DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 31 JANUARY 2014

1. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* ("the Bill") was reported from the Finance and Expenditure Committee on 28 November 2013, and contains a number of changes from the rules as originally introduced on 20 May 2013. Over the past four weeks, I looked at the foreign superannuation withdrawals rules.

2. This week and next week I look at the other important changes in the Bill. These proposed changes were discussed in *Weekly Comment* 31 May 2013 when they were introduced. Since then, the *Financial Reporting Act 2013* ("the FRA 2013") and the *Financial Reporting (Amendments to Other Enactments) Act 2013* ("the Other FR Amendments Act 2013") have been enacted and Inland Revenue has released an Issues Paper on financial reporting requirements.

3. The topics covered this week are:

   (a) Financial reporting developments since introduction of the Bill

   (b) New financial reporting requirements for companies;

   (c) Minimum financial reporting requirements for tax purposes;

   (d) Imputation credits and Australian dividends.

Financial reporting developments since introduction of the Bill

4. Since the Bill was introduced, there have been a couple of developments:

   (a) In November 2013 Inland Revenue released *Minimum financial reporting requirements for companies – An officials' issues paper on possible changes to the preparation of financial statements* ("the Reporting Requirements IP"); and

   (b) The FRA 2013 and the Other FR Amendments Act 2013 have been enacted with a date of assent of 3 December 2013.

New financial reporting requirements for companies

5. Section 54 of the FRA 2013 repealed the *Financial Reporting Act 1993*. Section 30 of the Other FR Amendments Act 2013 replaces Part 11 of the *Companies Act 1993*. Under replaced section 196, financial reporting requirements are limited to:

   (a) Every "large" company (which, under the definition in s. 45(1) of the FRA 2013 means a company whose assets (including subsidiaries' assets) exceed $60 million at the balance date of each of the two preceding accounting periods, or whose revenue (including

subsidiaries) exceeds $30 million in each of the two preceding accounting periods, but excludes a company that was inactive in the period); and

(b) Every large overseas company that carries on business in New Zealand (which, under the definition in s. 45(2) of the FRA 2013 means a company whose assets (including subsidiaries' assets) exceed $20 million at the balance date of each of the two preceding accounting periods, or whose revenue (including subsidiaries) exceeds $10 million in each of the two preceding accounting periods, but excludes a company that was inactive in the period); and

(c) Every other company with 10 or more shareholders (unless the shareholders opt out of compliance); and

(d) Every other company with fewer than 10 shareholders if shareholders of the company holding at least 5% of the voting shares require the company to comply.

6. Apart from the above, there are no longer any financial reporting requirements for small and medium-sized companies.

7. The details of the financial reporting amendments, as contained in the Financial Reporting Bill reported from the Finance and Expenditure Committee, were discussed in *Weekly Comment* 19 April 2013.

Minimum financial reporting requirements for tax purposes

8. Effective from the income year after the year in which the *Financial Reporting Act 1993* is repealed (which will now be the tax year commencing 1 April 2014 or equivalent), clause 110 of the Bill proposes inserting new sections 21B and 21C into the *Tax Administration Act 1994*, which will require:

(a) Companies to prepare financial statements in accordance with applicable minimum requirements prescribed in an Order in Council made under s. 21C;

(b) Other classes of taxpayers who are specified in an Order in Council under s. 21C to prepare financial statements in accordance with applicable minimum requirements prescribed in an Order in Council made under s. 21C; and

(c) Companies or other taxpayers who are required by other enactments to use other applicable minimum requirements for preparing financial statements, to prepare financial statements in accordance with those other minimum requirements.

9. The retention of records rules in s. 22 will apply to financial statements prepared under the new minimum requirements. Section 17(2) is to be repealed: the section currently requires companies to provide, upon request by the Commissioner, information that includes copies of balance sheets, profit and loss accounts, other accounts and statements of assets and liabilities.

10. New s. 21C(2) requires the Minister of Revenue to consult with "professional accounting bodies that the Minister decides it is reasonable to consult" before recommending the making or amending an Order in Council under s. 21C.

11. There have been no specific announcements on the implementation timeline for the new minimum reporting requirements or what the actual reporting requirements would be. However, the Inland Revenue Department has indicated in the Reporting Requirements IP that:

    (a) The new minimum financial reporting requirements for companies would apply from 1 April 2014 (paragraph 1.5);

    (b) The minimum financial reporting requirements for companies would likely be only slightly more extensive than the present requirement of the *Financial Reporting Order 1994*, which presently applies to small companies (paragraph 3.5);

    (c) The proposed reporting requirements for companies include disclosure of related party transactions with appropriate supporting information – including remuneration, rents, dividends and interest: given the complexity of the related party information required Inland Revenue proposes that this requirement apply for tax years commencing on or after 1 April 2015 (Appendix and paragraph 3.7);

    (d) The financial statements would not have to be held in hard copy, as long as they are prepared as part of the tax return process (paragraph 2.10);

    (e) There would be no requirement to annually file these financial statements with Inland Revenue: rather, they would form the basis from which the IR 10 is prepared and filed and they would be available to Inland Revenue upon request (paragraph 2.10);

    (f) From the tax year commencing 1 April 2015 or equivalent, subject to a minimum threshold – which could be the GST registration threshold of $60,000 turnover – other taxpayers that are in business such as sole traders, partnerships and limited partnerships, and trusts could also be required to prepare special purpose financial statements.

12. The details of the proposed minimum reporting requirements are contained in the Appendix to the Reporting Requirements IP. The key requirements are:

    (a) There must be a balance sheet and a profit and loss account, appropriately detailed;

    (b) The financial statements must be based on double-entry historical cost accounts prepared using accrual concepts;

    (c) Tax values can be used where possible to determine income and expenses, fixed assets and depreciation, and the balance sheet;

    (d) Accounting policies used and last year's comparables should be disclosed; and

    (e) Supporting schedules should contain a financial statement to taxable income reconciliation and IR10 key points.

13. One further aspect is worth specifically commenting on: the time within which taxpayers must furnish financial statements when requested to do so by Inland Revenue. NZICA suggested a three month period, and expressed a preference for this to be codified into the legislation rather than confirmed in a statement issued by Inland Revenue. Inland Revenue responded as follows:

    (a) Officials expect that the financial statements would be prepared, or largely prepared, as part of the tax return preparation process;

(b) However, the NZICA submission seems to envisage that the preparation of financial statements and supporting data analysis may in some cases commence after the request, which begs the question as to the basis on which the tax return was prepared;

(c) Generally Inland Revenue allows 28 days for the provision of requested information, but it will take into account circumstances where different periods are appropriate;

(d) The 28 days could be codified, but that would reduce flexibility and would be unusual given that no other information requests are subject to codified periods, therefore a codified period is not required.

Imputation credits and Australian dividends

14. Amendments, which will come into force on 1 April 2014, are proposed to limit the imputation credit received by a shareholder under the trans-Tasman imputation rules to the imputation credit that could be attached if the dividend paid was equal to the FIF income that arises. In the *Commentary* on the Bill, the background to the amendment is stated on pages 42 to 43 as follows:

    "The trans-Tasman imputation rules permit an Australian company to operate an imputation credit account (ICA). An Australian ICA company that has paid New Zealand tax can attach imputation credits to dividends paid to New Zealand shareholders. Wholly owned Australian and New Zealand companies can also form a trans-Tasman imputation group. New Zealand tax paid by a member of the group will generate imputation credits that can be distributed to a New Zealand shareholder. *The amount of imputation credits that a particular shareholder receives is determined with reference to the actual dividend paid by the company*. In the domestic context, this works as intended.

    However, an issue arises when a New Zealand-resident shareholder receives a dividend with imputation credits attached that is paid from *a closely held Australian company. The New Zealand resident's investment in that company will generally be an attributing interest under the FIF rules*. Under the FIF rules, a New Zealand resident is taxed only on the deemed FIF income; the actual dividend is disregarded.

    A mismatch therefore arises, with imputation credits being calculated on the actual dividend paid but income tax arising only on the FIF income. If the dividend is of greater value than the amount of FIF income, the shareholder will receive excess imputation credits, which they can use against the tax on their other income, such as salary and wage income. This is inconsistent with the policy intent. The amendment is intended to address this mismatch." (emphasis added)

15. Section LE 1 deals with tax credits for imputation credits. Section LE 1(1) states that a person whose assessable income for an income year includes an imputation credit has a tax credit for the year equal to the imputation credit.

16. Section LE 1(4B) deals with FIF income, and provides that, for the purposes of section LE 1, an amount that would be income of a person from an attributing interest in a FIF, if the "no income other than under the FIF rules" limitation in section EX 59 did not apply, is treated as if it were assessable income of the person.

17. The combination of sections LE 1(4B) and LE 1(1) mean that an imputation credit attached to a dividend under the trans-Tasman imputation rules, from an interest in an Australian company that is a FIF interest, is treated as a tax credit.

18. Clause 86 of the Bill proposes inserting a new section LE 8B, which will apply when a person has assessable income for the purposes of section LE 1, because section LE 1(4B) applies, and the LE 1(4B) income includes an imputation credit. The tax credit will be limited to the lesser of the actual credit, or an amount calculated as:

(imputation ratio x FIF income)

19. The "imputation ratio" will be calculated treating the section LE 1(4B) income as a net dividend to which the imputation credits are attached.

20. In addition, clause 15 inserts new section CV 19 which is designed to ensure that the tax credit calculated under section LE 8B is included in the person's income.

21. Officials consider the amendment is consistent with the existing rule that allows a tax credit for foreign tax paid on the dividend received by New Zealand resident even though the actual dividend is not subject to New Zealand tax because the shareholder is subject to the FIF rules. However, in this case, the foreign tax credit is limited to the New Zealand tax liability on the FIF income. A submission by NZICA to allow the excess imputation credit forwards or backwards was declined. A submission to limit the amendments to the FDR and cost FIF calculation methods was also declined.

Arun David, Director

DavidCo Limited