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KPMG submission – PUB00443: Foreign investment fund (FIF) default calculation method

We welcome the opportunity to make a submission on the draft Question We've Been Asked *PUB00443: Foreign investment fund (FIF) default calculation method* (the "QWBA"). We apologise for the delay in making a submission but thought it important to state our view.

We have briefly summarised the conclusions reached by the Tax Counsel Office ("TCO") and our key submissions points below. This is followed by a more detailed discussion of our submissions.

Conclusions reached in the draft QWBA

The draft QWBA considers whether a person has a choice of calculation method for FIF income when they make a voluntary disclosure or file a late return.

The draft QWBA concludes that no choice is available in these circumstances. Rather, the person must use the default method (usually the fair dividend rate ("FDR") method) where they:

- have failed to declare FIF income in a tax return and later make a voluntary disclosure; or
- fail to file a tax return by the due date and later provide one with FIF income included (even if the return is filed only one day late).

The TCO has noted that they have consulted with IR Policy and Regulatory Stewardship ("IR PaRS") to determine whether this conclusion is consistent with the policy settings. IR PaRS has advised that this area warrants further consideration however they are not able to consider it due to competing priorities.

Summary of our submission points

We summarise below our key submission points.

- We disagree with TCO's draft view that the wording of ss EX 44(2) and EX 48 must be read (in conjunction with s YA 1 and the TAA) in such a strict fashion. We consider the legislative wording is sufficiently ambiguous that an alternative view can prevail.
- The conclusions reached are not consistent with our understanding of the desired tax policy settings. The outcome is unduly harsh and we consider cannot have been intended by Parliament when legislating the FIF rules.

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- In the event TCO's view in the draft QWBA stands:
  - A policy/legislative response is required to put the issue beyond doubt. However, given the demand on tax policy and legislative drafting resource our strong preference would be for an interpretive approach that favours what we understand is the intended policy outcome.
  - In the interim, the Commissioner should confirm that he will not devote resources to challenging positions taken in late-filed returns or voluntary disclosures which may be inconsistent with the position reached in the draft QWBA. We consider this is within the scope of the Commissioner's care and management powers set out in s 6A of the TAA.

Detailed discussion

The legislation and TCO's view

The key legislative provisions relied on by TCO in forming its view can be summarised as follows:

- Section EX 44(2) sets out the requirements to choose one of the five applicable FIF methods (to the extent the choice is not otherwise limited) and reads:

  Choosing method

  (2) The person must choose which calculation method applies by completing their return of income accordingly, but the choice is limited by sections EX 46, EX 47, EX 47B, EX 48, and EX 62.

- "Return of income" is defined in s YA 1 as a return of income required under s 33 of the TAA.
- Section 33 of the TAA requires a person to file a return for each tax year. The dates by which returns are required to be furnished are set out in s 37 of the TAA.
- Section EX 48 provides further limitations on the choice of a calculation method. This section provides:

  EX 48 Default calculation method

  When this section applies

  (1) This section applies when—

  (a) a person does not choose a calculation method to calculate FIF income or loss from an attributing interest for a period; and

  (b) sections EX 46, EX 47, and EX 62 do not have the effect of requiring a particular calculation method to be used.

  Default choice

  (2) The person is treated as having chosen to use, for the period,—

  (a) the fair dividend rate method if it is practical to use it; and

  (b) the cost method if it is not practical to use the fair dividend rate method.

The draft QWBA states that in the Commissioner's view:

- the failure to choose a FIF method occurs when a person does not file a return by the due date; and
- even where a tax return is filed on time, if a person excludes FIF income (whether due to inadvertent omission or incorrect application of the law, e.g. mistakenly including dividends from a FIF interest as assessable income rather than calculating assessable income under

the applicable FIF rules), then the person has not "calculated" FIF income by the due date for filing the tax return and accordingly they no longer have a choice of FIF method. The default method must be applied in the amended assessment.

Submission 1 – the legislation supports an alternative reading allowing choice

We disagree with the TCO's draft view that the wording of ss EX 44(2) and EX 48 must be read (in conjunction with s YA 1 and the TAA) in such a strict fashion.

While we agree the legislation requires that a choice must be made in a return of income to be filed for each tax year, we do not agree that the statutory deadlines in s 37 of the TAA constrain the ability to make such a choice in a late-filed return or a subsequently amended return.

We consider that the wording of the legislation supports an alternative view. That is, that a person has chosen a FIF method in their return of income when that return is filed late or they subsequently request to amend the return to include FIF income.

While there are of course due dates for the filing of a return (and use of money interest and penalties may apply to late filed or incorrectly filed returns), filing a return late or requesting an amendment does not mean a person has not or cannot *"choose a calculation method…for a period"* (i.e. a FIF method to apply to the tax year in question). We do not agree with the deadlines in s 37 being effectively imported into the s 33 "return of income" requirements cross-referenced in s YA 1, as applicable here. In our view, the return filing deadlines serve a different purpose, and late filing should not automatically mean a return pursuant to s 33 has not been filed and a choice of FIF method cannot therefore be made after the s 37 due dates.

We believe there is sufficient ambiguity in the black letter wording such that the legislative intent behind the provisions should be given weight when interpreting the law. We do not believe that Parliament's intention was that a person who files a tax return one day late should have permanently forfeited the right to choose between FIF methods otherwise available to them.

Accordingly, we strongly encourage the TCO to reconsider its view in the draft QWBA. Particularly, as the alternative will require a legislative change. In light of the current pressure on tax policy and legislative drafting resource, we do not believe this is the best use of these limited resources.

Submission 2 – should the TCO's draft QWBA interpretation stand

In the event the TCO's view in the draft QWBA stands following consultation, a policy/legislative response will be required to put the interpretive issue beyond doubt.

Pending such a change, we strongly recommend that the Commissioner confirms that he will not devote resources to challenging positions taken in late-filed tax returns or voluntary disclosures that may be inconsistent with the interpretative approach. We believe that the Commissioner's care and management powers should be applied here.

We note that the Commissioner's care and management duties set out in s 6A of the TAA are broad. As set out in s 6A(2), it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to:

- the resources available to the Commissioner;
- the importance of promoting compliance, especially voluntary compliance, by all persons with the Inland Revenue Acts; and
- the compliance costs incurred by persons.

We consider that the TCO's current interpretation of ss EX 44(2) and EX 48 in the draft QWBA is likely to result in the Commissioner not collecting over time the highest net revenue, because it will disincentivise voluntary compliance in our view.

The FIF rules are not a simple area of the tax law. There are many features which may result in inadvertent non-compliance. For example, the cessation of different FIF exemptions, such as the transitional residence exemption for new migrants and certain returning New Zealanders, the NZD50,000 total cost "de minimis", and even the ASX-listed share exemption. Similarly, there may be genuine reasons why tax returns may be filed late. In these circumstances, it seems unduly harsh to deny taxpayers the choice of FIF method and it will be widely viewed as such with a corresponding adverse impact on compliance.

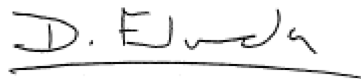
Taxpayers should also be encouraged to make voluntary disclosures if they have detected errors in their original assessments and to file returns where they have otherwise neglected to do so. By taking the view that taxpayers are prohibited from choosing between FIF methods in late filed returns or amended assessments, the Commissioner will discourage people from coming forward with these issues.

We submit that exercising his discretion to not devote resources to challenging such positions will result in the collection of the highest net revenue over time and should therefore be embraced by the Commissioner[1].

Further information

We would be happy to discuss our submission with TCO. Please contact us – Darshana on 09 367 5940 or Rebecca on 09 367 5926 – if you require any further information on our submission.

Yours sincerely



Darshana Elwela
Partner

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[1] We do acknowledge there a technical difference between late-filed returns and voluntary disclosures. A late-filed return results in a taxpayer's self-assessment whereas a voluntary disclosure requires Inland Revenue to amend the assessment. At a minimum we would encourage the Commissioner to accept our submission in relation to late-filed returns if he considers it not within his authority to do so for voluntary disclosures.