

Supplementary Departmental Disclosure Statement

Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill

A supplementary departmental disclosure statement for a Bill the government is proposing to amend seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill in amended form.

It highlights material changes to previous disclosures relating to:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

The original disclosure statement for the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill, dated 3 September 2021, can be found at <http://disclosure.legislation.govt.nz/bill/government/2021/65/>

This supplementary disclosure statement was prepared by the Inland Revenue Department.

The Inland Revenue Department certifies that, to the best of its knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

27 September 2021

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The Main Areas of Change to the Original Disclosures

This is a supplementary disclosure statement for the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill.

A supplementary disclosure statement supplements the original disclosure statement for the Bill by reporting the additions and changes that would need to be made to the original disclosure statement to accurately reflect the Bill with the proposed government amendments incorporated.

The main areas of change to the original disclosure statement include:

- the addition of a new proposal limiting the deductibility of interest on residential investment property, and changes related to the bright-line extension
- the addition of remedial changes to the business continuity test that clarify the policy intent, and
- the addition of a new proposal to provide employers with another option for calculating fringe benefit tax (FBT) on fringe benefits provided to employees.

Part One: General Policy Statement

Tax measures relating to housing

This Supplementary Order Paper (**SOP**) proposes to make changes to tax settings to improve affordability for first home buyers by dampening investor demand for existing properties.

The SOP proposes to:

- limit interest deductions for investors in residential property; and
- address issues arising out of the extension of the bright-line test from 5 years to 10 years.

Many landlords who invest in residential property do so expecting to earn a large capital gain when they sell their property. The current tax system allows landlords to deduct all interest expenditure relating to their residential rental properties, even if they do not pay any tax on the capital gain when they sell their property. Interest deductions related to residential rental properties will therefore be limited. To ensure there is no adverse impact on housing supply, property development and new builds will be exempt from the interest limitation rules.

In summary, the key features of the interest limitation proposal are:

- the rules would apply to interest incurred on or after 1 October 2021;
- for pre-existing loans relating to property acquired before 27 March 2021, interest denial would be phased at 25% per year over four years;
- loans drawn down on or after 27 March 2021 would be subject to full limitation from 1 October 2021, unless the property was acquired as a result of an offer made on or before 23 March 2021 that could not be withdrawn before 27 March 2021;
- property developers would continue deducting interest expenses as incurred;
- new build properties would be exempt from the interest limitation rules; and
- interest deductions would be allowed when a taxable sale of residential property is made.

Loss continuity

The business continuity test (the **BCT**), which was enacted in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021, allows a company to carry forward tax losses to future years if they have a change in ownership as long as there is no major change in the nature of the company's business activities.

It was intended that tax losses incurred in an income year in which a breach of ownership continuity occurs could be considered for carry-forward under the BCT (to the extent to which they are incurred post-ownership continuity breach). However, the legislation technically does not allow this in all the circumstances in which it was intended.

For companies relying on the BCT that have a breach of business continuity, the legislation does not currently allow tax losses incurred in earlier years to be offset against a profit for the pre-breach part-year. The policy intent was that losses incurred in years preceding a breach of business continuity could be used in this way, like they can when ownership continuity is breached.

The SOP proposes amendments to align the legislation with the policy intent.

Fringe benefit tax: further alternate rate option

An employer who provides a fringe benefit to an employee is liable to pay fringe benefit tax (**FBT**). The calculation of the employer's FBT liability can be a complex exercise and there are different options they can choose. They may choose to pay FBT at a flat maximum rate, being 63.93% (49.25% prior to 1 April 2021), or at a rate reflecting the employee's personal tax rate.

The flat rate or “single rate” option is a low compliance cost option for employers, but it may result in many employers having a significantly higher FBT liability despite having no or few employees with income over \$180,000 (being the income threshold above which the 39% personal tax rate applies). While a more accurate alternative is currently available to employers, it requires compliance cost intensive calculations to be carried out for each employee who receives a fringe benefit.

The SOP proposes a new option for calculating FBT on fringe benefits provided to employees during the 2021–22 tax year and in future years. Under the proposed new option, employers would pay FBT at the rate of 49.25% for all employees with “all-inclusive pay” under \$129,681. FBT would be payable at the rate of 63.93% for employees with all-inclusive pay of \$129,681 or more. This would generally only be those employees earning over \$180,000 in (pre-tax) salary or wages or close to that threshold, assuming they do not receive significant fringe benefits.

Departmental disclosure statement

The Inland Revenue Department is required to prepare a disclosure statement to assist with the scrutiny of this Supplementary Order Paper. The disclosure statement provides access to information about any material policy changes to the Bill and identifies any new significant or unusual legislative features of the Bill as amended.

A copy of the statement can be found at

<http://disclosure.legislation.govt.nz/sop/government/2021/>

Regulatory impact statement

The Inland Revenue Department produced a regulatory impact statement on 8 September 2021 to help inform the new policy decisions taken by the Government relating to the contents of this SOP.

A copy of this regulatory impact statement can be found at—

- <https://taxpolicy.ird.govt.nz/publications>
- <https://www.treasury.govt.nz/publications/legislation/regulatory-impact-assessments>

Part Two: Background Material and Policy Information

Published reviews or evaluations

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?	YES
A commentary covering the policy proposals in the Supplementary Order Paper will be made available on Inland Revenue's tax policy website in October 2021. The commentary will provide a more detailed explanation of the interest limitation proposal, business continuity test remedial items, and FBT proposal.	

Relevant international treaties

2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?	NO
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Regulatory impact analysis

2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?	YES
<p>A regulatory impact statement (RIS) was prepared by Inland Revenue for the interest limitation proposal, <i>Limiting interest deductibility on residential investment property</i> (8 September 2021), and is available at https://taxpolicy.ird.govt.nz/publications/2021/2021-ris-interest-deductibility</p> <p>A RIS was not required for the policy decisions on the loss continuity proposals. However, a supplementary analysis report (SAR), <i>Loosening the loss continuity rules</i> (11 February 2021) was prepared by Inland Revenue to accompany Supplementary Order Paper No 23 to the Taxation (Annual Rates 2020–21, Feasibility Expenditure, and Remedial Matters) Bill, and was published in March 2021. The resulting legislation was enacted as the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 in March 2021. A SAR provides an analysis of the policy development to aid understanding of the proposals as they go through the legislative process. The SAR is available at https://taxpolicy.ird.govt.nz/publications/2021/2021-ria-loss-continuity-rules</p> <p>Other proposals in the Supplementary Order Paper are exempt from Cabinet's impact analysis requirements as they involve technical revisions that improve legislative clarity and understanding (including correcting errors), or have no, or only minor, impacts on businesses individuals or non-for-profit entities.</p>	

2.3.1. If so, did the RIA Team in the Treasury provide an independent opinion on the quality of any of these regulatory impact statements?	NO
No, for the interest limitation proposal, the RIA Team at the Treasury determined that it was suitable for Inland Revenue to chair a joint QA panel with representatives from Inland Revenue and the RIA Team at the Treasury. The SAR for the loss continuity proposal was reviewed by a QA panel from Inland Revenue.	

2.3.2. Are there aspects of the policy to be given effect by this Bill that were not addressed by, or that now vary materially from, the policy options analysed in these regulatory impact statements?	NO
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Extent of impact analysis available

2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?	NO
No significant further impact analysis has become available for any aspects of the policy to be given effect by the Supplementary Order Paper.	

2.5. For the policy to be given effect by this Bill, is there analysis available on:	
(a) the size of the potential costs and benefits?	YES
(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?	YES
<p>2.5(a): The size of the potential costs and benefits</p> <p>The expected administration costs covered in the <i>Limiting interest deductibility on residential investment property</i> RIS listed under 2.3 is estimated to be \$19.38 million over the forecast period (2021–22 to 2024–25). While a significant proportion of administration costs will be incurred within the next four years, Inland Revenue will have ongoing administration costs. The expected revenue from is expected to be \$1.12 billion over the forecast period (2021–22 to 2024–25).</p> <p>The RIS and SAR listed under 2.3 provide further analysis on the size of the potential costs and benefits for the policy items included in the Supplementary Order Paper that are subject to the regulatory impact analysis requirements.</p> <p>For the proposed FBT changes and the changes to the bright-line extension in the Supplementary Order Paper, there is little or no publicly available analysis on the size of potential costs and benefits, as they have been assessed as having no or a very minor impact on businesses, individuals, or organisations.</p> <p>2.5(b): The potential for any group of persons to suffer a substantial unavoidable loss of income or wealth</p> <p>Analysis on the potential for any particular group of persons to suffer a substantial unavoidable loss of income or wealth was covered in the <i>Limiting interest deductibility on residential investment property</i> RIS listed under 2.3. In terms of direct impact, this Supplementary Order Paper contains amendments to the tax legislation that will result in residential property investors paying an expected \$1.12 billion in additional tax over the forecast period (2021–22 to 2024–25).</p>	

2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be affected by:	
(a) the level of effective compliance or non-compliance with applicable obligations or standards?	YES
(b) the nature and level of regulator effort put into encouraging or securing compliance?	YES

The effectiveness of taxation legislation is, by its nature, reliant on effective and voluntary compliance. The level of compliance or non-compliance with specific applicable obligations or standards, and the nature of regulator effort, may have an impact on the potential costs or benefits for some policy items to be given effect by the Supplementary Order Paper. For the appropriate policy items, this may be discussed in more detail in the regulatory impact statement and supplementary analysis report listed under 2.3.

Part Three: Testing of Legislative Content

Consistency with New Zealand's international obligations

3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?
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No formal steps to determine whether the policy to be given effect by this Supplementary Order Paper is consistent with New Zealand's international obligations.
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Consistency with the government's Treaty of Waitangi obligations

3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?

Under the Generic Tax Policy Process (described in part one of this statement), there is a focus on consultation (both with Māori and non-Māori interested parties) during the development of the relevant policy measures contained in the Bill. This is directly in line with the "duty to consult" principle of the Treaty of Waitangi.
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Inland Revenue engaged with interested parties on the development of the interest limitation proposal and additional rules for the bright-line test on rollover relief. Due to the limited time available, engagement was not as extensive as preferred. This engagement informed the development of exclusions from the interest limitation proposal for certain Māori land, papakāinga and kaumātua housing, and land transferred as part of a settlement under the Treaty of Waitangi or a post-Treaty settlement mechanism. This engagement also resulted in the development of a proposal to provide rollover relief under the bright-line test for the transfer of land as part of a settlement under the Treaty of Waitangi from a post-settlement governance entity to a member of the claimant group.
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Consistency with the New Zealand Bill of Rights Act 1990

3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?	NO
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There is no statutory requirement for a Supplementary Order paper to be vetted against the Bill of Rights Act 1990. Inland Revenue does not consider there is any inconsistency between the Supplementary Order Paper and the Bill of Rights Act 1990.
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Offences, penalties and court jurisdictions

3.4. Does this Bill create, amend, or remove:	
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(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?	NO
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(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?	NO
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Privacy issues

3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?	NO
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External consultation

3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?	YES
<p>A Government discussion document, <i>Design of the interest limitation rule and additional bright-line rules</i>, was released in June 2021 for public consultation on the interest limitation policy. The discussion document outlined the proposed policy and asked for submissions on specific areas. Over 484 submissions were received. Targeted external stakeholder consultation was also undertaken on the design of the interest limitation proposal. See appendix one for further information on the various parties consulted and the form in which consultation was undertaken for the policy items.</p>	

Other testing of proposals

3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill's provisions are workable and complete?	YES
<p>All proposals in the Supplementary Order Paper have been reviewed by internal operational subject matter experts under Inland Revenue's standard process for assessing the administrative impacts of any new policy initiatives and ensuring they are workable and complete. This involves assessing whether systems need to be changed and, if so, whether formal testing needs to be carried out. None of the measures in the Supplementary Order Paper have required formal testing.</p> <p>The proposals in the Supplementary Order Paper have been subject to the Generic Tax Policy Process to the extent possible, the purpose of which is to promote and improve the workability of proposals.</p>	

Part Four: Significant Legislative Features

Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	NO
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Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	NO
Given the Supplementary Order Paper is amending tax legislation, it does contain provisions that create or amend a power to impose a charge that is a tax. However, for the purposes of this statement, the answer is "No" as per the scope of this question explained in the guidance.	

Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	YES
There are policy items in the Supplementary Order Paper that may have retrospective effect, and given the nature of tax, the retrospective application may have some impacts on the rights of taxpayers. The interest limitation proposal has retrospective effect as the deductibility of interest expenses incurred by residential property investors will be restricted from 1 October 2021. This is consistent with the original announcement of the policy in March 2021. The changes to the business continuity test and fringe benefit tax have no retrospective effect.	

Strict liability or reversal of the burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	NO
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	NO
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Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	NO
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Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person's rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	NO
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Powers to make delegated legislation

4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?	NO
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4.8. Does this Bill create or amend any other powers to make delegated legislation?	NO
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Any other unusual provisions or features

4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?	NO
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Appendix One: Further Information Relating to Part Three

External consultation – question 3.6

External consultation on items contained in the Supplementary Order Paper was undertaken in various forms. Information on the consultation, including the form that the consultation took, what was covered, and the nature and extent of the feedback received is available in:

- The Government discussion document *Design of the interest limitation rule and additional bright line rules* (June 2021), available at <https://taxpolicy.ird.govt.nz/publications/2021/2021-dd-interest-limitation-and-bright-line-rules>
- Regulatory impact statement *Limiting interest deductibility on residential investment property* (8 September 2021), available at <https://taxpolicy.ird.govt.nz/publications/2021/2021-ris-interest-deductibility>
- Supplementary analysis report *Loosening the loss continuity rules* (11 February 2021), available at <https://taxpolicy.ird.govt.nz/publications/2021/2021-ria-loss-continuity-rules>
- A commentary with a more detailed explanation of the interest limitation proposal, business continuity test remedial items, and FBT proposals included in the Supplementary Order Paper. It will be available on the Inland Revenue's tax policy website in October 2021.

Targeted external stakeholder consultation on the design of the interest limitation proposals has also been undertaken, including an external reference group.

Representative organisations

- Chartered Accountants Australia and New Zealand
- Corporate Taxpayers Group
- New Zealand Bankers' Association
- New Zealand Law Society

Other parties/organisations/entities

- ANZ Bank
- ASB Bank
- Chapman Tripp
- Deloitte
- EY
- Findex
- Fletcher Building Limited
- HRL Morrison and Co
- KPMG
- Kiwibank
- OliverShaw
- Powerco
- PriceWaterhouseCoopers
- Russ + Associate
- Terris Legal
- Tomlinson Law

Officials sought information from these stakeholders on multiple aspects of the interest limitation proposals, including the scope of property subject to interest limitation, entities affected, rollover relief, and the design of a development and new build exemptions from the interest limitation proposals.

The changes to the business continuity test were not consulted on, while the fringe benefit tax change was consulted with Chartered Accountants Australia and New Zealand.