[2017] NZSSAA 056

Reference No. SSA 64/17

IN THE MATTER of the Social Security Act 1964

AND

IN THE MATTER of an appeal by **XXXX** of Christchurch against a decision of a Benefits Review Committee

BEFORE THE SOCIAL SECURITY APPEAL AUTHORITY

Mr G Pearson - Chairperson

Mr K Williams - Member

Mr C Joe - Member

Hearing at WELLINGTON on 5 September 2017

Appearances

The Appellant in person

For Chief Executive of the Ministry of Social Development: R Barnett

DECISION

Background

[1] The appellant is a professional engineer who is 65 years of age. To qualify for New Zealand Superannuation a person must be resident and present in New Zealand for not less than ten years since the age of 20, and that must include five years since attaining the age of 50 years, pursuant to s 8 of the New Zealand Superannuation and Retirement Income Act 2001.

[2] The appellant came to New Zealand in 2006. Because of the specialised nature of his profession, he has had to work outside New Zealand for a significant period of time. During the qualifying period, he has been in New

Zealand while "present" for 1330 days, whereas he needs to have been present for 3650 days. There is no dispute that he has been resident in New Zealand throughout the relevant period. It is not necessary to distinguish between the number of days before and after he attained 50 years, as he was that age when he first became resident in New Zealand.

[3] There are various exceptions to the "resident and present" requirement but only one element potentially applied to the appellant. That is section 79 of the Social Security Act 1965 ("the Act"), which provides:

> **79 Persons who have had income tax deducted or withheld on earnings from employment overseas to be treated as resident and present in New Zealand**
>
> (1) This section applies to any person who was employed outside New Zealand if, with respect to the person's period of employment, the person's employer (or other relevant person) makes—
>
> (a) PAYE income payments (as that term is used in the Income Tax Act 2007) from which the person, employer, or other relevant person must withhold an amount of tax under the PAYE rules as defined in that Act:
>
> (b) source deduction payments,—
>
> (i) as that term is used in the Income Tax Act 2004, from which the person, employer, or other relevant person must withhold an amount of tax under the PAYE rules as defined in that Act:
>
> (ii) as that term is used in the Income Tax Act 1994, from which the person, employer, or other relevant person must make a tax deduction under the PAYE rules as defined in that Act:
>
> (iii) as that term is used in the Income Tax Act 1976, from which the person, employer, or other relevant person must make a tax deduction under Part 11 of that Act:

(iv) as that term is used in the Income Tax Assessment Act 1957, from which the person, employer, or other relevant person must make a tax deduction under Part 2 of that Act.

[4] Section 79 in its current form which is set out above replaced an earlier form of the legislation on 10 April 2015, as inserted by s 6 of the Social Security Amendment Act 2015. The previous form of the section made reference to being "liable for the payment of income tax on earnings from that employment". We discuss the former provision below.

[5] The following matters are uncontentious:

[5.1] The appellant meets the age qualification under s 7 of the New Zealand Superannuation and Retirement Income Act 2001 ("the New Zealand Superannuation Act"). The appellant does not meet the residential qualifications due to lack of presence in New Zealand under s 8 of the New Zealand Superannuation Act, unless he comes within an exception.

[5.2] The appellant does not come within any of the exceptions of the residential qualification provisions in either s 9 or s 10 of the New Zealand Superannuation Act.

[5.3] If the appellant comes within s 79 of the Social Security Act 1964, that exception would allow him to receive New Zealand Superannuation.

[6] The appeal turns on whether the appellant comes within the scope of section 79(1) of the Act; that question is in contention. There is no dispute that the appellant was employed outside of New Zealand, and he paid income tax on the income he received.

The Facts

[7] The facts are not contentious. The appellant came to New Zealand with his wife and settled here. Because he could not work in New Zealand as he has specialist qualifications, he established a company which was incorporated in 2007. He is a majority shareholder and director of the

company. The company provided engineering services particularly to governments in the Pacific. The appellant is the sole engineer in the company, and he was remunerated by means of a "shareholder salary". A shareholder salary is calculated annually and declared in the appellant's personal New Zealand income tax return. The appellant paid income tax as a provisional taxpayer on this income. Accordingly, he paid regular instalments of income tax subject to a wash up figure after calculating the total amount of tax at the end of the year. The appellant paid an accident compensation levy and earners levy annually to the ACC Corporation based on his shareholder salary.

[8] In all respects, the appellant was a compliant taxpayer and paid tax on all his income under the structure. In the year ending 31 March 2007, the appellant received a relatively similar amount of income from an offshore entity, where tax was paid at source. This was, accordingly, credited against his New Zealand tax liability. The balance of his income came from his shareholder salary and it was taxed fully in New Zealand. After that year, it appears that all of the appellant's income has been in the form of a shareholder salary from the company and throughout he has paid income tax in New Zealand and it appears he has not paid tax elsewhere. Accordingly, all of the income tax was taxed in New Zealand in exactly the same way as any other person earning income and paying tax in New Zealand.

[9] In summary, throughout the relevant period, with the exception of approximately half his income in the first year, the appellant has been paying tax on the whole of his income to the New Zealand government. His tax obligations, which he complied with, have been no different from what they would have been if he was present in New Zealand when earning the money.

Discussion

[10] Section 79 of the Act applies to New Zealand superannuation. The provision applies to satisfying "the residential qualification for any benefit after return to New Zealand" (s 79(3)). "Benefit" is defined in s 3 of the Act to include New Zealand Superannuation. It follows that if a person comes within the provisions of s 79(1), then they have the benefit of being treated

as “resident and present in New Zealand” during the period to which the section applies.

[11] In this case, the matter turns, primarily, on s 79(1)(a), which deals with the application of the Income Tax Act 2007. The first part of the period is concerned with s 79(1)(b), which deals with the Income Tax Act 2004 which applied in the early period of time under consideration.

[12] The phrase “PAYE income payments” is defined in s YA 1 of the Income Tax Act 2007 with reference to s RD 3 of that Act.

[13] The meaning of the phrase in s RD3 is:

> **RD 3 PAYE income payments**
>
> *Meaning generally*
>
> (1) The PAYE rules apply to a *PAYE income payment* which—
>
> (a) means—
>
> (i) a payment of salary or wages, *see* section RD 5; or
>
> (ii) extra pay, *see* section RD 7; or
>
> (iii) a schedular payment, *see* section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
>
> (ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:
>
> (iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.

[14] The starting point in applying the terms of s RD 3 of the Income Tax Act 2007 is subs (1)(a)(i); it refers to “a payment of salary or wages”, and the phrase is defined very broadly by s RD 5 to essentially include all forms of income from employment. The only potential for exclusion is

s RD 3(1)(b)(ii) which says that it does not include "an amount paid to a shareholder-employee in the circumstances set out in s RD 3B or RD 3C".

[15] Section RD 3B is the primary provision relating to shareholder salaries. In essence if a person receives a "shareholder salary", the income is treated as "income other than from a PAYE income payment"[1].

[16] The key requirements for section RD 3B to apply are:

[16.1] the recipient must be a shareholder and employee of a company, it is not a look-through company and is a close company or has 25 or fewer shareholders;

[16.2] the shareholder-employee does not receive regular pay over monthly or shorter periods throughout the year; or

[16.3] the shareholder-employee receives less than 66 percent of their gross annual income as an employee; or

[16.4] an amount is paid as income that may be allocated to the shareholder-employee as an employee for the income year.

[17] It is clear that the accountant preparing the financial statements for the appellant understood that he did meet the qualifications for being a shareholder-employee; the financial statements and tax returns are prepared on that basis. Accordingly the appellant did not comply with the PAYE regime. The appellant indicated that his income was irregular, and as it was a small company, it would meet one or more of the definitions of the companies which may have a shareholder-employee.

[18] Section RD 3C makes provision for certain persons who would also qualify under s RD 3D, but includes regular pay periods where an amount may later be allocated to the person as an employee for the income year. It allows a shareholder-employee to continue, if, during one of the last three income years, they had qualified as a shareholder-employee. Otherwise the section provides that a shareholder employee receiving "a regular amount for regular pay periods" is treated as receiving PAYE income

---

[1] Section RD 3B(3)

payments. The appellant's evidence was that he did not receive regular payments.

[19] Section 79(1)(b) of the Act applies to the first period in issue, at that time the Income Tax Act 2004 applied. Under that Act the question was whether the appellant was receiving source deduction payments, for present purposes the provisions relating to shareholder salaries were not materially different.

[20] We are in the position where we must accept that on the evidence before us the appellant was receiving a shareholder salary, he was doing so properly; and accordingly, his circumstances are not within s 79(1) of the Act at any point in time relevant to this appeal.

[21] We do, however record that the distinction between what would qualify as an exception under s 79 and the appellant's circumstances is purely one of form. The appellant was paying his tax in advance under the provisional tax regime in exactly the same way as would have occurred, subject to timing differences that are not intended to be material, had he been receiving the income as PAYE income. The election to take a shareholder salary was no more than one of convenience; the choice between being in the PAYE regime and taking a shareholder salary is significant only for two reasons:

[21.1] under the PAYE regime, the compliance obligations are usually more onerous; and

[21.2] there are some minor differences in terms of timing and cash flow, and the shareholder salary regime tends to make it easier for retaining profits so that working capital requirements are managed easily. The advantage for working capital is that it is not necessary to commit to regular payments to a shareholder-employee; they can be managed in line with cashflow.

[22] We note that s 79 makes no provision for people who do not establish a company or other structure. When providing professional services like the appellant, they will not be in an employment relationship. They may operate as sole traders, and return all of their income in New Zealand; nonetheless, they will be treated differently from a person who is an

employee, notwithstanding that their tax obligations are, like the appellant, not different in substance.

[23] In these circumstances, we have no alternative but to conclude that this appeal must fail, notwithstanding that there are no substantial reasons for treating the appellant differently because he is a shareholder-employee rather than an employee paying PAYE.

Retrospective effect

[24] Until 10 April 2015 the Appellant had every reason to expect he would be entitled to New Zealand superannuation when he retired. Section 6 of the Social Security Amendment Act 2015 (2015 No 41) changed s 79 of the Act to its current form. Until that date section 79 provided:

> **79 Persons liable for income tax on earnings while employed overseas deemed to be resident in New Zealand**
>
> (1) Where any person has been employed outside New Zealand and while so employed was liable for the payment of income tax on earnings from that employment, then, for the purposes of satisfying the residential qualification for any benefit after the return, on or after 23 June 1987, to New Zealand of that person or the spouse or partner or any child of that person,—
>
> (a) that person shall be deemed to have been resident and present in New Zealand during the period of such employment outside New Zealand:
>
> (b) if the spouse or partner or any child of that person was with the person during that period or any part of it, the spouse or partner or child shall be deemed to have been resident and present in New Zealand during that period or that part of it, as the case may be:
>
> (c) any child of that person born out of New Zealand during that period shall be deemed to have been born in New Zealand.
>
> (2) Nothing in subsection (1) shall be construed to derogate from the provisions of section 77.

[25] On one view the current form of section 79 retrospectively alters the appellant's entitlement to New Zealand Superannuation. However, that is not a true characterisation. Rather than being retrospective, the issue is whether a person currently qualifies for New Zealand Superannuation. It does not affect past entitlements, which would be a true retrospective

effect. Current entitlement may be defined differently from time to time, without the legislation being retrospective; it is neither more nor less than a change in the current eligibility rules. None-the-less, people have organised their affairs around the principles as they existed. The appellant would have clearly been entitled to New Zealand Superannuation if the rules down to 2015 applied; his entitlement was removed or deferred by the 2015 amendment.

[26] The current form of section 79 provides specifications for past periods. The specification relates to the past version of the Income Tax Act that was in force for any given period applicable to the "resident and present" determination. That is quite different from the previous form of section 79. Accordingly, there can be little doubt the clear intention is that the current version of section 79 is intended to determine eligibility as a substitute for the previous rules.

[27] There are no relevant[2] savings provisions in the Social Security Amendment Act 2015; accordingly there will be a number of people who were receiving New Zealand Superannuation on 10 April 2015 who then became ineligible. The new legislation in 2015 deprived them of the right to ongoing superannuation payments. While such changes are within the power of the legislature, it is not usual to take such steps without making provision for persons who have relied on the existing law. If that was the intention of Parliament, it might be expected that the Ministry would have conducted a campaign to identify person who would cease to be paid New Zealand Superannuation. Otherwise, the people affected would become liable for significant overpayments.

[28] Accordingly, we are satisfied that the appellant is in the situation where the only reason he does not qualify has nothing to do with the substance of his tax arrangements. He was fully compliant and paid tax on his income in New Zealand, and did not receive tax credits for tax paid elsewhere (other than for one year). He would have qualified if he paid his tax under the

---

[2] Section 11(1) and (3) of the Social Security Amendment Act 2015, appear to provide the current s 79 does not apply to reviews, appeals and other proceedings challenging a decision under the Act. That is provided the dispute commenced before 6 July 2013, and it relates to whether the person was taxed on income outside New Zealand under what must be the old version of section 79 that was in force at that time. However, it is not clear why the saving is necessary. The new section would only apply to pre 2013 disputes, if it was retrospective, rather than taking effect as from 2015. This saving provision does not appear in schedule 32 of the Act.

PAYE system, and he could have done so if he knew that in the future the law would be changed to introduce a distinction between PAYE and shareholder salaries. Given that there is no difference in substance between the PAYE regime and the shareholder salary regime, it appears very unfair that the appellant and others in his position should be disadvantaged in this way.

Recommendation

[29] We request that the Chief Executive consider the outcome of this appeal. In particular, that he investigate whether the present law treats New Zealand resident taxpayers differently for appropriate policy reasons, or whether the current law is anomalous and requires further consideration.

Decision

[30] For the reasons discussed the appeal is dismissed.

Dated at **Wellington** this 9th day of October 2017

_____
G Pearson
Chairperson

_____
K Williams
Member

_____
C Joe JP
Member