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BILLS DIGEST

Digest No. 1633

Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill 2008

Date of Introduction:	02 July 2008
Portfolio:	Revenue
Select Committee:	As at 24 July, 1st Reading not held.
Published: 28 July 2008 Prepared by John McSoriley BA LL.B. , Barrister Legislative Analyst P: (04) 471-9626 (Ext. 9626) F: (04) 471-1250	Caution: This Digest was prepared to assist consideration of the Bill by members of Parliament. It has no official status. Although every effort has been made to ensure accuracy, it should not be taken as a complete or authoritative guide to the Bill. Other sources should be consulted to determine the subsequent official status of the Bill.

Purpose

The aim of this Bill is to introduce changes to tax law.

The Inland Revenue Department has provided full details of all the amendments in the Bill as introduced including detailed analysis of the reforms and explanatory examples where necessary. This digest is based on that report:

<http://www.taxpolicy.ird.govt.nz/publications/files/taxbilljuly08.doc>

The main changes proposed are:

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- the reform of the international tax rules by means of a tax exemption for off-shore companies owned by New Zealand businesses;
- the reform of the taxation of life insurance business by aligning life insurance taxation rules closer to the accounting treatment of life insurance profits, and at the same time extending portfolio investment entity rules to life insurer's savings products;
- the enabling of employers, employees, and donee organisations to establish their own systems for payroll giving;
- the taxation of emissions units arising under the Climate Change Response Act 2002;
- the definitions of associated persons in the Income Tax Act 2007 reformed;
- the raising of tax thresholds;
- the clarification of relocation payments and overtime meal allowances for employees;
- changes to the income tax rules for petroleum mining;
- the provision of a new film grant – the Screen Production Incentive Fund grant;
- the introduction of specific tax rules for the treatment of honoraria and payments that reimburse expenditure incurred in undertaking voluntary activities; and
- numerous other changes.

Main Provisions

Active business test for controlled foreign companies

An “active business” test is being provided for controlled foreign companies (CFCs) engaged in active business. CFCs that pass the test will not be required to attribute any income to New Zealand residents. CFCs will pass the test if less than 5 percent of their gross income is “passive income”. Some insurance businesses may also qualify for a separate exemption. (*Part 1, Clauses 122, 123 and 408; Part 2, Clause 484*).

The definition of passive income for controlled foreign companies

The Bill introduces a definition of “passive income” (referred to in the legislation as the *attributable CFC amount*), which is central to the new CFC rules. This definition may apply, in the first instance, in the active business test to decide whether a CFC is active or passive and thus whether the CFC should be exempt from attribution. It is primarily used when a CFC fails the active business test. If this occurs, the CFC has to attribute its passive income as

defined in the legislation (unless the CFC is resident in Australia) and will be subjected to New Zealand tax on that income. (*Part 1, Clauses 119 and 408*).

Interest allocation rules for outbound international investment

Amendments are made to Subpart FE of the Income Tax Act 2007 to extend the existing interest allocation rules to New Zealand residents. Interest allocation rules have been extended to New Zealand residents that have an income interest in a CFC, unless they have 90 percent or more of their assets in New Zealand or less than \$250,000 of interest deductions. (*Part 1, Clauses 154-174 and 408*).

Foreign dividend exemption for companies

The Bill provides, in general, an exemption from tax when most foreign dividends are received from companies (*Part 1, Clauses 5, 6, 13, 16, 19, 30, 32, 53, 54, 55, 98, 122, 126, 132, 176-178, 184, 189, 190, 192, 195, 199, 200, 254, 273, 277, 286-288, 290-295, 299-304, 306, 316-322, 330, 332, 340, 342-348, 350, 352, 353, 361-367, 370, 373-376, 391, 392, 396, 398, 408 and 409; Part 2, Clauses 433, 434, 452, 468, 469, 483, 486, 487, 489, 496, 497, 500, 501, 505-507, 512, 514 and 515*).

Other international tax measures – changes to conduit tax relief and the grey list

The Bill prevents further conduit tax relief arising under the conduit mechanism. The bill also removes the grey list tax exemption for CFC income in eight countries as this is being replaced by an active business test and an Australian exemption. (*Part 1, Clauses 17, 25, 26, 60, 66, 67, 80, 118, 122, 124, 125, 138, 147, 175, 193, 251, 255, 269, 308-315, 354-360, and 408; Part 2, Clause 488 (repealing Section 103A of the Act)*).

Taxation of life insurance business

The aim of the reforms to the taxation of life insurance business is to tax life risk business on actual profits in a manner similar to the way other businesses are taxed and extend the tax benefits of the portfolio investment entity (PIE) rules to all savers in life products. Life insurers will be taxed on two bases: the shareholder base (representing income derived for the benefit of shareholders) and the policyholder base (representing income derived for the benefit of policyholders). Detailed provisions apply to taxing participating policy income between the shareholder and the policyholder bases. (*Part 1, Clauses 2(22), 28, 44, 50(1), 56, 68, 98(2) and (6), 140-143, 146, 149, 150, 205(1) and (2), 216(1) and (4), 217, 222, 225, 238-240, 264, 267, 268(3), 272, 273(1) and (5), 274, 278, 279(1) and (3), 283, 285, 287(1) and (4), 289, 297, 324, 330(2) and (3), 331(1) and (3), 333-335, 336(1), (2) and (4), 338, 341, 342(2), 343(1) and (4), 344(2), 353(2), 368, 369, 372, 408(6), (11), (19), (45), (75), (77), (81), (102-105), (110), (113 and 114), (126 and 127), (130), (135), (140), (148), 421(1) and 493*).

Tax treatment of relocation payments and overtime meal allowances

The Bill amends the Income Tax Acts 1994, 2004 and 2007 to ensure that payments by employers when relocating their employees, and providing them with overtime meal allowances are exempt from income tax and fringe benefit tax if certain criteria are met (*part 1, Clauses 34, 35, and 42; Part 2, and 485; Part 5, Clauses 545, 547-549; Part 6, Clauses 616, 617 and 619*).

Payroll giving

The Bill provides for a voluntary payroll giving scheme that will allow employees to make regular payroll donations from their pay to charitable organisations of their choice. It will also enable employees to receive the tax benefit of their payroll donations each payday without the need to have donation receipts as an alternative to claiming the charitable donation tax credit at the end of the tax year (*Part 1, Clauses 232, 233, 235, 236, 379, 384, 402, 403, 408(23), 408(38), 408(89), 408(99); Part 2, Clauses, 442(1) & (3), 443, 447, 458 and 504*).

Reforming the income tax act definitions of “associated persons”

The bill makes amendments to strengthen and rationalise the definitions of “associated persons” in the Income Tax Act 2007 (*Clauses 7, 10-13, 18, 40, 41, 57, 82, 120, 152, 182, 183, 186, 188, 201-203, 408, 414, 415, 431; Part 2, Clauses 436, 477, 502 and 503; Part 3, Clause 624*).

Tax treatment of emissions trading units

The Bill amends the Income Tax Act 2007 to provide for the tax treatment of emissions trading units. Most costs of emissions trading will be tax-deductible, and the government subsidy (the award of “free” emission units by government) of emissions costs will generally be assessable. The specific taxation treatment varies depending on the emissions type, of which there are four:

- non-forestry (generally dealt with on an accruals basis);
- post-1989 forestry (dealt with on a cash basis);
- pre-1990 forestry where the land is held on capital account (outside the tax system); and
- pre-1990 forestry where the land is held on revenue account (special rules apply).

There are special rules for the surrender of emission units to government and for the timing of the recognition of income arising from the government subsidy. Emissions units will be treated as excepted financial arrangements that are revenue account property. Emissions units will generally therefore be deductible upon acquisition, but added back at cost at year end to the extent they are still on hand (*Part 1, Clauses 9, 31, 48, 61, 81, 84, 85, 98, 187 and 408; Part 3, Clause 524*).

Tax treatment of reimbursements and honoraria paid to volunteers

The Bill provides specific tax rules for the treatment of payments that reimburse expenditure incurred in undertaking voluntary activities (*Part 1, Clauses 23 and 39*).

Film and government funding

The Bill provides for the New Zealand Screen Production Incentive Fund (SPIF) grant, which will be available for “New Zealand” film and other screen formats (*Part 1, Clauses 36, 45, 46, 62, 63, 65, 69, 70, 89-92, 408, Part 2, Clauses 470, 471 and 473*).

Changes to the tax treatment of petroleum mining

The bill makes detailed provision for the tax treatment of petroleum mining *Part 1, (Clauses 71, 73, 74, 93-97; Part 5, Clauses 551, 553, 554, 558, 559, 560, 561 and 562)*.

Raising certain tax thresholds

The Bill raises certain tax thresholds (*Part 1, Clauses 83, 105, 106, 109-114, 387(5) and (8) 389, 390,; Part 2, Clause 494; Part 3, Clauses 526 and 527*).

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