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# RECENT TAX DEVELOPMENTS AFFECTING LARGER COMPANIES

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1. 2011 to 2013 tax depreciation changes and earthquake relief tax measures
2. Canterbury earthquakes tax relief measures
3. Thin capitalisation rules applying to outbound companies
4. Profit distribution plans
5. Withdrawals from foreign superannuation schemes
6. Mixed-use assets
7. Lease inducement and lease surrender payments

## 1. TAX RATES

1. The company tax rate is 0.28 for income years from 2011-12 onwards.
2. For the 2008-09 to 2010-11 income years, the company tax rate was 0.30.
3. Prior to that, for the 2007-08 income years and earlier it was 0.33.

## 2. INCOME TAX LAW CHANGES TO OCTOBER 2013

4. The *Taxation (Tax Administration and Remedial Matters) Act 2011* (the "Tax Administration Act 2011") was enacted with a date of assent of 29 August 2011 and contained a number of amendments, including the initial Christchurch earthquake-related tax depreciation amendments.

5. The *Taxation (International Investment and Remedial Matters) Act 2012* (the "International Investment Tax Act") was enacted with a date of assent of 7 May 2012 and contained, among other amendments, a number of significant amendments to the thin capitalisation regime applying to outbound companies, and significant amendments to the FIF tax regime. (The FIF changes are set out in the *FIFs* section of this website.)

6. The *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012* (the "Annual Rates Tax Act"), with a date of assent of 2 November 2012, contained a number of important amendments including changes to:

   (a) The Christchurch earthquake tax depreciation and rollover relief rules;

(b) The tax treatment of expenditure on unsuccessful software development;

(c) The tax treatment of profit distribution plans; and

(d) The CFC and FIF rules, including a revised formula for calculating Net Attributable CFC Income Or Loss and the ability to elect to be an attributing active CFC or FIF (refer to the *CFCs* and *FIFs* sections of this website for details of these changes).

7. The *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* (the "Assets Expenditure Tax Act") with a date of assent of 17 July 2013 contained another whole raft of significant amendments including:

   (a) The mixed-use assets rules;

   (b) The livestock valuation rules;

   (c) An alternative tax treatment for certain hedges of funds used to hedge FIF interests for which the daily valuation FDR method is used;

   (d) More amendments to the tax depreciation and capital contribution rules;

   (e) Rules for the taxation of lease inducement and lease surrender payments;

   (f) Rules on the taxation of short-term charge facilities;

   (g) Rules on the tax treatment of the transfer of short-term agreements for sale and purchase of property; and

   (h) Rules relating to the NZ Railways restructure.

8. The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill* ("the Superannuation Tax Bill") was introduced on 20 May 2013. It is under consideration by the Finance and Expenditure Committee, which is due to report back on 12 December 2013. The changes proposed are as follows:

   (a) Significant changes to the taxation of an interest in a foreign superannuation scheme, including changing from taxing accrued increases in the value of the interest under the FIF tax regime to taxing withdrawals under the general tax rules;

   (b) Significant changes to the tax rules on mineral mining, following the release of *Taxation of specified mineral mining – An officials' issues paper* in October 2012;

   (c) Authorising the use of Orders in Council to specify minimum special purpose reporting requirements for companies and other specified classes of taxpayers;

   (d) Matching the use of imputation credits on FIF dividends to the FIF income;

   (e) Two changes to the tax rules regarding bad debt deductions for holders of debt;

   (f) Removing the ability to claim deductions on notional interest amounts that can arise under IFRS financial accounting.

9. A *Supplementary Order Paper* ("the Superannuation Bill SOP") to the Superannuation Tax Bill was tabled on 25 June 2013, and contains some significant amendments affecting Canterbury earthquake relief, including generally extending the application of the relief measures to the end of the 2018-19 income year. As previously noted, the Superannuation Tax Bill is under consideration by the Parliamentary Finance and Expenditure Committee, which is due to report back to Parliament on 12 December 2013. There could be changes to the amendments as currently proposed, based on the submissions heard.

## 3. OTHER RECENT DEVELOPMENTS IN INCOME TAX AND BUSINESS LAW

10. There have been a number of *Officials' Issues Papers* released in 2012 and to date in (October) 2013 for comments and discussion. The Issues Paper on *Recognising salary trade-offs as income* (discussed in *Weekly Comment* 2 May 2012) has resulted in legislation in the Assets Expenditure Tax Act on the tax treatment of short-term charge facilities, but the proposed changes to FBT on car parks were not proceeded with. No draft legislation addressing any of the other matters raised in that Issues Paper has been introduced as yet.

11. The following Issues Papers have also been recently released, most of which have been discussed in various *Weekly Comments*:

    (a) *Financial arrangements – the sale and purchase of property or services* – discussed in Weekly Comment 11 July 2012;

    (b) *Use of Old GAAP in the CFC rules* – released in August 2012;

    (c) *Taxation of foreign superannuation* – discussed in *Weekly Comment* 6 September 2012 (this has resulted in draft legislation in the Foreign Superannuation Tax Bill);

    (d) *Taxation of specified mineral mining* – released on 31 October 2012 (this has resulted in draft legislation in the Foreign Superannuation Tax Bill);

    (e) *Reviewing the tax treatment of employee allowances and other expenditure payments* – discussed in *Weekly Comment* 15 and 22 February 2013;

    (f) *Review of the thin capitalisation rules* – discussed in *Weekly Comment* 1 March 2013; this was followed by *Thin capitalisation review – technical issues* – discussed in *Weekly Comment* 2 August 2013;

    (g) *The taxation of land-related lease payments* – discussed in *Weekly Comment* 3 May 2013;

    (h) *Clarifying the acquisition date of land* – discussed in *Weekly Comment* 19 July 2013;

    (i) *Clarifying the tax consequences for deregistered charities* – discussed in *Weekly Comment* 9 August 2013;

    (j) *R&D tax losses* – discussed in *Weekly Comment* 23 August 2013.

12. In conjunction with two of the above Issues Papers, Inland Revenue released Statements setting out the Commissioner's current position:

    (a) *CS 12/01 Commissioner's Statement: Income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances* – discussed in *Weekly Comment* 15 February 2013; and

    (b) *Revenue Alert RA 13/01: Salary Packaging – reducing income from employment by replacing part of salary or wages with vouchers* – discussed in *Weekly Comment* 5 April 2013;

13. Inland Revenue has released several Interpretation Statements, an Interpretation Guideline and public rulings, a number of which have been discussed in *Weekly Comments*:

    (a) IS 12/01 *Timing of share transfers for the purposes of the continuity provisions* – discussed in *Weekly Comment* 23 May 2012;

(b) IS 12/02 *Whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income* – also discussed in *Weekly Comment* 23 May 2012;

(c) IS 12/03 *Deductibility of repairs and maintenance expenditure – general principles* – discussed in *Weekly Comment* 13 June 2012;

(d) IS 13/01 *Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax act 2007* issued on 13 June 2013 – see the separate section on *Tax Avoidance* in this website;

(e) IS 13/02: *Income tax – Whether certain rights conferred by the Companies Act 1993 could give rise to a "shareholder decision-making right"* – discussed in *Weekly Comment* 20 September 2013;

(f) IG 12/01 *"Sham"* – referred to in *Weekly Comment* 6 June 2012;

(g) Public Ruling BR Pub 13/01 & 13/02: *Income tax - Treatment of a subdivision of shares under section CB 4* and *Treatment of a disposal of subdivided shares under section CB 4* – issued on 21 May 2013 and discussed in *Weekly Comment* 26 July 2013; and

(h) Public Ruling BR Pub 13/03: *Income tax – Treatment of unclaimed amounts of $100 or less* – issued on 6 June 2013 and discussed in *Weekly Comment* 26 July 2013.

14. Inland Revenue has also recently released the following *Questions We've Been Asked*, which have also been discussed in *Weekly Comments*:

(a) QB 12/12 *Abusive tax position penalty and the anti-avoidance provision* – discussed in *Weekly Comment* 27 June 2012;

(b) QB 13/02: *Income tax – Determining the "subscriptions" amount for an amalgamated company under the available subscribed capital rules* – issued in June 2013 and discussed in *Weekly Comment* 26 July 2013;

(c) QB 13/04: *Income tax – Retention money* – issued in September 2013 and discussed in *Weekly Comment* 27 September 2013.

15. Other draft Interpretation Statements, draft Questions We've Been Asked, and draft Rulings on income tax recently released for comments and discussion include:

(a) Draft INS 0033 *Deductibility of company administration costs* – discussed later in this section, which was released in 2011 and intended to replace *Company deductions* an earlier draft released in 2005, but has still not been released in final form; the *Public Rulings Work Programme* as at 20 September states it is on hold pending finalisation of legislative amendments addressing black-hole expenditure, and will be published to complement these changes;

(b) Draft IS *Deductibility of expenditure incurred in borrowing money* – discussed in *Weekly Comment* 20 June 2012 and which the *Public Rulings Work Programme* as at 20 September states is to be discussed with submitters before finalising in October 2013;

(c) Draft INS 0117 *Income tax - Residence* – discussed in *Weekly Comment* 11 and 18 January 2013 and for which the *Public Rulings Work Programme* as at 20 September states external submissions are currently being considered and it is expected to be finalised in October 2013;

(d) Draft Interpretation Statement Ref INS0122: *Income tax – Foreign tax credits – What is a tax of substantially the same nature as income tax imposed under s BB 1?* – discussed in *Weekly Comment* 4 October 2013 and for which the *Public Rulings Work Programme* as at 20 September states external submissions are currently being considered;

(e) Draft QWBA *Whether residual land is part of an undertaking or scheme of development or division of land* – discussed in *Weekly Comment* 18 July 2012 and which the *Public Rulings Work Programme* as at 20 September states is not currently being worked on;

(f) Draft QWBA *Income tax – Depreciation roll-over relief for Canterbury* with a deadline for comments of 11 October 2013 – discussed in *Weekly Comment* 13 September 2013;

(g) Draft Public Ruling Ref PUB0195: *Income tax – Standard project agreement for a public-private partnership* – for which comments closed on 24 May 2013 and which the *Public Rulings Work Programme* as at 20 September states is close to completion;

16. Two important Bills and a related Supplementary Order Paper currently before Parliament and recently enacted legislation that will affect company organisation and reporting are:

(a) The *Companies and Limited Partnerships Amendment Bill* (the "CLP Bill"), as reported from the Commerce Committee on 1 December 2012 – refer to Section 14 below;

(b) The *Financial Reporting Bill* (the "FR Bill"), as reported from the Commerce Committee on 22 May 2013 – refer to Section 15 below;

(c) The *Financial Markets Conduct Act 2013* (the "FMC Act"), with a date of assent of 13 September 2013, including, as Part 7 the amendments to the FMC Act relating to reporting requirements for issuers and other financial markets participants – refer to Section 16 below.

## 4. 2011 TO 2013 TAX DEPRECIATION CHANGES

17. The PDF attachment *2011 to 2013 Tax Depreciation Changes and Earthquakes Relief Tax Measures* contains all the details of the various changes that are discussed below. The separate PDF attachment *Canterbury Earthquakes Tax Relief Measures* contains all the earthquakes relief changes, including the proposed amendments in the 25 June 2013 SOP to the Superannuation Tax Bill.

### 4.1 0% Depreciation rate for buildings

*(Refer to pages 4-7 of the attached PDF on the 2011 on the tax depreciation changes)*

18. From the 2011-12 income year onwards, the tax depreciation rate for buildings is 0%. The definition of a "building" in s. YA 1 of *the Income Tax Act 2007* does not state what a building is. Inland Revenue has released Interpretation Statement IS 10/02 *Meaning of "Building" in the Depreciation Provisions*, which sets out Inland Revenue's view of what constitutes a building. This is the link: (http://www.ird.govt.nz/technical-tax/interpretations/2010/interpretations-2010-is1002.html)

19. The 0% rate does not apply to the following types of buildings:

    (a) A "grandparented structure"; these are 6 listed types of structures; they had to have been acquired on or before 30 July 2009; however, the 0% rate does apply to improvements to these structures made after 30 July 2009.

    (b) A type of building listed in Schedule 39, acquired before 1 April 1993.

    (c) A building in a class for which the Commissioner has issued a provisional rate stating that a building in that class has an estimated useful life of less than 50 years.

### 4.2 Depreciation of commercial fit-out

*(Refer to pages 8-17 of the attached PDF on the tax depreciation changes)*

20. New rules apply from the 2011-12 income year onwards, to distinguish "commercial fit-out" from a building. Commercial fit-out can be separately depreciated. It must be non-structural and cannot be an item used for weatherproofing a building.

21. A building must be predominantly commercial in order for commercial fit-out that is plant to be depreciable. Commercial fit-out other than plant, in a predominantly residential building, can be depreciated, provided it is not used in relation to, and not part of, the residential portion of the building. However, if the building is predominantly commercial, fit-out, other than plant, may be used in the residential portion, and it will still be depreciable, provided that it is not part of the residential portion.

22. There are certain listed exclusions from the definition of a residential "dwelling" - hospitals, hotels and motels, serviced apartments, nursing homes and rest homes etc. Commercial fit-out in these types of buildings can continue to be depreciated. A distinction is made however between a serviced dwelling that has a level of compulsory care, and one that permits "independent living". A serviced dwelling that permits independent living will not qualify as a listed exclusion and commercial fit-out will not be depreciable.

23. If the predominant use of a building changes from commercial to residential, the depreciation recovery provisions will apply to the commercial fit-out. The change in use will be treated as a disposal event occurring on the first day of the income year following the change of use.

24. Where a building that is to be depreciated at 0% includes commercial fit-out that has not been separately depreciated, a transition concession applies under which 15% of the building's adjusted tax value is treated as relating to the fit-out. That portion can continue to be depreciated at 2% per annum.

25. Residential rental property chattels are separately depreciable and should not be confused with commercial fit-out. The Commissioner's position is set out in Interpretation Statement IS 10/01 *Residential Rental Properties – Depreciation of Items of Depreciable Property*.

### 4.3 20% loading no longer available

*(Refer to pages 18-19 of the attached PDF on the tax depreciation changes)*

26. The depreciation loading of 20% is not available for assets acquired after 20 May 2010.

27. A concession applies for an item acquired after 20 May 2010 where a person decided to purchase or construct the item on or before 20 May 2010 and

    (a) Entered into a binding contract for the purchase or construction of the item on or before 20 May 2010; or

    (b) After deciding to purchase or construct the item, incurred expenditure on its purchase or construction on or before 20 May 2010.

28. In order for the concession to apply, documents that evidence the purchase decision on or before 20 May 2010 must be available for review by the IRD, and a statutory declaration must be made that the decision to purchase or construct the item had been made on or before 20 May 2010.

29. An improvement made, after 20 May 2010, to assets for which the 20% depreciation loading is available, must be treated as a separate item of depreciable property. The loading will not be available for the improvement.

### 4.4 Capital contributions

*(Refer to pages 20-21 of the attached PDF on the tax depreciation changes)*

30. New rules apply to treat a capital contribution towards depreciable property as income, unless the depreciable value of the property is reduced by the contribution. In the latter case, the contribution is treated as a depreciation deduction when calculating depreciation recovery income upon disposal.

31. Amendments in the Assets Expenditure Tax Act result in farming, horticultural, aquacultural, and forestry improvements, and horticultural expenditure on land, being treated as "capital contribution property" to which the capital contribution rules apply.

32. If a capital contribution is treated as income, it must be spread over 10 years. The new rules apply to capital contributions derived after 20 May 2010.

## 5. EARTHQUAKES RELIEF TAX MEASURES

33. Changes to the tax depreciation rules have been enacted to cater for damage caused by the Christchurch earthquakes. A number of the changes are generic, in the sense that they can apply generally, rather than specifically to the Christchurch earthquakes. The depreciation recovery rollover relief rules, however, apply only to assets damaged as a result of the Christchurch earthquakes.

34. The timing of the derivation of business interruption insurance has changed. This is also a change that applies generally.

35. Rollover relief has also been provided for buildings that are revenue account property along the same lines as the depreciation recovery rollover relief rules. This applies only to buildings affected by the Christchurch earthquakes.

36. The tax relief originally available until the end of the 2015-16 income year, has generally been extended to the end of the 2018-19 income year by the Superannuation Bill SOP. The SOP:

    (a) Generally extends the roll-over relief measures from the 2015-16 income year to the 2018-19 income year;

    (b) Removes the exemption for Crown purchases of land where the profits would be taxable under s. CB 12 (undertaking or scheme where development or division work is not minor) currently contained in s. CZ 26, effective from when the new Act receives the Royal assent;

    (c) Extends the operation of sections EZ 23C to EZ 23G (various provisions explained further in paragraph 65 below) to the 2018-19 income year and changes the numbering of the sections to s. EZ 65 to EZ 69 effective from 1 April 2016 (i.e. from the date of the extension);

    (d) Extends the depreciation roll-over relief for replacement property to 2018-19 providing that, in the case of a building, a replacement has been acquired or a construction consent applied for before the end of the 2015-16 income year;

    (e) Introduces additional depreciation roll-over relief for replacement property acquired through an owned company ("a replacement interest") subject again to the proviso that, in the case of a building, a replacement has been acquired or a construction consent applied for before the end of the 2015-16 income year;

    (f) Extends the revenue account property roll-over relief so as to include property from which profits would be taxable under s. CB 6, CB 7, CB 12 and CB 13 – i.e. various land taxing provisions - (as well as s. CG 6) and extends the roll-over measures to the 2018-19 income year; and

    (g) Extends the operation of the thin-capitalisation asset valuation concession to the 2018-19 income year.

### 5.1 Event resulting in a deemed disposal

*(Refer to page 7 of the attached PDF on the Earthquakes Relief Tax Measures)*

37. The definition of a disposal event that arises from irreparable damage to property has changed so as to include a building affected by neighbourhood damage (even if the building itself was relatively undamaged or repairable). The depreciation recovered in such cases is based on the amount derived in relation to the "affected item" as opposed to the "irreparably damaged item". This change was enacted in the Tax Administration Act and came into force on 4 September 2010. It is a generic change that applies generally, and not only to property affected by the Christchurch earthquakes.

### 5.2 Deductibility of disposal costs

*(Refer to pages 8-9 of the attached PDF on the Earthquakes Relief Tax Measures)*

38. The legislation regarding the consideration received on disposal for depreciation recovery/loss purposes has been clarified. The cost of disposing of an asset is separately deductible when calculating the consideration. The change was made to ensure that the disposal and demolition costs of an insured earthquake damaged building would be deductible, but the change applies generally, and not just to buildings

damaged by the September 2010 earthquake. This change applies retrospectively from 1 April 2008.

### 5.3 Timing of depreciation recovery income or loss

*(Refer to pages 10-11 of the attached PDF on the Earthquakes Relief Tax Measures)*

39. Depreciation recovery income is derived in the earliest income year in which the consideration can be reasonably estimated. (The rule that depreciation recovery income is derived in the income year in which the disposal or the disposal event occurs has been repealed.)

40. The rule that a person has a depreciation loss in the income year in which the disposal or the disposal event occurs has also been repealed.

41. These changes apply generally (not just to property affected by the Christchurch earthquakes). They were enacted in the Tax Administration Act and came into force on 4 September 2010.

### 5.4 Depreciation loss on certain buildings

*(Refer to page 7 of the attached PDF on the Earthquakes Relief Tax Measures)*

42. A depreciation loss may be claimed on a building or grandparented structure that is damaged, or abandoned for later demolition due to damage to the neighbourhood, and therefore useless for deriving income. The damage must be caused by a natural event not under the control of the taxpayer (or agent or associate), and other than as a result of the action or failure to act of the taxpayer (or agent or associate).

43. These changes apply generally (not just to property affected by the Christchurch earthquakes). They were enacted in the Tax Administration Act and came into force on 4 September 2010.

### 5.5 Depreciation rollover relief: property acquired by the affected person

*(Refer to pages 12-23 of the attached PDF on the Earthquakes Relief Tax Measures)*

44. Depreciation rollover relief is available only for property affected by the Christchurch earthquakes. It applies when there would otherwise be depreciation recovery income. It is available for affected property – irreparably damaged property or, if a building or grandparented structure, property abandoned due to damage to the neighbourhood – for which a replacement is planned. The rollover relief originally available until the end of the 2015-16 income year, has generally been extended to the end of the 2018-19 income year by the Superannuation Bill SOP.

45. Depreciation recovery income from affected property for which replacements are planned can be deferred until after the replacements have been made, or until the end of the 2018-19 income year if that is earlier.

46. The deferred income is referred to as "suspended recovery income". Suspended recovery income can be applied towards reducing the depreciable cost of replacements. Any remaining suspended recovery income must be returned once all planned replacements have been made. In any case, any remaining suspended recovery income at the end of the 2018-19 income year must be returned in that year.

47. Affected items must be classified into: depreciable property for which the pool method of depreciation was used, and three classes of non-pool method depreciable property – buildings and grandparented structures, commercial fit-out and "other depreciable property". Each class must be treated separately.

48. The amount by which the cost is reduced for each replacement item in an affected class is: a proportion of the depreciation recovery income of affected items in that class – the proportion being the replacement cost as a fraction of the original cost of the affected item that is replaced. The cost reduction for a class of replacement items cannot exceed the depreciation recovery income for the affected items in that class.

49. The cost reductions are treated as depreciation deductions that have been allowed for the purpose of determining the depreciation recovery or loss when the replaced items are disposed of.

50. Written election notices must be completed and filed with the return of income for each year commencing in the year in which the suspended recovery income is derived until the earlier of: when it is exhausted by cost reductions, or the remaining suspended recovery income is returned, or the end of the 2018-19 income year. The deadline for filing the election notice for the earliest year was extended to 31 January 2012 if that was later than the date on which the return for that year was filed.

51. A detailed example of the operation of depreciation roll-over relief when replacement property is acquired by the affected person is contained in Draft QWBA *Income tax – Depreciation roll-over relief for Canterbury* discussed in *Weekly Comment* 13 September 2013.

### 5.6 Depreciation rollover relief: property acquired by an owned company

*(Refer to pages 24-26 of the attached PDF on the Earthquakes Relief Tax Measures)*

52. New rules are proposed in the Superannuation Bill SOP to allow roll-over relief in circumstances where the replacement item is bought by a company owned by the person who suffered the loss (as a result of the Canterbury earthquakes) that is compensated for.

53. The new rules introduced in the Superannuation Bill SOP extend the roll-over relief to replacement property acquired through a company in which a person has an ownership interest (referred to as the "*replacement interest*"). They operate by applying a person's *fractional interest* in the acquiring company to the cost of the company's replacement property so as to determine the person's *fractional interest value* in the company's replacement property. The person's excess recovery is then applied to reduce the cost of the replacement property to the acquiring company up to the amount of the person's *fractional interest value*.

54. Where the company that acquires the replacement property is owned through a trust, the relevant *fractional interest* in the company of the person with the excess recovery is the proportion of the trust's corpus that was settled by the person multiplied by the trust's voting interest in the company. That fractional interest is then multiplied by the company's expenditure on replacement property to determine the person's *fractional interest value* in the replacement property. The person's excess recovery can then be

used to reduce the depreciable cost of the company's replacement property up to a maximum of the person's fractional interest value.

55. The main aspects of the new rules are:

    (a) They do not apply to depreciable intangible property or to pool depreciated property.

    (b) There are 3 classes of property they apply to: buildings (or grandparented structures), commercial fit-out, and other depreciable property.

    (c) The insurance or compensation must relate to:

       (i) Property that is irreparably damaged; or

       (ii) Damage to a building or its neighbourhood that precludes further use; or

       (iii) Property that is assessed as uneconomic to repair and deemed to be disposed of and reacquired under s. EZ 23C.

    (d) The replacement property must be acquired by a company in which a voting interest is held by:

       (i) The person who received the compensation; or

       (ii) A trustee of a trust settled by the person who received the compensation.

56. The other requirements more or less parallel the existing roll-over relief rules when the replacement property is acquired directly by the affected person. *Weekly Comment* 13 September extends the examples in the draft QWBA to a scenario where the person has a voting interest in the company that acquires the replacement property, or has settled a trust that has a voting interest in the company that acquires the property.

### 5.7 Timing of derivation of business interruption insurance

*(Refer to pages 39-42 of the attached PDF on the Earthquakes Relief Tax Measures)*

57. From 4 September 2010 an amount of insurance, indemnity or compensation received for an interruption or impairment of business activities because of an event is allocated to the later of:

    (a) The income year to which the replaced income relates; or

    (b) The earlier of:

       (i) The income year in which the amount is received; and

       (ii) The income year in which the amount is reasonably able to be estimated.

58. This new rule applies generally and not just to business activities affected by the Christchurch earthquakes.

### 5.8 Revenue account buildings rollover relief

*(Refer to pages 43-47 of the attached PDF on the Earthquakes Relief Tax Measures)*

59. Rollover relief is available for income that would otherwise result from the receipt of insurance or other compensation in respect of a *building* held on revenue account:

    (a) Which, because of the Christchurch earthquakes, is irreparably damaged or abandoned for demolition due to damage to the neighbourhood; and

    (b) For which a replacement *building*:

    (i) Is to be acquired in or before the 2018-19 income year; and

    (ii) That will also be revenue account property; and

    (iii) That will be located in greater Christchurch.

60. The rollover relief is available for income years up to and including the 2018-19 income year.

61. The amount by which the insurance or other compensation receipts exceed the cost deductible under section DB 23 (the *excess recovery*) can be deferred until after the replacement(s) has been acquired, or until the end of the 2018-19 income year if that is earlier.

62. The deferred income is referred to as "suspended recovery income". Suspended recovery income can be applied towards reducing the value of the replacement(s) for tax purposes. Any remaining suspended recovery income must be returned once the planned replacement(s) has been acquired. In any case, any remaining suspended recovery income at the end of the 2018-19 income year must be returned in that year.

63. The amount by which the value of the replacement(s) is reduced is: a proportion of the excess recovery – the proportion being the replacement cost as a fraction of the original deductible cost under section DB 23 of the building that is replaced. The total reduction in value cannot exceed the excess recovery.

64. Written election notices must be completed and filed with the return of income for each year commencing in the year in which the suspended recovery income is derived until the earlier of: when it is exhausted by the total reduction in value of the replacement building, or the remaining suspended recovery income is returned, or the end of the 2015-16 income year. The deadline for filing the election notice for the earliest year was extended to 31 January 2012 if that was later than the date on which the return for that year was filed.

### 5.9 Other earthquakes relief measures

*(Refer to pages 27-36 of the attached PDF on the Earthquakes Relief Tax Measures)*

65. There are a number of tax relief rules relating to depreciation recoveries from compensation:

    (a) Property assessed as uneconomic to repair is treated as disposed of (instead of there being an adjustment to the item's adjusted tax value);

    (b) Depreciation recovered is limited to the depreciation deductions claimed for Canterbury property damaged but not assessed as uneconomic to repair;

(c) An ability to choose to defer depreciation recovery income and disposal costs, upon a deemed disposal, to the 2018-19 income year if the disposal costs are not incurred or able to be estimated until then; and

(d) An ability to choose to defer insurance income upon disposal of pool depreciated items, and insurance income and repair costs of non-pool items until the 2018-19 income year, when there is no deemed disposal and repair expenditure is not incurred or able to be estimated until then.

66. Other changes related to the Christchurch earthquakes are as follows:

(a) The land tax provisions in sections CB 9 to CB 12 will not apply to compulsory government acquisitions of land and buildings affected by the Christchurch earthquakes;

(b) Expenditure that is incurred while an income-earning activity is interrupted by a Canterbury earthquake will be deductible in the year in which the activity resumes;

(c) Depreciable property to which access is restricted due to a Canterbury earthquake will be treated as being available for use while access is restricted; and

(d) The value of an asset for thin capitalisation purposes may include an amount of insurance corresponding to the amount of impairment or the derecognised value of the asset.

## 6. CHANGES TO INTEREST APPORTIONMENT FOR THIN CAPITALISATION

67. A number of changes are currently proposed as part of the thin capitalisation review following the 2013 government budget. These are discussed in **Section 12 Thin Capitalisation Review**. The enacted 2011/2012 changes to the thin capitalisation regime are as follows:

(a) Following the 2010 budget, the debt percentage threshold at which the thin capitalisation rules would apply was lowered for companies owned by non-residents, effective from the 2011-12 income year.

(b) The following changes were enacted in the Tax Administration Act 2011:

(i) Allowing the transfer of income from interest apportionment to another wholly-owned group company, effective from the 2008-09 income year.

(ii) Altering the concession for groups of companies with low interest deductions so that it applies only if the interest deduction limits are met by the group as a whole, and not just by an individual group member, effective from 23 November 2010.

(iii) Ensuring that the on-lending concession applies to all taxpayers, as intended, and not just to natural persons, effective from the 2008-09 income year onwards.

68. The International Investment Tax Act contained a number of significant amendments to the regime, particularly for “outbound” companies. (The thin capitalisation regime has applied to “outbound” companies from the first income year that began on or after 1 July 2009.)

### 6.1 Lowering of the debt percentage threshold for inbound companies

69. For companies owned by non-residents, the NZ group debt percentage threshold, above which there will be income under the thin capitalisation rules, has been lowered from 75% to 60%, from the 2011-12 and later income years (i.e. for income years beginning on 2 October 2010 onwards.) The threshold for outbound companies is unchanged at 75% (see paragraphs 70 onwards below).

70. The measurement date alternatives are unchanged: the daily average, the quarterly average, or the debt percentage at the end of the year, based on the balance date of the NZ parent.

71. If the threshold is breached - i.e. if the debt percentage of the New Zealand group exceeds 60%, and also exceeds 110% of the debt percentage of the worldwide group, the company has income calculated under a formula.

72. From income years beginning on or after 1 July 2009, the formula for calculating income has included dividends paid on fixed-rate foreign equity and fixed-rate shares that have been issued by the company and are held by NZ residents. Under the formula, such dividends are treated as if they were interest. Consequently, the income that results consists not only of interest deductions disallowed, but also a portion of the dividends referred to above, even though such dividends are not deductible.

73. A dividend paid on a stapled debt security could also be included in the formula, if the share to which it is attached fits the definition of either fixed-rate foreign equity or fixed-rate shares when the security is treated as part of the share.

74. Companies owned by non-residents, that are subject to the thin capitalisation rules should check their debt levels now. From income years beginning on or after 1 July 2009, New Zealand group debt also includes fixed-rate foreign equity, fixed rate shares, and stapled debt securities, that are held by NZ residents. These shares do not have to have been issued by the company – they could have been issued by any New Zealand group member.

### 6.2 Non-application to non-residents with no fixed establishment

75. Changes have been made in the International Investment Tax Act to limit the application of the thin capitalisation rules when non-resident companies do not carry on business through a fixed establishment in New Zealand. These companies will no longer be subject to the rules if all their New Zealand sourced income that is not relieved under a double tax agreement is non-resident passive income. The change applies to income years beginning on or after 1 July 2011.

### 6.3 Transfer of income to another wholly-owned group company

76. An amendment contained in the Tax Administration Act 2011 allows an excess debt company to transfer income arising under the interest apportionment calculation to another company that is in the same wholly owned group, provided that:

    (a) The other company has interest deductions; and

(b) The income transferred does not exceed the interest deductions, or the reduced interest deductions (if some income has already been transferred to the company under this allowance) of the transferee company.

77. This amendment applies retrospectively from the 2008-09 income year onwards.

### 6.4 Outbound Companies

78. The thin capitalisation interest apportionment rules have applied to an "excess debt outbound company" from income years beginning on or after 1 July 2009. The rules previously applied only to a NZ company with an income interest in a CFC, or a NZ parent company with an ownership interest of 50% or more in a NZ company with an income interest in a CFC.

***(a) Extension of application of the rules***
*(Refer also to page 3 of the attached PDF on Excess Debt Outbound Companies)*

79. The International Investment Tax Act extended the application of the rules so as to include:

(a) A NZ company with a direct income interest of 10% or more in a FIF that is resident in Australia; (such interests are exempt from the FIF rules under a new exemption);

(b) A NZ company with a direct income interest in a FIF for which the company uses the proposed new attributed FIF income method (AFI method) for calculating FIF income (which is to replace the branch equivalent [BE] method).

80. The AFI method can be used, from income years commencing on or after 1 July 2011, to calculate FIF income on a FIF that is a company, by:

(a) A company with an income interest of 10% or more in the FIF; or

(b) A company with a less than 10% income interest in a FIF, if the FIF is a CFC and the market value of the interest at the beginning of the accounting period can only be determined by independent valuation.

81. PIEs cannot use the AFI method. The concessional use of the method for companies with a less than 10% income interest in a FIF is not available to listed companies, unit trusts, superannuation schemes and GIFs.

82. The AFI method is based on the attributed CFC income method, and allows FIF holders to access the active income exemption applying to CFCs. (If the active income exemption applies, there will be no FIF income.)

83. The rationale behind the extension of the thin capitalisation rules appears to be that: where FIF holdings are, or could be, exempt from the FIF rules, there could be unfair loading of interest expenditure onto the NZ company holding the FIFs relative to the interest expenditure of the FIFs themselves.

84. Where FIFs are held, the question of whether the AFI method should be used is one that will have to be answered at the same time as the debt percentages are reviewed. The new default FIF calculation methods are:

(a) The fair dividend rate (FDR) method which, following amendments in the International Investment Tax Act, is available to everyone, and is no longer limited to less than 10% FIF interests; or

(b) The cost method if it is not practical to use the FDR method.

***(b) Previous exceptions removed***

*(Refer to pages 9 to 12 of the attached PDF on Excess Debt Outbound Companies)*

85. Under the previous rules, if the debt percentage threshold was breached, no income arose if the NZ group's interest deductions did not exceed $250,000 or if the company's NZ Group's finance cost was not more than $1 million. There was also a reduction in income that would otherwise result from interest apportionment if the company's NZ Group's finance cost exceeded $1 million but was less than $2 million: the reduction in the company's income was proportional to the company's share of the NZ group's finance cost.

86. The exception for interest deductions that did not exceed $250,000 has been removed. In its place, a new threshold test has been introduced (**see below**).

87. The exceptions relating to NZ Group finance costs of less than $1 million or between $1 million and $2 million, that previously applied based only on the company's finance costs, now apply only if the threshold amounts are not breached by the NZ Group as a whole (unless a return of income was filed before 20 June 2011 based on the finance cost of the company only).

***(c) The new threshold test***

*(Refer to pages 17 to 20 of the attached PDF on Excess Debt Outbound Companies)*

88. Outbound companies have the option of using a new threshold test, instead of the standard debt percentage threshold. The stated objective is to cater for a higher level of interest expenditure that is warranted due to goodwill that may not be recognised in the accounts.

89. This test is available to all outbound companies regardless of the level of interest deductions, *provided the eligibility criteria are met*. When the new threshold is breached, a proportion of the outbound company's net interest deduction is treated as income.

90. To be eligible to use the new threshold test,

(a) The net profit, *excluding* CFC and FIF investments, interest income and deductions, depreciation, amortisation and tax, must be greater than zero, for both the company's NZ group and company's worldwide group; and

(b) Interest deductions must exceed interest income for both the NZ group and the worldwide group; and

(c) The total group debt of the worldwide group must be at least 75% of group assets excluding goodwill; and

(d) At least 80% of the company's worldwide group's total debt must have been borrowed from non-associated lenders.

91. The company is required to calculate *the interest-income ratio* for both its NZ group and its worldwide group. In broad terms, the interest-income ratio is the proportion of net NZ profit (before depreciation, amortisation and tax, and before interest deductions and any interest income) used to fund interest expenditure.

92. A portion of the company's net interest deductions is treated as income, if the company's NZ group interest-income ratio is higher than the lesser of:

    (a) 50%; or

    (b) 110% of the worldwide group's interest-income ratio.

93. If the threshold is breached, income is calculated by reference to the amount by which the NZ group's interest-income ratio exceeds the threshold ratio.

94. The advantage with this test is that fixed-rate dividends are not included in the income calculation if the debt percentage is breached. Whether it results in a lower level of income than the standard test will depend on the outbound company's particular circumstances. The disadvantage with this test is that the worldwide group's interest-income ratio must always be calculated.

95. There are also additional compliance requirements. By the time its tax return is due for filing, the company must notify the Commissioner that the new threshold test has been applied, and provide:

    (a) A reconciliation of the relevant calculations to GAAP net profits; and

    (b) A reconciliation of goodwill to items presented in the GAAP balance sheet; and

    (c) Any further information that is required by the Commissioner.

***(d) Exclusion of non-residents deriving only non-resident passive income***

96. Non-residents who derive only non-resident passive income are excluded from the excess debt outbound company's NZ group.

## 7. OTHER CHANGES ENACTED IN THE TAX ADMINISTRATION ACT 2011

97. A number of other changes that affect larger companies were enacted in the Tax Administration Act 2011 and in the International Investment Tax Act. Changes relating to the reduced company tax rate were enacted in 2010 and apply from the 2011-12 income year.

### 7.1 Deductibility of use of money interest (UOMI) and tax pooling fees

98. A person is allowed a deduction for UOMI. The deduction is allocated to the income year in which the person pays the interest. This deduction supplements the general permission and overrides the capital limitation, the private limitation and the employment limitation. The other limitations (the exempt income limitation, the withholding tax limitation and the non-residents' foreign-sourced income limitation) still apply.

99. This new rule applies from the 2010-11 income year onwards. It will also apply:
    (a) For the 2009-10 income year to a person that had not filed a return for that year on or before 24 November 2010.
    (b) For the 2009-10 income year, to a person who has filed a return for that year treating use of money interest as deductible, or who has filed a NOPA for that year on or before 24 November 2010 treating use of money interest as deductible.
    (c) For the 2008-09 income year, to a person who has filed a return for that year treating use of money interest as deductible, or who has filed a NOPA for that year on or before 24 November 2010 treating use of money interest as deductible.

100. Effective from 29 August 2011, a person is allowed a deduction for expenditure incurred in purchasing an amount held in a tax pooling account to pay for provisional tax, terminal tax, or an increase in an assessment of tax as described in the tax pooling rules. The deduction is allocated to the income year in which the amount is transferred into the person's tax account by the Commissioner to satisfy the person's tax obligation. This deduction supplements the general permission and overrides the capital limitation, the private limitation and the employment limitation. The other limitations still apply as they do for UOMI (see paragraph 90).

### 7.2 Allocation rule for UOMI received

101. From the 2011-12 income year onwards UOMI is allocated to the income year in which it is received.

102. The pre-existing rules that require UOMI received to be returned in the year following receipt in some circumstances have been repealed from the 2011-12 income year. Under the old rules, if UOMI was received in the same tax year as that to which the original assessment related, the UOMI was allocated to the following year. Also under the old rules, if UOMI was received as a result of an amended assessment, the UOMI was allocated to the year following the year in which the amended assessment was issued. These rules have been repealed.

### 7.3 Tax pooling changes

103. A number of changes to the tax pooling rules are effective from 29 August 2011.

104. Pooled funds can be used to settle an increased tax liability following a voluntary disclosure after a return has been filed. Pooled funds can also be used to settle an increased tax liability due to an initial tax assessment being higher than the amount shown in the return as filed.

105. The Commissioner now has the discretion to allow the use of pooled funds to settle an increased income tax or RWT liability following a voluntary disclosure before a return has been filed.

106. The time frame within which a transfer must be requested to settle a provisional tax or a terminal tax liability has increased from 60 to 75 days starting from the day after the terminal tax date (even if that day is not a working day). In addition, the time frame has been removed altogether for a taxpayer who requests a transfer from their own funds deposited with a tax pooling intermediary, providing they have filed their return.

107. If a "person" is a company, the term refers to all companies in the group for the purpose of using tax pool accounts. Therefore, when a company group has funds deposited with a tax pooling intermediary, the removal of the time frame for transfer requests from own deposited funds applies to any company in the group at the time the funds were deposited, providing all companies in the group have met their return filing obligations.

108. The tax types to which tax pooling applies have been expanded to include tax payable under the PAYE rules, the ESCT rules, RSCT rules, RWT rules and NRWT rules, as well as income tax, GST, FBT, further income tax and imputation penalty tax.

109. New rules apply to transfers in respect of expected tax liabilities. These rules are consistent with the way in which Inland Revenue administers the tax pooling system. In general, a transfer in respect of an expected tax liability will not be accepted unless all income tax returns for earlier years have been filed and all provisional tax obligations have been met for the tax year.

110. The tax pooling changes are explained in detail in *Tax Information Bulletin* Vol 23 No 8 October 2011 (pages 35 to 55).

### 7.4 Balance date alignment for intra-group dividend exemption repealed

111. Companies within a wholly-owned group need no longer have aligned balance dates in order for the intra-group dividend exemption to apply. Section CW 10(2) has been repealed.

112. The change applies to dividends derived on or after the beginning of the 2010-11 income year.

### 7.5 Corporate spinouts

113. The corporate spinout rules in section YC 13 have been amended so as to allow the rules to apply if the original parent company holds more than 50% of the voting interest (and if relevant market value interest) in the spun-out company immediately before the spinout.

114. Before the amendment, the spinout rules could not apply unless the original parent company held 100% of the spinout company before the spinout, despite the immediate shareholding in the spun-out company pre- and post-spinout being in substance unchanged.

115. The amendment applies from 1 May 2011.

### 7.6 Directors' knowledge of shareholding continuity breach

116. Amendments that apply retrospectively from 2008-09 income year onwards more clearly specify the *circumstances in which*, the single notional person and no look-through *shareholding concessions cannot be relied on*, to avoid a shareholding continuity breach, if the directors could reasonably be expected to know that there would be a breach if the concessions were not used.

117. Under the new wording, the test is to see, without using the concessions, whether a shareholding continuity breach would have occurred ignoring the effect on shareholding continuity of certain specified transactions.

118. In addition to the existing specified transactions the effects of which are ignored (i.e. ordinary trading by less than 10% holders, and cancellation, either directly or through a manager, of shares held by less than 10% holders in a widely held unit trust), two new types of transactions are proposed, the effects which can be ignored:

    (a) "Off-market" transfers of shares in a company between persons (none of whom are a companies associated with the company) who hold less than 5% of the shares in the company.

    (b) The following transactions involving shares or options that, *in total for the company's income year*, would be a direct voting interest or direct market value interest of less than 5% if held by a single person:

        (i) The issue, redemption or cancellation by a company of its shares or options.

        (ii) A transfer of shares or options to or from the company.

        (iii) The transfer of shares or options in the company to an employee of the company from the company's employee share trust (in which only the company and its employees are beneficiaries).

### 7.7 Transitional period dividend imputation

119. The transitional period during which a company can continue to impute dividends at 0.30 ran from the beginning of the 2011-2012 income year to 31 March 2013.

120. To the extent the company has a credit balance in its ICA or FDP account from items dealt with, arising, or calculated, using the old company tax rate, the company could choose to treat the item "tax rate" in the *maximum permitted ratio* formula as 30%.

### 7.8 Tax credit for supplementary dividends

121. From the 2011-12 income year onwards, the formula for calculating the tax credit for a supplementary dividend has changed, due to the lower company tax rate, to:

    Attached imputation credit x (54/119)

### 7.9 Transitional provisional tax

122. The formulae for the standard 5% and 10% uplift methods changed for the 2011-12 income year due to the lowering of the tax rate:

    (a) Provisional tax payable under the 5% uplift method is 100% of the residual income tax for the 2010-11 income year.

    (b) Provisional tax payable under the 10% uplift method is 105% of the residual income tax for the 2009-10 income year.

## 8. OTHER CHANGES IN THE INTERNATIONAL INVESTMENT TAX ACT

123. Apart from the changes to the CFC and FIF tax regimes (see the separate sections in this website on *CFCs* and *FIFs*) the International Investment Tax Act contained a number of other changes that will affect larger companies. Two proposed changes with a general impact are discussed below.

### 8.1 Changes To The Foreign Dividend Exemption

124. Changes in s. 9 of the International Investment Tax Act to the foreign dividend exemption in s. CW 9 apply when a dividend from a foreign company is derived by a NZ resident company.

125. The exemption previously applied to all dividends received in relation to income interests of 10% or more, provided that the dividends were not paid on fixed-rate foreign equities or on rights to a deductible foreign equity distribution. The exemption also previously applied to dividends received in relation to income interests of less than 10%, except where the dividends relate to an income interest of less than 10% that was exempt from the FIF regime under one of a number of specified FIF exemptions: listed Australian companies, Australian unit trusts with adequate turnover or distributions, grey list shares relating to venture capital companies, and a grey list company with numerous New Zealand shareholders.

126. The changes mean that the exemption does not apply to dividends received in relation to *all income interests that are exempt from the FIF regime under the specified FIF exemptions*, not just a less than 10% interest, unless, one of the following FIF exemptions applies (neither of which are available to a PIE or a NZ unit trust):

    (a) The exemption in section EX 34 for interests of 10% or more in FIFs that are CFCs; or

    (b) The new exemption in s. EX 35 for interests of 10% or more in a FIF resident in Australia.

127. The exemption will not apply and foreign dividends received by a New Zealand resident company will be assessable income if the dividend is paid in relation to fixed-rate foreign equity or deductible foreign equity.

128. In addition, the exemption will not apply and foreign dividends received by a New Zealand resident company will be assessable income if:

    (a) One or more of the following exemptions from the FIF rules applies:

        (i) Section EX 31 (ASX-listed companies);

        (ii) Section EX 32 (certain Australian unit trusts: or

        (iii) Sections EX 36, EX 37, or EX 37B (various exemptions for venture capital companies); and

    (b) Neither of the following two exemptions applies:

        (i) Section EX 34 (a 10% or greater interest in a CFC) nor

        (ii) Section EX 35 (the new exemption for a 10% or greater interest in a FIF that is resident and subject to tax in Australia).

129. The foreign dividend exemption also does not apply to dividends received from a FIF interest in a grey list company for which the fair dividend rate (FDR) method is used, if the income interest in the grey list company at the beginning of the year was 10% or more. For example, if an interest held of 10% or more in a foreign company at the beginning of the 2012-13 income year dropped below 10% during the year, and the taxpayer began using the FDR method, there would be no attributed income for 2012-13 because the opening market value of the FIF is treated as zero. To compensate the foreign dividend exemption will not apply in 2012-13 and dividends received during that year will be assessable.

130. Apart from the above, foreign dividends will be exempt if received by a New Zealand resident company. The changes apply to dividends derived in income years beginning on or after 1 July 2011.

131. The definition of "deductible foreign equity distribution" has also been changed, so that the definition includes distributions that are deductible to any person, and not just the company making the distribution. This change took effect from the date of assent – 7 May 2012.

132. Note also that s. EX 20B(3)(a) mirrors the above rules by treating dividends received by a CFC as attributable if the foreign dividend exemption would not have applied had the CFC been a New Zealand resident company.

### 8.2 0% Rate Of Approved Issuer Levy

133. A 0% rate of approved issuer levy applies from 7 May 2012 – the date of assent of the International Investment Tax Act, for a registered security that meets all the following requirements:

    (a) The security must be denominated in New Zealand dollars.

    (b) The issue of the security must be a public offer and not a private placement.

    (c) The security must not be an asset-backed security.

    (d) The security must be administered through a fixed establishment in New Zealand.

    (e) The security must be listed and traded in a securities market, and at the time of each interest payment:

        (i) The security must be one of a number of identical debt securities; and

        (ii) There must be at least 100 persons who each hold a security in that class; and

        (iii) The issuer must have reasonable grounds to expect that each of 100 or more persons, is not associated with the issuer other than by being a beneficiary of a trust established to protect their interests, and is not associated with another member of the group; and

        (iv) No person or group of associated persons must hold more than 10% by value of the class of securities.

134. If the 0% rate is used, a statement must be provided to the Commissioner showing the prescribed details by the time that AIL would have been payable. This will be the usual IR 67A showing an AIL payment of zero.

## 9. CHANGES CONTAINED IN THE ANNUAL RATES TAX ACT

135. There are a number of changes contained in the Annual Rates Tax Act that will affect larger companies.

### 9.1 Deduction For Expenditure On Unsuccessful Software Development

136. An amendment contained in the Annual Rates Tax Act allows for an immediate deduction of expenses incurred on unsuccessful software development projects, in the year that the development of the software is abandoned. The deduction is set out in a new section DB 40B.

137. In order for a person to qualify for the deduction all the following requirements must be met:

(a) The person must incur expenditure in the development of software for use in the person's business.

(b) The development of the software must be abandoned when the software is not depreciable property of the person.

(c) The software must have been depreciable property of the person if the development had been completed.

138. Note especially that the Finance and Expenditure Committee sought to make it clear that the deduction is for expenditure on *software that would need further development to become depreciable property*. The deduction overrides the capital limitation and applies from the 2008–09 income year onwards.

### 9.2 Taxation Of Shares Issued Under A Profit Distribution Plan

*(Refer to the attached PDP Profit Distribution Plans for details of the legislation)*

139. Under a profit distribution plan (PDP) a company issues bonus shares to all shareholders and offers to repurchase the shares immediately after the shareholder receives them. If the shareholder does not elect for the repurchase, the shareholder retains the bonus shares.

140. The previous tax treatment of PDP's was covered in Inland Revenue Product Ruling *BR PRD 05/09*. That ruling held that a distribution of shares under a PDP is a non-taxable bonus issue. If the shares were repurchased, the cash amount received was treated as a taxable dividend and imputation credits could be attached.

141. In April 2009 the government announced its intention to amend the law so that bonus issues under PDPs are taxed in the same way as shares issued under other dividend reinvestment plans. The new tax rules are contained in the Annual Rates Tax Act and apply from 1 October 2012.

#### *(a) Definition of a PDP*

142. There is a new definition of a PDP in s. YA 1. A PDP will mean a scheme comprising one or more steps undertaken by company by which it:

(a) Notifies all shareholders that shares are to be issued on a particular date; and

(b) Gives those shareholders an option to have some or all of the shares issued to them repurchased by the company.

***(b) A share issued under a PDP will be a dividend***

143. A share issued by company under a PDP will be a dividend. The amount of the dividend will be the money offered by the company for the repurchase of the share. [s. CD 7B(1) & (2)]

144. If a shareholder exercises the option to have a share that was issued under a PDP repurchased by the issuing company, any amount paid by the company to repurchase the share will not be a dividend. [s. CD 23B]

145. If the share is repurchased, s. CD 22, which contains the rules to determine the extent to which a payment by a company to a shareholder is a return of capital and not a dividend (the off-market share cancellation dividend rules), will not apply. [s. CD 7B(3)]

***(c) Available Subscribed Capital (ASC) implications***

146. The amount offered by the company for the repurchase will be a "subscription" for the purposes of determining ASC. Any amount paid on the repurchase of a share issued under a PDP will be a "return" for ASC purposes. [s. CD 43(6)(ab)]

***(d) Tax accounting implications***

147. The tax accounting entries will be as follows:

Upon issue of the share under a PDP:

| | | | |
|---|---|---|---|
| Retained earnings | Dr | $XXX | |
| Available subscribed capital | Cr | | $XXX |

Upon repurchase of a share issued under a PDP:

| | | | |
|---|---|---|---|
| Available subscribed capital | Dr | $XXX | |
| Bank | Cr | | $XXX |

***(e) Bonus issue in lieu tax rules will apply***

148. The definition of a "bonus issue" has changed so as to include the issue of shares under a PDP. The definition of a "taxable bonus issue" has also changed so as to include shares issued under PDP. [Amendments to section YA 1 definitions]

149. The same rules for the calculation of tax as those that apply to a bonus issue in lieu apply to shares issued under a PDP. This is:

33% x (amount offered for repurchase + credit attached or tax paid)

Credit attached or tax paid is: ICs or FDP credits attached or, if the share repurchase is offered by a foreign company, the foreign withholding tax paid. [Amendments to s. RE 14 and RE 15]

150. There is a corresponding amendment to the quantification of the dividend derived upon a bonus issue: the amount of the dividend arising on a bonus issue will include any resident withholding tax (RWT) payable on the dividend. [Amendment to section CD 7(2)]

***(f) Treatment when non-residents are issued shares under a PDP***

151. Shares issued under PDP to a non-resident will be treated as non-cash dividends subject to non-resident withholding tax (NRWT) and the rules that apply to the calculation of tax payable on a non-cash dividend to non-residents will apply. To the extent the dividend is not fully imputed or FDP credited, the pre-treaty rate of NRWT is 30%. To the extent the dividend is fully imputed or FDP credited, the NRWT rate is 15%. [Amendments to section RF 10(5)]

### 9.3 Expenditure On Account Of An Employee To Include Future Expenditure

152. The meaning of "expenditure on account of an employee" in s. CE 5(1) has been amended. Expenditure on account of an employee means a payment made by an employer relating to expenditure incurred by an employee *or to be incurred by an employee*. A payment of expenditure on account of an employee is included in their salary and wages. The amendment means that expenditure on account of an employee's future expenditure will be included in an employee's taxable income. The amendment applies for the 2008-09 and later income years. [Amendment to s. CE 5(1) by s. 11 of the Annual Rates Tax Act]

153. Under s. CW 17(1), expenditure on account of an employee incurred by an employer in connection with the employee's employment or service is exempt income of the employee to the extent to which, if the employee had incurred the expenditure, the employee would be allowed a deduction for the expenditure if the employment limitation did not exist. Section CW 17(1) has been amended so that the reference to "expenditure on account of an employee" is now a reference to "expenditure on account of an employee, being a payment to which section CE 5(1) applies". This means that the exemption in s. CW 17(1) also applies to expenditure on account of an employee relating to expenditure to be incurred by an employee.

### 9.4 Tightening Up Debt Remission Within A Consolidated Group

154. Remission of a financial arrangement within a consolidated group now results in income unless the parties were *within the consolidated group* for the whole term of the arrangement.

155. Under the previous rules in section FM 8, income from the remission of a financial arrangement within a consolidated group is excluded income if the parties were *a group of companies* for the whole term of the arrangement. Under the amended s. FM 8 the parties will have to have been *consolidated group companies* for the whole term of the arrangement.

156. The amendment applies from the 2008-09 income year except for a tax position that is inconsistent with the change and is taken in a tax return filed before 14 September 2011. [Amendment to s. FM 8(3)(b)(ii) in s. 72 of the Annual Rates Tax Act]

## 10. CHANGES CONTAINED IN THE ASSETS EXPENDITURE TAX ACT

157. The remedial income tax changes in Assets Expenditure Tax Act were discussed in Weekly Comment 6 September 2013 and are reproduced here. As far as the major changes are concerned:

 (a) The Mixed-use Assets amendments as originally were discussed 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 are contained in an Inland Revenue *Special Report* and are detailed in the attached PDF *Mixed-use Assets*.

 (b) The changes relating to lease inducements and lease surrender payments were discussed in *Weekly Comment* 22 March 2013 and are detailed in the attached PDF *Lease Inducement and Lease Surrender Payments*. The rules have been enacted in essentially the same form, with the principal change relating to limiting the residential exemption to natural persons. The rules are explained in an Inland Revenue *Special Report*.

 (c) The changes relating to short-term charge facilities and excepted financial arrangements were discussed 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.

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

158. 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.

159. 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.

160. 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."

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

161. 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.

162. 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.

163. 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).

### 10.3 Deductibility of repairs and maintenance on commercial fit-out

164. 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.

165. 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.

### 10.4 Capital contributions for farming and aquaculture business

166. 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.

167. 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.

### 10.5 Limitation of time limit for tax refunds

168. 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*.

169. 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.

## 11. CHANGES PROPOSED IN THE FOREIGN SUPERANNUATION TAX BILL

170. The new rules proposed for the taxation of interests in foreign superannuation schemes and the proposed new rules applying to mineral mining are the main focus of the Foreign Superannuation Tax Bill.

### 11.1 Foreign superannuation tax changes

171. The inclusions and exclusions, circumstances in which the FIF rules can continue to apply, and the reduced-rate temporary amnesty for pre-1 April 2014 withdrawals are explained in some detail in *Weekly Comment* 7 June 2013.

172. There are two alternative methods proposed for calculating taxable income: the formula method and the schedule method. The determination of the assessable period, which is the period during which the exemptions will not apply, is of central importance. How the assessable period is determined, and the explanation of the formula method is contained in *Weekly Comment* 14 June 2013.

173. The schedule method is explained in *Weekly Comment* 21 June 2013.

### 11.2 Financial reporting requirements for tax purposes

174. Effective from the income year after the year in which the Financial Reporting Act 1993 is repealed (expected to be the tax year commencing 1 April 2014 or equivalent), clause 110 of the Superannuation Tax 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 section 21C; and

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

175. The retention of records rules in section 22 will apply to financial statements prepared under the new minimum requirements, and section 17(2), which requires companies to produce a form of financial statements is being repealed.

176. New section 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 section 21C.

177. It is stated on page 49 of the *Commentary* on the Bill that:

"While nothing has been finalised, the intention is that the financial statements will be simple and based on double entry and accrual concepts, using where possible tax-related figures. Certain notes are likely to be required, including a statement of accounting policies, disclosure of related-party transactions and where necessary, a book-to-tax reconciliation. All of this detail will be subject to full consultation later this year."

### 11.3 Imputation credits and Australian dividends

178. A proposed amendment addresses a mismatch arising under the tax rules when imputation credits are calculated on the basis of the dividend paid but income tax arises only on the foreign investment fund (FIF) income (which could be lower than the amount of the dividend). Changes, 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. (emphasis added)

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. (emphasis added)

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."

179. 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.

180. 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 FIF income" limitation in section EX 59 did not apply, is treated as if it were assessable income of the person.

181. 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.

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

183. In addition, clause 15 inserts new section CV 18 which is designed to ensure that the tax credit calculated under section LE 8B is included in the person's income.

### 11.4 Bad debt deductions for holders of debt

184. The Superannuation Tax Bill proposes 2 changes to the tax rules regarding bad debt deductions for holders of debt:

    (a) Bad debt deductions permitted: Bad debt deductions will be where the debt has been remitted by law (for instance, following liquidation or bankruptcy of the debtor), or where a debtor company entered into a composition with its creditors; and

    (b) Bad debt deductions limited: Bad debt deductions of holders or dealers in financial arrangements will be limited to the purchase price paid for a debt that was purchased.

185. Under existing section DB 31(1)(a), a deduction for a bad debt is denied unless the debt is written off as bad in the income year. Clause 29 of the Bill contains a proposed amendment to this subsection, which will allow a person a deduction for a bad debt if either:

    (a) The debt is written off as bad in the income year; or

    (b) The debtor is released from making all remaining payments under the *Insolvency Act 2006* (excluding Part 5, subparts 1 and 2), or under the *Companies Act 1993*, or under the laws of a foreign country and the person is required, under section EW 29, to calculate a base price adjustment for the debt for the income year; or

    (c) The debtor is a company that is released from making all remaining payments by a deed or agreement of composition, and the person is required, under section EW 29, to calculate a base price adjustment for the debt for the income year.

186. This amendment will apply to a debt that goes bad on or after the date of assent of the Bill if a tax return has been already filed for the year in which the debt went bad. Otherwise, it will apply retrospectively to a debt that went bad in the 2008-09 income year or later.

187. The proposed amendment will mean that a creditor can take a deduction for a debt that is a bad debt, without having written the debt off, if a debtor goes into liquidation or

bankruptcy, or when a debtor company has entered into a composition with them. The stated background to this amendment in the *Commentary* is that the requirement to write off a debt as bad can be unnecessarily onerous for example, for "mum and dad" investors in failed finance companies, who may not have up-to-date knowledge of the financial state of the debtor.

188. Note that a requirement for the deduction is that a base price adjustment must be performed.

189. Other proposed amendments relating to bad debt deductions for dealers in financial arrangements are to apply from the date of introduction of the Bill: 20 May 2013:

(a) Clause 29 contains:

(i) New section DB 31(4B), under which a dealer will be allowed a deduction, for a debt acquired for less than its face value, only to the extent of the consideration the dealer pays for acquiring the debt.

(ii) New section DB 31(4C), under which a dealer will be allowed a deduction, for a debt that a *limited recourse arrangement* relates to, only to the extent to which the limited recourse arrangement does not relate to the debt.

(b) Clause 26 contains new section CZ 27 which provides for a clawback of previous bad debt deductions to the level proposed under new sections DB 31(4B) and (4C), for a dealer who still holds, on the first day of the 2014-15 income year, a debt which arose before the introduction date of the Bill and for which a bad debt deduction has been taken in a tax return for an income year that started before the date of introduction of the Bill.

190. A *limited recourse arrangement* is defined for this purpose, in relation to a debt, as an arrangement:

(a) That is for the person's business of dealing in or holding financial arrangements; and

(b) That requires repayment or no repayment of an amount under the arrangement contingent upon payment or no payment, in whole or in part, of the debt.

191. This amendment is explained in the *Commentary* to the Bill on page 47 as follows:

"Both original and subsequent holders of debt who carry on a business of dealing in or holding the same or similar financial arrangements will be limited to taking bad debt deductions up to the true economic loss. This means original holders will be able to take bad debt deductions up to the amount lent, and subsequent holders will be able to take bad debt deductions up to the purchase price.

Deductions for amounts greater than the economic loss will be allowed if the amounts have previously been returned as income.

As an anti-avoidance measure, a holder of debt who deals in or holds the same or similar financial arrangements will only be able to take bad debt deductions for the true money at risk. This means that if the purchase of a debt was funded by a limited recourse arrangement, a bad debt deduction will only be allowed to the extent to which the limited recourse arrangement does not relate to the debt."

### 11.5 Notional interest adjustments under IFRS will not have a tax effect

192. A change is proposed to clarify that taxpayers with interest-free and low-interest loans should not be able to claim tax deductions on notional interest amounts that can arise under IFRS financial accounting. Effective from the 2013-14 income year onwards, further modifications to the IFRS rules, when the IFRS financial reporting method under section EW 15D is used, will prevent notional interest or adjustments to a loan's fair value from being recognised for tax purposes:

    (a) Under clause 38:

    (i) New section EW 15D(2)(ac) will mean that no interest can be recognised for tax purposes in relation to an interest-free loan; and

    (ii) New section EW 15D(2)(ad) will mean that a reduction in the recognised value of a loan, due to a concessional interest rate, below the consideration actually provided, will not be recognised for tax purposes.

    (b) Under clause 55, new section EZ 64 will mean that a change of spreading method adjustment under section EW 26(2) will apply to a loan for which notional interest was recognised in the 2012-13 income year, and for which notional interest is not allowed to be recognised from the 2013-14 income year under new section EW 15D(2)(ac). The change of spreading method adjustment must be undertaken in the 2014-15 income year.

## 12. THIN CAPITALISATION REVIEW

193. On 6 June 2013 Inland Revenue released *Thin capitalisation review: technical issues* ("the Technical Note") which sets out the views of Treasury and Inland Revenue on the technical details relating to the proposals. These technical details have been formulated after the feedback requested in the *Review of the thin capitalisation rules – An officials' issues paper* released in January 2013 ("the January IP") discussed in *Weekly Comment* 1 March 2013.

194. It is possible these technical details could change as a result of the feedback that was requested by 28 June 2013, but the Technical Note provides a clear indication, in the meanwhile, of officials' thinking on the subject.

### 12.1 Expanding the rules to apply to a group of foreign investors "acting together"

195. The proposal in the January IP was that the inbound thin capitalisation rules be widened to include companies in which non-residents who are not necessarily associated persons according to the tax definition, but who *act together*, hold an interest of 50% or more. What it means to *act together* would not be exhaustively defined, but would include at least:

    (a) Explicitly cooperating with each other through a written or tacit shareholder agreement; or

    (b) Being effectively coordinated by a person or group of people, such as a private equity manager or managers.

196. Submissions on the January IP apparently raised concerns about the uncertainty the proposal would cause, so the Technical Note contains a revised alternative under which the thin capitalisation rules would apply if:
    (a) 50% or more of the entity's shares are owned by a group of non-residents who (directly or indirectly) hold debt in proportion to their equity in the entity; or
    (b) The entity has fewer than 25 shareholders and
        (i) The shareholders have a shareholders' agreement that sets out how the entity should be funded; and
        (ii) 50% or more of the shares are owned by non-residents; or
    (c) A person or group of people, such as a private equity manager, effectively coordinates non-residents who hold 50% or more of the entity's shares.

197. At present, interest deductions are denied when certain debt instruments are recharacterised as equity:
    (a) So-called "substituting" debentures, issued to a shareholder or a class of shareholders, where the amount of the debenture is determined by reference to specified aspects of the shares of the company, for which a deduction for any interest payable is denied under s. FA 2; and
    (b) Stapled debt securities where, under an arrangement with the (widely held) issuing company, the debt security can be disposed of only together with the share, for which interest deductions are denied under s. FA 2B.

198. Officials have stated that:
    (a) The substituting debenture rule would not apply to entities subject to the thin capitalisation rules (as the debt in proportion to equity rule would apply to such entities instead);
    (b) The stapled debt securities rule would effectively be expanded to include companies that are not widely held and in which non-residents hold 50% or more of the shares; and
    (c) The "catch-all" rule where non-residents are effectively coordinated by a private equity manager is required to ensure that the thin capitalisation rules cannot be circumvented by structuring so as to avoid the brightline tests.

199. Officials have stated that the revised *acting together* test would not be effective for trusts, as settlors do not require a return on settlements. The proportionality rule does not seem to work (i.e. measuring debt in proportion to settlements). Therefore, officials' are of the view that the *acting together* test for trusts should be as originally proposed in the January IP (and set out in paragraph 3 above). The Technical Note also contains a number of other complicated suggestions for trusts described in paragraph 14 onwards below.

200. This means that there will be two *acting together* tests: one that applies to trusts and one that applies to companies.

201. The proposal in the January IP that for entities subject to the *acting together* test the worldwide group would be the same as the New Zealand group is unchanged. This means the 110% rule will be ineffective. Instead, genuine third party debt will be

allowed, but shareholder debt will be limited to a maximum of 10% of the genuine third party debt, as explained further below.

### 12.2 Excluding shareholder debt from the worldwide group debt proposal

202. In the January IP officials proposed that the worldwide group debt threshold would not include any debt that is linked to shareholders of group entities, and that debt would be excluded in the following cases:

(a) The debt is owed to a person having an income interest in a group entity; or

(b) The debt is owed to a person that has received funds directly or indirectly from a group entity, a person with an income interest in a group entity, or an associated person, on the condition or expectation of both parties that some or all of those funds would be used to provide the debt. This condition would prevent back-to-back loans;

(c) The security for the debt or a guarantee of repayment comes from outside the worldwide group, which could indicate that the debt has been artificially increased to a level that would not be sustainable if the worldwide group was standing alone. The following example was provided:

*Example*: Cayman Co. and Bahama Co each own 40% of NZ Co. They also own 47% of Tiger Co which is not part of the worldwide group for thin capitalisation purposes. Tiger Co has $100 of assets. NZ Co has $20 worth of assets. NZ Co borrows $20 from a bank. The loan is secured over NZ Co's asset and Tiger Co's assets. The proposal is that the loan may not be included in the worldwide group's debt-to-asset ratio.

203. Note also that in the January IP, officials stated that because it is difficult to anticipate all the ways in which shareholder debt might be transformed into apparently external debt, a specific anti-avoidance rule might be required in addition to the listed exclusions.

204. These proposals are unchanged. In addition, in the Technical Note officials have proposed an exception under which debt owed to a shareholder can be included in the worldwide debt ratio if the entity:

(a) Is publicly listed; and

(b) Has publicly traded debt; and

(c) That shareholder owns less than 10% of the company.

205. The effect of the proposals to exclude shareholder debts, as noted above, will be to limit these types of debts to 10% of total funding, otherwise interest deductions will be denied:

(a) For taxpayers that are subject to the thin capitalisation rules due to the *acting together* test, this will result from the fact that the worldwide group (which will also be the NZ group) will have a level of debt that excludes all shareholder debts. Therefore, when applying the worldwide group test, allowable total NZ debt (including shareholder debt) cannot exceed 110% of "worldwide debt", which will in fact be third party debt excluding shareholder debt.

(b) For other taxpayers subject to the thin capitalisation regime under the existing rules, excluding shareholder debt from the worldwide group debt ratio will also

mean shareholder debt in NZ must be limited to an additional 10%, or interest deductions will be denied.

### 12.3 Extension of the rules to trusts

206. In the January IP, officials stated their concern that in circumstances where a New Zealand business is owned by a resident trustee of a trust, and the trust has been settled by a resident subsidiary of a foreign company, the trustee will be able to borrow its capital directly from the foreign company and will not be subject to the thin capitalisation rules.

207. The proposal in the January IP was that the thin capitalisation rules should apply to a resident trustee if 50% or more of settlements made on the trust have been made by: a non-resident or a group of non-residents acting together, or by an entity that is subject to the inbound rules.

208. In the Technical Note, officials have proposed that:

    (a) Due to the difficulty in applying a "debt proportional to equity" type test to trusts, for the purposes of determining whether persons are *acting together*, the *acting together* test for trusts would remain as proposed in the January IP and described in paragraph 3 above.

    (b) A trust would be subject to the thin capitalisation rules if a person that is subject to the thin capitalisation rules (i.e. is an entity described in s. FE 2) has the power to appoint or remove a trustee, to cover situations where a non-resident takes over control of a trust originally settled by a NZ resident.

    (c) The worldwide group of any trust (including a trust settled by a single non-resident) would be the same as the New Zealand group, and any debt from a person associated with the trust (such as the trustees, settlor, and beneficiaries of the trust) will be excluded from the trust's worldwide group debt: this means there will be no constraints on genuine third party debt, but related party debt will be limited to 60% (if the trust is able to use the safe harbour by having total debt of 60% or less), or 10% of its third party debt (if the 110% of the worldwide group test is used).

    (d) The worldwide group of any company controlled by a trust that is subject to the thin capitalisation rules will also be the same as the New Zealand group, and the worldwide debt ratio of such a company will also exclude related party debt.

    (e) Two other technical changes may be warranted to ensure the rules work as intended:

        (i) The NZ group of the trust should be only the trust; and

        (ii) An entity owned by a trust that is an excess debt entity will itself be an excess debt entity.

    (f) There should be no specific exclusion for securitisation vehicles: there will be no restriction on genuine third party debt in any case, but the rules will apply if some of the debt has come from those associated with the trust.

### 12.4 Excluding capitalised interest from asset values

209. In the January IP, officials proposed that where asset values include capitalised interest costs, those interest expenses should be deducted from asset values to the extent that the expenses have been deducted for New Zealand tax purposes.

210. Following submissions, officials are considering limiting this restriction to assets that are not carried at fair value. Officials have accepted submissions that, for assets carried at fair value, capitalising interest has no real impact because of the requirement that they be carried at fair value.

### 12.5 Prohibiting uplifted asset values

211. In the January IP, officials expressed concern regarding uplifted asset values for intangibles and internally generated goodwill following internal reorganisations. Consequently, officials proposed that when the total asset value of a New Zealand or worldwide group increases as a result of the sale of assets between associated persons, the increase will be ignored for thin capitalisation purposes.

212. This proposal has been retained in the Technical Note. However, in the January IP officials noted that an exception might be made if:

    (a) The sale of assets took place as part of the sale of the entire group to a previously non-associated party; and

    (b) The increased asset value reflected the fair value of the assets to the buyer, as determined under GAAP; and

    (c) A sensible rule can be written for determining when the sale of assets is linked to the sale of the entire group.

213. In the Technical Note, officials mentioned discussing with submitters the possibility of recognising asset impairment in an offshore company. Officials do not consider this can occur at present, so no remedial change is proposed relating to this.

## 13. DRAFT INTERPRETATION STATEMENT: COMPANY ADMINISTRATION COSTS

214. Draft Interpretation Statement INS0033 *Deductibility of Company Administration Costs* was released in 2011 and intended to replace *Company deductions* an earlier draft released in 2005, but has still not been released in final form. The *Public Rulings Work Programme* as at 20 September states it is on hold pending finalisation of legislative amendments addressing black-hole expenditure, and will be published to complement these changes.

215. In the Exposure Draft, the Commissioner has reconsidered the analysis and conclusions contained in the earlier draft *Company Deductions*. The draft conclusions regarding the deductibility of various types of company administration costs are set out below.

216. *Annual general meeting costs* are considered to be *deductible* as part of the carrying on of the company's business.

217. *Audit fees* are *deductible* because the expenditure arises from the requirement to comply with statutory obligations and is a recurrent annual expense.

218. *Costs associated with directors authorising dividends* are *deductible* on the basis that they are incurred in the process of carrying on the company's business.

219. *Costs associated with allocating and paying dividends and disputes over dividends* are *not deductible* because such costs are incurred in applying profits and/or are capital expenditure.

220. *Legal and accounting fees associated with company administration costs* would either be *deductible or non-deductible* depending on the deductibility of the specific company administration costs to which the legal and accounting costs relate. However a deduction may be available under section DB 62, which allows a deduction for legal expenses no greater than $10,000.

221. *Listing fees* are *non-deductible* on the basis that they are capital expenditure. However a deduction maybe available under section DB 5, which allows a deduction for money borrowed for use as capital. For example, a deduction would be available under that section for listing fees paid in relation to the issue of debt securities.

222. *Share registry expenses* would generally be regarded as being on revenue account and would therefore be deductible, except where share registry expenses relate to matters that create enduring benefits such as in relation to mergers, acquisitions, migrations etc. It is therefore necessary to *consider the facts in each case*.

223. *Special meetings costs relating to altering the company's constitution or altering shareholders rights* would generally be *non-deductible* except in circumstances where the alteration of shareholders rights coincide with the interests of the company. It may be that the alteration of the rights of shareholders is merely ancillary or incidental to expenditure incurred for the purpose of the company's business activities, in which case the expenditure would be deductible.

224. *Special meetings costs relating to arrangements with creditors* would be *deductible* because such costs are not expenditure that is made "once and for all" and do not bring into existence an identifiable asset.

225. *Costs incurred in respect of a special meeting for the purpose of considering the liquidation of a company* are *not deductible* because expenditure incurred in closing the business is not deductible as it is incurred in disposing of a business and ceasing to derive income. However if the liquidator continues to carry on the company's business, expenditure incurred during the period that the company is liquidation may be deductible.

226. *Costs relating to special meetings for major transactions*–such as to consider whether to ratify an action by directors in exercising their power to manage the company's business– would be *deductible*. In general, expenditure incurred holding such special meetings would be directly related to a company's business.

227. *Expenditure incurred on a special meeting to consider a takeover offer* may or may not be deductible. It *depends on the facts in each case*. Expenditure incurred merely to provide information to shareholders as to the adequacy of a takeover offer is not deductible. Such expenditure would be incurred in providing information to shareholders in relation to a takeover offer to obtain a benefit of a capital nature and is therefore capital expenditure. Expenditure incurred in providing information to shareholders regarding

a takeover offer with a view to preventing a takeover offer that would detrimentally affect the company's ability to continue its business in the same form is deductible.

228. *Expenditure relating to the filing of statutory returns* is *deductible* because such expenses relate to maintaining the company as a statutorily compliant entity and are not about enlarging or altering the business structure.

## 14. COMPANIES AND LIMITED PARTNERSHIPS AMENDMENT BILL

229. The *Companies and Limited Partnerships Bill* ("the CLP Bill") as reported from the Commerce Committee contained a major change from the Bill that was initially introduced. The requirement for companies and limited partnerships to have a resident agent, and all the consequential requirements, has been omitted. Instead, there is now a requirement for a company director or a general partner of a limited partnership who lives in New Zealand (or meets "reciprocal arrangement country" requirements). Additional information requirements include the date and place of a director's birth (not to be made publicly available) and, in the case of companies, the ultimate holding company.

### 14.1 Commencement date

230. The requirement for a director or general partner who lives in New Zealand and the enhanced powers of the Registrar are to come into force 6 months after the date on which the Act receives the Royal assent, unless brought into force earlier by the Governor-General by Order in Council. The rest of the Act will come into force on the day after the date on which it receives the Royal assent.

231. In conjunction with the transitional provisions in sections 22B, 22C, 52A and 52B, this means that:

   (a) A company registered later than 6 months after the Act receives the Royal assent must comply with all the new requirements.

   (b) A company registered earlier than 6 months after the Act's date of assent, which includes all existing companies, will have a further 6 months after the rules come into force within which to organise for a director who meets the new requirements to live in New Zealand etc. (see paragraph 213 below) – i.e. 12 months from the date of assent.

   (c) A company registered earlier than 6 months after the Act's date of assent must provide details of directors' date and place of birth and details of any ultimate holding company etc.(see paragraph 214 below) by the date the rules come into force – i.e. by 6 months from the date of assent.

   (d) A limited partnership registered later than 6 months after the Act receives the Royal assent must comply with all the new requirements.

   (e) A limited partnership registered earlier than 6 months after the Act's date of assent, which includes all existing limited partnerships, will have a further 6 months after the rules come into force within which to organise for a general partner who meets the new requirements for a natural person to live in New Zealand etc. (see paragraph 218 below) – i.e. 12 months from the date of assent.

(f) A limited partnership registered earlier than 6 months after the Act's date of assent must provide details of their natural person general partners' date and place of birth etc. (see paragraph 219 below) by the date the rules come into force – i.e. by 6 months from the date of assent.

### 14.2 Criminalisation of breaches of certain directors' duties

232. Criminal sanctions are being introduced for very serious breaches of two existing duties that directors owe to their companies and creditors. The Commerce Committee considered that such behavior is "sufficiently blameworthy to warrant criminal punishment".

233. Under new section 138A of the *Companies Act 1993*, a director commits an offence and is liable upon conviction to be imprisoned for up to 5 years or fined up to $200,000 if:

(a) The director breaches the duty to act in good faith and in the best interests of the company, and the breach is seriously detrimental to the interests of the company; or

(b) The director breaches the duty not to agree to, or cause or allow, company business to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors, and the director knows that the breach will result in serious loss to the company's creditors.

### 14.3 One or more directors to live in New Zealand and other measures

234. Section 10 of the *Companies Act 1993*, which stipulates the essential requirements, will under replacement paragraph (d), require at least 1 director to live in New Zealand, or live in an "enforcement country" and be a director of a company registered in that country.

235. Amended registration requirements in section 12 will require:

(a) Directors to provide details of their date and place of birth;

(b) Directors who live in an "enforcement country" to confirm that they are directors of a company registered in that country; and

(c) The proposed company's "ultimate holding company information".

236. "Ultimate holding company information" essentially means the name of the ultimate holding company and country of registration. Any changes in ultimate holding company information are required to be delivered to the Registrar for registration within 20 working days of the date of the change.

237. The same requirements will apply to amalgamating companies and an amalgamated company.

238. Under new section 367A, details of a director's date and place of birth must be kept confidential and the *Official Information Act 1982* will not apply to that information.

### 14.4 One or more general partners to live in New Zealand and other measures

239. Section 8 of the *Limited Partnerships Act 2008* (the "LPA") is to be amended so as to require a limited partnership to have a general partner:
    (a) Who is a natural person who lives in New Zealand, or lives in an "enforcement country" and is a director of a company registered in that country; or
    (b) That is a partnership governed by the *Partnership Act 1908*, which has at least 1 partner who is a natural person who meets the above requirements; or
    (c) That is a company registered under the *Companies Act 1993*.

240. Amended registration requirements in section 52 will require every general partner who is a natural person to:
    (a) Provide details of their place of birth (in addition to the existing requirement to provide their date of birth);
    (b) Confirm that they are directors of a company registered in an enforcement country, if they live in that country.

241. Details of the date and place of birth will be kept confidential: only the Registrar may search the Register by reference to those criteria.

242. The Commerce Committee has left unchanged the qualification requirements for a general partner, contained in new sections 19A and 19B of the LPA. There are no qualification requirements to be a limited partner of a limited partnership.

243. The Commerce Committee has also left unchanged all of the new provisions in sections 103A to 103G relating to persons prohibited from managing limited partnerships, and general partners who may be disqualified by the Court.

### 14.5 No long-form amalgamations of code companies

244. A code company is defined in section 2A of the *Takeovers Act 1993*. The definition is for the purposes of the takeovers code. A code company is either a listed company, or a company that has 50 or more shareholders. A code company can remain a code company for certain time periods before and after these criteria were met, or ceased to be met, for the purposes of certain parts of the takeovers code.

245. A code company will not be allowed to amalgamate under sections 220 and 221 of the *Companies Act 1993*. These provisions allow ordinary or "long-form" amalgamations.

246. The stated purpose behind this change is to ensure that shareholders of companies that fall under the takeovers code will not be disadvantaged if a change to the company is effected under the *Companies Act 1993* rather than the takeovers code.

247. As part of the changes, there will be more rigorous voting thresholds and additional judicial oversight for court-approved schemes of arrangement, amalgamation, or compromise under Part 15 of the *Companies Act 1993*. For court-approved schemes, the changes will provide a mechanism for the scheme promoter to seek a preliminary "no objection" statement from the Takeovers Panel, which could assist the court to decide whether to approve the scheme.

## 15. FINANCIAL REPORTING BILL

248. The *General policy statement* in the *Explanatory note* states the objective of the *Financial Reporting Bill* ("the FR Bill) is to require an entity to prepare financial statements only where any of 3 indicators that financial reporting is in the public interest are met:

    (a) The entity is **accountable to the public**:

    (i) Because it is owned by taxpayers and ratepayers (such as government departments, Crown entities and local authorities); or

    (ii) Because it has sought funding through debt or equity instruments offered to the public (entities covered by the provisions of the FMC Bill and the reporting requirements set out in the FR SOP, as discussed last week); or

    (iii) Because it takes deposits from the public, or holds assets in a fiduciary capacity for broad groups of outsiders (for example, banks, insurers, and mutual funds); or

    (iv) It receives donations and bequests direct from the public - a main change in the Bill being a requirement for registered charities to adhere to financial reporting standards issued by the *External Reporting Board* (the "XRB"); specified non-profit entities – those with total operating payments of $40,000 or more for the immediately preceding 2 accounting periods – must prepare financial statements in accordance with generally accepted accounting practice ("GAAP"); (see paragraphs 26 onwards below).

    (b) The entity is **economically significant** because it is a large entity, or a large overseas company. A large entity is one where:

    (i) At the balance date of each of the two preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed $60 million; or

    (ii) In each of the two preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds $30 million.

    (c) Due to the **separation between ownership and management**, owners or members of an entity are likely to need financial statements. Accordingly the requirements to prepare general-purpose financial statements cover:

    (i) A company with 10 or more shareholders, unless shareholders holding 95% of the votes "opt out" of compliance under the "opt out" rules for a company that is not an issuer; or

    (ii) A company with fewer than 10 shareholders where shareholders holding at least 5% of the voting shares "opt in" and require the company to comply with general-purpose financial reporting requirements.

249. Apart from the above, the *major impact of the FR Bill will be to remove the requirement for non-large non-issuer companies to prepare general-purpose financial reports*. Although, as noted above, companies can "opt in" to the reporting requirements.

250. The FR Bill widens the powers of the XRB to issue financial reporting standards for a range of entities. It also changes the organisation of financial reporting legislation: only core financial reporting principles and definitions that are intended to apply to more than one class of reporting entities (such as the definition of "large") will be included in

the Financial Reporting Act itself. All substantive reporting requirement and related offence provisions to be covered in sector, industry, and entity- specific Acts.

### 15.1 Commencement date

251. The new Financial Reporting Act comes into force on 1 April 2015. However, various portions of the new Act will come into force on different dates appointed by the Governor-general by 1 or more Orders in Council.

### 15.2 Tiers of financial reporting

252. The XRB is to continue to implement the strategy for establishing different tiers of financial reporting as set out in sections 34 to 34D of the *Financial Reporting Act 1993*. In November 2012, the New Zealand Accounting Standards Board ("NZASB") issued the For-Profit Package of standards that apply to for-profit entities preparing general-purpose financial statements in accordance with GAAP. The For-profit Package will be followed by two other packages for public sector public benefit entities and not-for-profit entities.

253. These packages establish the new tiered structure. Standard XRB A1 (FP Entities Update) applies for reporting periods beginning on or after I December 2012 and establishes a four-tier structure for for-profit entities:

    (a) Tier 1: Full NZ IFRS is the default tier – entities in Tier 1 will have to prepare financial statements applying full NZ IFRS.

    (b) Tier 2: NZ IFRS RDR is a Reduced Disclosure Regime ("RDR"), which can apply to an entity that does not have public accountability (as defined) or which is a public sector entity with expenses less than $30 million. This regime has the same recognition and measurement requirements as Full NZ IFRS but with an estimated 50% fewer disclosures, depending on the specific circumstances of the entity. Hence the costs of preparing financial statements for Tier 2 entities are potentially significantly less than for Tier 1 entities.

    (c) Tier 3: NZ IFRS Differential Reporting is the same as under the old framework, and is a "temporary tier" until the FR Bill is enacted, because following enactment, the majority of small and medium-sized companies will no longer have to prepare general-purpose financial statements.

    (d) Tier 4: Old GAAP is another temporary tier and applies to entities that previously applied old GAAP, and which will be able to continue doing so until they do not have to prepare general-purpose reports once the FR Bill gets enacted.

### 15.3 Non-financial reporting and non-GAAP standards

254. The FR Bill provides for financial reporting standards to cover reporting on an entity's service performance, related party transactions, or other non-financial matters. The Governor-General can authorise the Board issue financial reporting standards relating to reporting on an entity's governance, strategic direction, or any other matters.

255. A financial reporting standard may be a non-GAAP standard and may apply to an entity even if the financial statements of the entity are not required to comply with GAAP.

### 15.4 Current reporting and registration obligations

256. Currently, the FRA 1993 distinguishes between a "reporting entity" (which includes an issuer, a company other than an exempt company, and a person required by any other Act to comply as a reporting entity), and an "exempt company", which is defined in section 6A of the FRA 1993 as:

    (a) A company that is not an overseas company or an issuer; and

    (b) A company that satisfies at least two of the following criteria:

        (i) At balance date, total assets did not exceed $1 million; and/or

        (ii) For the accounting period the turnover did not exceed 42 million and/or

        (iii) At balance date the company had 5 or fewer full-time employees; and

    (c) At balance date the company was not a subsidiary of another company and did not have any subsidiaries of its own.

257. Under s. 10 of the FRA 1993 reporting entities must prepare financial statements that comply with GAAP, and have them signed by at least 2 directors (if there is more than 1 director) within 5 months after balance date. Exempt companies, on the other hand, are given up to 9 months after balance date to prepare financial statements and have them signed (providing all shareholders agree to the extension). In addition, the financial statements of an exempt company need only comply with the lesser requirements set out in the *Financial Reporting Order 1994*.

258. Section 18 of the FRA 1993 requires an issuer to deliver its financial statements to the Registrar for registration within 20 working days after the date they are required to be signed. An issuer must appoint an auditor and have its financial statements audited, under s. 196 of the *Companies Act 1993*.

259. Under s. 19 of the FRA 1993, an overseas company, a subsidiary of an overseas company, or any "large" company in which 25% or more of the voting power is held by non-residents, must deliver their financial statements to the Registrar for registration within 20 working days after the date they are required to be signed. (For this purpose a company is "large" if two of the following criteria are met: total assets at balance date exceed $10 million; turnover for the accounting period exceeds $20 million; 50 or more full-time employees at balance date.) A company that is subject to the registration requirements of s. 19 of the FRA 1993 must have its financial statements audited, under s. 196 of the *Companies Act 1993*.

### 15.5 New reporting and registration obligations

260. Under Part 7 of the *Financial Markets Conduct Act 2013* ("the FMC Act"), an issuer is an FMC reporting entity to which the reporting rules in Part 7 will apply. Refer to paragraph 271 onwards in Section 16 below.

261. Note that the FRA 1993 will continue to apply to an issuer in relation to securities issued prior to the commencement of the transitional provisions of the FMC Act until all

of those securities are cancelled, redeemed, or forfeited, or all of the obligations owing under those securities have been discharged.

262. Furthermore, under cl. 57 of the FR Bill, the FRA 1993 continues to apply to an issuer for all accounting periods that end before date specified in regulations made under cl. 57 of the FR Bill.

263. Apart from issuers, general-purpose financial reporting obligations are imposed, under replacement s. 196 of the *Companies Act 1993* contained in cl. 86 of the FR Bill, only on:

    (a) A "large" company; and

    (b) A "large" overseas company that carries on business in New Zealand; and

    (c) A company with 10 or more shareholders (unless the shareholders "opt out" of compliance – see paragraph 248(c)(i) above); and

    (d) A company with less than 10 shareholders if holders of at least 5% of the voting rights require the company to comply (i.e. "opt in").

264. For the purpose of counting shareholders to see if the 10-shareholder threshold is breached, joint holders of a parcel of shares are counted as a single shareholder. The meaning of "large" is set out in paragraph 248(b) above.

265. Except for a company that is an issuer or for a "large" overseas company, there is a significant relaxation to the requirement to have accounts audited. The requirements for a company that is an issuer, or for a "large " overseas company, to have its accounts audited and registered with the Registrar is unchanged.

266. For all other companies, it will be possible to "opt out" of the audit requirement if 95% of holders of voting rights elect to do so. "Large" companies (that are not overseas companies) may opt out of the audit requirement under replacement s. 207I of the *Companies Act 1993*. Companies with 10 or more shareholders may opt out under replacement s. 207H. And companies with less than 10 shareholders may "opt in" under replacement s. 207J.

267. The existing requirements to prepare audited financial statements and have them registered with the Registrar will be removed for an overseas company that is not "large", and for an overseas company's New Zealand subsidiary to which the requirement to prepare financial statements would not otherwise apply.

268. The audit and registration requirements are being retained for a "large" overseas company, a large company that is at least 25% owned by non-residents, and for an overseas company's New Zealand subsidiary to which the requirements to prepare financial statements under the FR Bill will otherwise apply.

269. Apart from issuers, the reporting obligations for partnerships and limited partnerships apply only to "large" entities as defined in paragraph 248(b) above. Large partnerships and large limited partnerships have the ability to "opt out" of the audit requirements by resolution passed or signed by partners entitled to at least 95% of the capital of the firm (for ordinary partnerships), and by partners who together have contributed at least 95% of the capital contributions of all the partners (for a limited partnership).

270. Entities subject to the reporting requirements under the FR Bill, and that have not opted out if able to do so, will have only 3 months following the balance date within

which to have the accounts prepared and signed by the directors. The timeframe for delivery to the Registrar for registration will remain 20 working days following the date by which the financial statements were required to be signed.

## 16. FINANCIAL MARKETS CONDUCT ACT 2013

271. The FMC Act covers four types of financial products: debt securities, equity securities, managed investment products, and derivatives. The Act is concerned with:

    (a) Providing investors with understandable and accurate information in a form that readily allows comparison of different product offerings;

    (b) More robust safeguards in the form of better governance arrangements when others invest money on behalf of the public (e.g. managed investment schemes and discretionary investment management services);

    (c) Reduced compliance costs of raising capital through the removal of unnecessary processes such as director certification of advertisements;

    (d) Promoting innovation and effective competition by providing more opportunities for securities exchanges to develop markets suitable for smaller companies.

### 16.1 Commencement date

272. The FMC Act received the Royal Assent on 13 September 2013. The Bill as introduced was divided by the committee of the whole house into two separate Bills that were enacted as the FMC Act 2013 and the *Financial Markets (Repeals and Amendments) Act 2013* ("the Repeals Act"). The Commerce Committee recommended that the default commencement date be moved back from 1 April 2015 to 1 April 2017. However, the Committee expected that most of the provisions of the Act would come into force well before that date. Various parts of the Act may have different start dates as appointed by the Governor-General by Order in Council.

273. The following provisions came into force on 14 September 2013, the day after the FMC Act received the Royal assent:

    (a) Certain rules relating to dealing with financial products on markets, including certain disclosures of substantial interests in listed issuers and the regulation of unsolicited offers to purchase products;

    (b) Regulations that apply to a derivatives issuer, including prescribed requirements for the safe custody of investors' money and property;

    (c) All of the regulations and exemptions, and the transitional and miscellaneous matters, provided for in Part 8 of the Bill.

### 16.2 Misleading or deceptive conduct

274. Prohibitions against misleading or deceptive conduct in relation to matters covered by the FMC Act will no longer be dealt with by the Commerce Commission under the Fair Trading Act 1986 (the "FT Act"). Instead, the Financial Markets Authority (the "FMA") will deal with conduct regulated by the FMC Act. Conduct that is covered includes both conduct in New Zealand and certain conduct outside New Zealand that relates to dealings in financial products or the provision of financial services in New Zealand.

### 16.3 General disclosure requirements and exclusions

275. An offer of financial products in New Zealand, (regardless of where any resulting issue or transfer occurs), to which the disclosure requirements in the FMC Act apply, is called a *regulated offer*. A *product disclosure statement* (PDS) for regulated offers must be prepared and lodged with the Registrar of Financial Service Providers (the "Registrar"). A PDS is not meant to be a long document – it will contain only key information. The remainder of the information will be contained in a *register entry* on the register of offers of financial products that will be maintained on the Internet. This is meant to allow such additional information in the register entry to be readily updated. There are ongoing disclosure requirements relating to the updating of registers.

276. A PDS must be worded and presented in a clear, concise and effective manner, otherwise the FMA may make a stop order preventing offers under the PDS or preventing the PDS from being distributed. The Commerce Committee expanded the territorial scope of the Bill, so that such stop orders can apply to restricted communications distributed to persons outside of New Zealand. Issuers are required to supply additional information and documents to the Registrar when the PDS is lodged. The FMA and the Registrar are given an initial opportunity to consider a PDS for compliance with the FMC Bill. The issuer must publish on its Internet site a statement relating to the lodgement of a PDS.

277. The penalty for knowingly or recklessly contravening the requirement to prepare and lodge a PDS or for contravening the requirement to give a PDS is, for an individual, imprisonment for a term of up to 5 years or a fine of up to $500,000, and for a non-individual, a fine of up to $2.5 million. The penalty for continuing to offer financial products under a PDS that does not comply is, for an individual, imprisonment for a term of up to 10 years or a fine of up to $1 million, and for a non-individual, a fine of up to $5 million.

278. There are a number of disclosure exclusions. The disclosure exclusions will not apply if at least one of the investors is not within the disclosure exclusions. The disclosure exclusions can, however, separately apply to any excluded investors.

279. Offers to wholesale investors, (i.e. persons who meet the specified criteria in Schedule 1, including persons who will invest at least $500,000), are excluded. Such persons are expected to perform sufficient due diligence to allow them to independently assess the merits of the offer. Also excluded are small "specified" offers that involve a maximum of 20 investors and $2 million being raised in any 12-month period, that may be accepted only by an interested person or a person with annual gross income of at least $200,000. Other exclusions are for:

    (a) Close business associates of the offeror: this includes directors and senior managers who hold 5% of the issuer's voting products or 20% of a related body corporate's voting products, relatives of close business associates, and persons who have a close professional or business relationship with the offeror;

    (b) Relatives of the offeror or of a director of the offeror;

    (c) Offers through intermediaries that hold a market services license or by a provider of discretionary investment management services that holds such a license;

    (d) Offers under employee share purchase schemes or dividend reinvestment plans;

(e) Certain offers of derivatives;

(f) Offers of interest in retirement villages;

(g) Offers of interest in contributory mortgages offered by solicitors;

(h) Generally offers by registered banks, and all offers by the Crown and local authorities;

(i) Offers of renewals or variations; and

(j) Offers of financial products of the same class as quoted financial products.

### 16.4 Disclosure requirements for derivatives

280. The Commerce Committee recognised that derivatives differ from other financial products and recommended several amendments. A PDS can be lodged for a derivative product type rather than for each individual derivative contract. Customised terms for specific investors need not be disclosed. In addition, the general disclosure exemption where the minimum amount payable by the investor is at least $500,000 would not apply to many derivatives, as they seldom require large up-front payments. The Commerce Committee recommended an exclusion for derivatives with a minimum notional value of $5 million.

281. Other disclosure requirements for derivatives are as follows:

(a) For a derivative between a licensed derivatives issuer and a retail investor (e.g. a bank and a customer) the issuer must make disclosure, but the retail investor need not.

(b) For a derivative between a person who is in the business of entering into derivatives and an investor who is not (e.g. an energy company and a retail investor) the first person needs to be licensed and must make disclosure, but the investor does not.

(c) For a derivative between two licensed derivatives issuers (e.g. two banks) disclosure is not required.

(d) For a derivative between two wholesale investors (e.g. two large energy companies) disclosure is not required.

(e) For a derivative between two investors who are not in the business of issuing derivatives, disclosure is not required.

### 16.5 Governance of financial products and services

282. Strict governance rules apply to financial products offered under a regulated offer, and to managed investment products in a registered scheme (whether or not there has been a regulated offer).

283. There must be a trust deed, which complies with contents requirements, for regulated offers of debt securities, and a licensed supervisor who is the trustee. The supervisor/trustee is responsible for acting on behalf of the holders of the debt security, and must act honestly, and comply with a professional standard of care.

284. There are special additional registration requirements for specific types of managed investment schemes, including Kiwisaver and superannuation schemes. Kiwisaver scheme requirements largely carry over existing requirements.

285. Superannuation schemes must be for the purpose of retirement, with any benefits paid or early withdrawal provisions being ancillary to that purpose. If a scheme has purposes that are not merely ancillary to providing retirement benefits, the Commerce Committee considered it should be registered as a standard managed investment scheme. However, some existing superannuation schemes will be treated as having a "principal retirement purpose" and some workplace schemes can provide benefits and withdrawals on leaving employment with the relevant workplace or industry.

286. Superannuation schemes will need to limit new members to those with a specified link to New Zealand (e.g. employed by a New Zealand employer or a New Zealand resident) or meet prescribed requirements that include lock-in and transfer requirements.

287. Managers of managed investment schemes will have to licensed by the FMA and comply with duties that include acting in the best interests of scheme participants. The FMA will be responsible for the issue of licenses and the monitoring and enforcement of licenses. The FMA must adhere to the licensing criteria in the FMC Bill and licensees must adhere to the disclosure obligations.

288. Related party transactions will be regulated. The related party transactions of managed investment schemes must be in the best interests of investors and be made on arm's length terms. Restricted schemes, which include employer superannuation schemes, will have a 5% limit on related party transactions (except for investments in registered schemes or some bank products). The Commerce Committee relaxed this requirement slightly so that investments in related parties are not cumulative if those related parties are not themselves related to each other.

### 16.6 Financial reporting

289. Part 7 of the FMC relates to financial reporting. The reporting rules apply to an *FMC reporting entity* which includes all issuers of regulated products, licensees, supervisors, listed issuers, banks, licensed insurers and building societies. There is a specific exclusion for a company with fewer than 50 shareholders.

290. The External Reporting Board must have regard to which FMC reporting entities are considered to have a higher level of public accountability when preparing a proposal to vary or replace the strategy for establishing different tiers of financial reporting.

291. Every FMC reporting entity must ensure that, within 3 months after the balance date of the entity, financial statements (or, if appropriate, group financial statements) that comply with generally accepted accounting practice are completed, dated and signed. This requirement also applies to every manager of a registered scheme.

292. An FMC reporting entity that is an overseas company must prepare financial statements that include financial statements for its New Zealand business prepared as if that business were conducted by a company formed and registered in New Zealand.

293. The financial statements (or group financial statements) of every FMC reporting entity must be audited by a qualified auditor.

294. Within 20 working days after the financial statements (or group financial statements) are required to be signed, copies of the statements together with a copy of the auditor's report must be filed with the Registrar.

295. A contravention of any of the above requirements may give rise to a civil penalty of up to the greatest of the consideration for the relevant transaction, 3 times the amount of the gain made or the loss avoided, and $1 million in the case of an individual or $5 million in any other case.

### 16.7 Enforcement, liability and transitional provisions

296. The FMA can make stop orders that prohibit offers, issues, sales, or transfers of financial products, prohibit the supply of market services, prohibit the acceptance of contributions or deposits, or prohibit the distributions of PDSs or advertisements.

297. Offences of knowingly or recklessly contravening disclosure provisions carry a prison term of up to 10 years or a fine of up to $1 million in the case of an individual, and a fine of up to $5 million in any other case. The Commerce Committee recommended amendments to establish a separate criminal liability for a director where there is a disclosure defect that is materially adverse, and the Crown could prove a "guilty mind". The Committee's opinion was that directors should be liable for civil pecuniary penalties and to compensate investors that lose money if they fail to perform their duties, but should not be liable to imprisonment where there is no fault element.

298. In relation to civil liabilities, the Commerce Committee recommended a new term "involvement in a contravention" which would require proof that a person was an intentional participant in the primary contravention with knowledge of all the essential facts. This should mean that professional advisers would not risk being involved in a contravention in the course of their normal activities.

299. The Commerce Committee stated there awareness of the concern that directors might be unable to pay penalties or compensate investors, since most directors' assets can be transferred to trusts. The Committee stated that the use of trusts in commercial and asset-protection contexts has implications beyond the scope of the FMC Bill.

300. The FMC Act contains a number of transitional provisions and, in particular, provides for the Securities Act 1978, the Securities regulations 2009, and associated exemptions to continue to apply to securities offered under a prospectus registered in accordance with those former enactments up to 12 months after the commencement of the FMC Act. However, no offer or allotment of securities may be made under the former enactments after the date that is 2 years after the commencement of the new Act.