



WEEKLY COMMENT: FRIDAY 28 FEBRUARY 2014

1. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* (“the Foreign Superannuation Tax Act”) was passed by Parliament last week and received the Royal assent on 27 February 2014. Not long before that, on 11 February 2014, the Minister of Revenue introduced Supplementary Order Paper No. 413 (“SOP 413”), which contained some final amendments to the version of the Bill that was reported from the Finance and Expenditure Committee.
2. This week I look at the amendments contained in SOP 413. I have also taken the opportunity to comment on some enacted amendments to earthquakes tax relief that are additional to the changes that were proposed in Supplementary Order Paper No. 257 (“the Earthquakes SOP”) released on 25 June 2013 (which I discussed in Weekly Comment 13 September 2013).
3. The topics covered this week are:
 - (a) Extension to the temporary 15% reduced rate amnesty;
 - (b) Repeal of a mixed-use assets exemption;
 - (c) Earthquakes tax relief amendments;
 - (d) The period for which financial statements must be prepared;
 - (e) Other remedial amendments.

Temporary reduced-rate amnesty for pre-1 April 2014 lump sum withdrawals

4. The optional treatment of withdrawals from a foreign superannuation scheme will now apply when a person:
 - (a) In the period beginning on 1 January 2000 and ending with 31 March 2014, either:
 - (i) Derives an amount from a foreign superannuation scheme as a withdrawal, other than a pension or annuity; or
 - (ii) Applies for a withdrawal of such an amount; and
 - (b) Does not include the withdrawal (the *omitted withdrawal*) in a return of income for the income year in which the amount was derived; and
 - (c) Is not assessed before 1 April 2014 for income included in the omitted withdrawal; and

- (d) Chooses to include in a return of income for an income year (the **return year**) that is the 2013-14 or 2014-15 income year an amount of assessable income as relating to all omitted withdrawals from the foreign superannuation scheme.
5. The person is treated as deriving in the return year from the omitted withdrawals an amount of assessable income (the *withdrawal income*) equal to 15% of the total amount of the omitted withdrawals.
6. The amount of the liability of the person for income tax (the *withdrawal tax liability*) arising from the omitted withdrawal is the difference between the person's income tax liability for the return year, with the withdrawal income included in the person's assessable income for that year, and the income tax liability that the person would have for the return year if the withdrawal income were not included in the person's assessable income for that year.
7. This concession overrides:
- (a) The new law applying from 1 April 2014 to the taxation of withdrawals from foreign superannuation schemes contained in the new section CF 3;
 - (b) The previous law applying up to 31 March 2014 that would otherwise apply to omitted withdrawals derived on or before 31 March 2013 (new s. CZ 21B(5)(b)); and
 - (c) The previous law that would otherwise apply to the person's interest in the foreign superannuation scheme for the period ending by 31 March 2014 (new s. CZ 21B(5)(c)).
8. In the Media Statement on 18 February, the Minister of Revenue explained the amendment in SOP 413 as follows:
- “The changes extend the availability of the 15 per cent option to those whose funds haven't actually been transferred to New Zealand before 1 April 2014, but who can show they have lodged an application before that date.
- Funds transfers can be a lengthy process, so this extension is good news for those wishing to take up the 15 per cent option.
- For transfers or withdrawals before 1 April 2014, a person can either calculate the actual amount of tax payable under the rules at the time or simply apply the 15 per cent option. People who choose the 15 per cent option can include 15 per cent of their transferred or withdrawn foreign superannuation in their 2013–14 or 2014–15 income tax return and have their tax rate applied to that amount.”
9. The amendments in SOP 413 also makes it clear that:
- (a) Non-compliant non-FIF taxpayers who made a lump-sum withdrawal before 1 April 2014 will have the 15% option available to them – i.e. the non-FIF rules applying up to 31 March 2014 are overridden (see paragraph 7(b) above); and
 - (b) Non-compliant FIF taxpayers who made a lump-sum withdrawal before 1 April 2014 will have the 15% option available to them – i.e. the FIF rules up to 31 March 2014 are overridden (see paragraph 7(c) above).
10. The following points are also relevant:
- (a) Taxpayers are not required to use the 15% option proposed in the bill and may instead choose to apply the law as it existed at the time;

- (b) The 15% option will be available for lump sum withdrawals after 31 March 2014 providing that the application for the withdrawal was made by 31 March 2014, but only if the application was made by that date;
- (c) The proposed legislation originally provided for the omitted withdrawals to be returned in an income year later than the 2014-15 income year: this has been removed, and a request for reassessment of the 2014-15 income year will need to be made for withdrawals returned after the return for that year has been filed;
- (d) The proposed legislation originally provided for a due date for the payment of the withdrawal tax liability, which was the terminal tax date for the return year; this has been removed, so the withdrawal tax liability will need to be taken into account in provisional tax payments for the 2014-15 income year.

Repeal of a mixed-use assets exemption

- 11. Under s. DG 3(4)(c), an asset was excluded from the mixed-use assets rules if:
 - (a) It is being used in an income year by a person (person A); and
 - (b) During the income year, it undergoes a change of use; and
 - (c) The only uses made of the asset in the income year are the use by person A and the use by another person from which person A derives income.
- 12. Officials commented that the reason for this was so that the mixed-use asset rules will not apply where there is actually no mixed-use:
 - (a) Boats and aircraft that are initially used privately by the owner and then undergo a change of use, and are rented out after that change of use – such as a boat that is used privately for the first part of the year, and then rented out during the second part of the year following the owner’s acquisition of a new boat for private use; or
 - (b) Assets that are initially rented out and then used exclusively for private use by the owner following the change of use.
- 13. However, officials now feel that this exclusion results in a wider range of property being excluded than was originally intended. Therefore, the exclusion was entirely repealed by SOP 413 and by s. 35 of the Foreign Superannuation Tax Act.

Earthquakes tax relief amendments

- 14. The Earthquakes SOP released in June 2013 contained a requirement that taxpayers had to have applied for building consent by the end of 2015-16 in order to access the roll-over relief extension for the 2016-17 to 2018-19 income years. This was a requirement for rollover relief for both the taxpayer’s own replacement buildings and grandparented structures (dealt with in s. EZ 23B), and property replaced through an owned entity (dealt with in s. EZ 23BB).
- 15. Following submissions, officials agreed that it is preferable to remove the requirement for taxpayers to have applied for building consent by the end of the 2015-16 income year in order to access roll-over relief for the 2016-17 to 2018-19 income years. This is because of the on-going uncertainty around current planning and rebuilding activities in Canterbury. Therefore, the enacted rules do not include a requirement to have applied for building consent by the end of 2015-16.

16. Submitters raised the issue of transitioning from replacing property directly to replacing property through an owned entity. Many taxpayers who will wish to use new s. EZ 23BB to claim depreciation roll-over relief will have already relied on s. EZ 23B in earlier income years to suspend recognition of depreciation recovery income. Accordingly, the legislation should explicitly provide for a transition for taxpayers from s. EZ 23B to s. EZ 23BB.
17. Officials agreed that some form of transitional rule is required for taxpayers who have initially elected into roll-over relief under existing s. EZ 23B because they plan in the current year to acquire replacement property but will now be acquiring replacement property through a joint investment entity (and so meet the criteria for electing into new s. EZ 23BB).
18. Consequently, s. EZ 23B(11B) provides that a person with suspended recovery income under s. EZ 23B, who has not yet incurred expenditure in acquiring the replacement property, may instead make an election under s. EZ 23BB.
19. An issue has apparently been identified regarding items of replacement property acquired at the same time. Amendments to both s. EZ 23B and s. EZ 23BB provide that when items of replacement property are acquired at the same time, and the effect of the section depends on the order in which the items are acquired, the items are acquired in the order chosen by the person in the first tax return in which the order of acquisition is taken into account.
20. The formula for revenue account property ("RAP") roll-over relief in s. CZ 25 has been amended so that it works as intended. Officials noted that the formula provides for the RAP income amount derived to be pro-rata. If not all of the receipts from disposal of the original RAP are used to purchase replacement RAP, there is no deferral of tax on the unused remainder, that is, there is a pro rata approach, which is achieved through the formula. The three main situations and outcomes can be summarised as:
 - (a) The cost of replacement RAP is *less than* the insurance proceeds and *less than* the cost of the original RAP: in this situation no rollover relief will be due, because the tax liability arising on the sale of the original RAP can be met without affecting the taxpayers' ability to purchase the new RAP.
 - (b) The cost of replacement RAP is *less than* the insurance proceeds but *more than* the cost of the original RAP: in this situation a portion of the insurance proceeds received is taxable as income (under either s. CB 6, CB 7, CB 12, CB 13 or CG 6) immediately in the year of receipt, because it is not all needed to purchase the replacement RAP. The formula in s. CZ 25(3) requires a pro-rata approach. The remainder of the income that is not taxed immediately is still rolled-over to reduce the cost price (for the purposes of s. EA 2) of the replacement property.
 - (c) The cost of replacement RAP is *equal to or more than* the insurance proceeds, and *more than* the cost of the original RAP: in this situation all the proceeds are put towards the replacement RAP. There is no pro-rata, and the full amount of taxable income will be rolled over. The previous drafting in s. CZ 25(3) meant that the formula simply did not apply in the third situation.
21. The proposed amendments re-draft this formula to cover all three scenarios. Following submissions, officials also agreed that the calculation of 'excess recovery' is unclear. This term was intended to mean the excess (difference) between the amount received for the disposal of the original property and the cost of the replacement property. Officials agree that the derivation of this element of the calculation should be clarified. Officials agreed to consider

submissions about the provision of more guidance by Inland Revenue on the application of this formula, including a worked example.

22. The complete updated earthquakes tax relief measures are contained in the attached PDF *Canterbury Earthquakes Tax Relief Measures*.

The period for which financial statements must be prepared

23. New s. 21C in the *Tax Administration Act 1994* allows the Governor-General to prescribe:

- (a) Minimum requirements for preparing financial statements; and
- (b) Classes of taxpayers to whom the minimum requirements apply; and
- (c) Classes of companies that are exempt from the minimum requirements.

24. A correction in SOP 413 will allow the Governor-General to also prescribe the period for which financial statements must be prepared.

Other remedial amendments

25. A correction to the consolidated groups rules will ensure that a company joining the group is in the same wholly-owned group of companies as the other members in the consolidated group. This correction applies from the commencement of the 2007 Act.
26. A correction to the RWT rules restricts the circumstances in which a person is relieved from the obligation to withhold tax because of being treated as not resident or not carrying on a taxable activity. Section RE 4(4)(a) and (b) are being replaced by s. 125 of the Foreign Superannuation Tax Act, with effect from the commencement of the 2007 Act, unless the payment subject to RWT is made before 27 February 2014, the date of assent, and an amount was withheld under s. RE 4(4) before it was amended.



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