditure Tax Act clarifies that where FIF interests are deemed to be reacquired, they are reacquired *at* the start of the income year (and not immediately after the start).

15. New s. IQ 2C inserted by s. 67 of the Assets Expenditure Tax Act will allow a person with a current year FIF income interest of less than 10% (who, therefore cannot use the attributable FIF income method) and a branch equivalent tax loss ("available BE Loss") brought forward, to subtract the available BE loss from the FIF's current year income (if the FIF is resident in the jurisdiction in the current year) or to carry the surplus forward.

Foreign tax credits for CFCs that are foreign hybrids and foreign CFC-type taxes

16. Where a CFC is treated as a 'look-through" entity for foreign tax purposes, the foreign tax payable on the CFC's income, if any, will be paid by a person other than the CFC. This will be the case, for example, with a US LLC that is treated as a partnership for US tax purposes, but as a CFC for NZ tax purposes.

17. Replacement s. LK 1(1)(d) in s. 70 of the Assets Expenditure Tax Act clarifies that a person with CFC income has a foreign tax credit for foreign income tax paid by the person in relation to the CFC from which the income is derived.

18. In addition, new s. LK 1(1)(e) clarifies that the tax credit for foreign tax paid under the foreign equivalent of our international tax rules relates to foreign tax in relation to income of a CFC that is paid by a foreign company, and not "by the person" as was previously the case in s. LK 1(1)(d).

Family scheme income from employment benefits

19. Existing s. MB 8 includes the taxable value of fringe benefits within the family scheme income of a controlling shareholder. New S. MB 7B includes within the family scheme income of a person to whom s. MB 8 does not apply:

    (a) If, under the terms of employment, the person may choose to sacrifice a portion of employment income in order to receive a fringe benefit that is the private use of a motor vehicle, the amount of employment income sacrificed in order to receive that fringe benefit; and

    (b) The value, including FBT, of a short-term charge facility provided to an employee of a charitable organisation, if the total value of such fringe benefits excluding FBT for the year exceeds the lesser of 5% of the employee's salary or wages, or $1,200.

Limitation of time limit for tax refunds

20. Section 89 of the Assets Expenditure Tax Act repeals section RM 6 under which the Commissioner was authorised to issue refunds applied for within 8 years following the year in which an assessment was made. From the 2013-14 tax year onwards, the time limit within which tax refunds can be made, under revised s. RM 2 in s. 87 of the assets Expenditure Tax Act, is the 4-year period for amendment of an assessment, or an additional 2-year period for refunds relating to tax credits applied for under s. 78B of the *Tax Administration Act 1994*.

21. In addition, under amended s. RM 4 in s. 88 of the assets Expenditure Tax Act, refunds of overpaid tax as a result of an amended assessment can only be made within 4 years from the end of the tax year in which the assessment was amended.

Trustee associated with a person with a power of appointment

22. New s. YB 11(2) contains an exclusion from the rule in s. YB 11 that a trustee is associated with a person who has a power of appointment. The rule of association will not apply if the person with a power of appointment holds the power as a provider of professional services, and is a member of an approved organisation, and has not benefited from the trust, and is not eligible to benefit from the trust.

23. The exclusion applies:

    (a) For provisions other than the land provisions from the 2010-11 income year;

    (b) For land provisions other than s. CB 11 (which applies to a building business and disposal within 10 years of completing improvements), for land acquired on or after 6 October 2009;

    (c) For the purposes of s. CB 11, for land on which improvements are begun on or after 6 October 2009.

Time period for applying for a tax credit for a charitable donation

24. Replacement s. 41A(6) of the Tax Administration Act 1994 in s. 112 of the Assets Expenditure Tax Act provides that a taxpayer may apply for a refund up to 4 years commencing from:

    (a) 1 April following the end of the taxpayer's income year if the taxpayer has a standard or early balance date; and

(b) The day after the end of the taxpayer's income year if the taxpayer has a late balance date.

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