

Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provision) Bill

16 June, 2003

Acting Attorney-General

Legal Advice:

Taxation (Annual Rates, Gst, Trans-Tasman Imputation And Miscellaneous Provision) Bill: Consistency With The New Zealand Bill Of Rights Act 1990

INTRODUCTION

1. We have reviewed the Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provision) Bill ("the Bill") (PCO 5144/6) for consistency with the New Zealand Bill of Rights Act 1990 ("Bill of Rights Act"). We understand the Bill will be considered by Cabinet Legislation Committee at its meeting on Thursday, 19 June 2003.
2. The Bill contains a provision that appears to be inconsistent with the right to be free from discrimination as affirmed by section 19(1) of the Bill of Rights Act. We do not consider that this provision can be considered a justified limitation in terms of section 5 of the Bill of Rights Act.
3. We note the discrimination arising in this Bill results from distinctions between the legal rights and tax liabilities of married couples and de facto couples (opposite-sex or same-sex) that cut across the income taxation system as a whole. As you will be aware, this issue was discussed at length in the section 7 report tabled in late 2002 in respect of the Income Tax Bill 2002. Furthermore, we note the issues surrounding the legal rights and tax liabilities of opposite-sex and same-sex couples are likely to be addressed in the context of the government's proposals to remedy discrimination and distinctions made on the basis of marital status and sexual orientation across the statute book. However, this proposed future reform does not of itself provide a justification in terms of the Bill of Rights Act.
4. The Crown Law Office has seen this advice and agrees with the conclusions reached. We have also consulted with the Inland Revenue Department ("IRD") regarding the intended operation of various aspects of the Bill and the policy objectives underlying it.
5. Accordingly, we recommend that, as soon as practicable, you bring the Bill to the attention of the House of Representatives, pursuant to section 7 of the Bill of Rights Act. We have attached a draft section 7 report for this purpose for your consideration and signature, if you agree.

Brief overview of the Bill

6. The Bill seeks to introduce a number of significant changes to current taxation laws. In particular, the Bill will amend the Income Tax Act to make New Zealand income tax credits available to Australian companies. Changes are also proposed to the Goods and Services Tax Act 1985 to introduce a "reverse charge" mechanism to tax certain import of services. Finally, the Bill contains a large number of remedial and consequential amendments, some of which have retrospective application.
7. We consider that one of the amendments proposed appears to be inconsistent with the right to be free from discrimination as affirmed by section 19(1) of the Bill of Rights Act.

Section 19(1) of the Bill of Rights Act: The right to freedom from discrimination

8. Section 19(1) of the Bill of Rights Act provides the right to freedom from discrimination on the grounds set out in section 21 of the Human Rights Act 1993. These grounds include:
 - "Marital status", which includes the status of being single, married, or living in a relationship in the nature of marriage; and
 - "Sexual orientation", which means a heterosexual, homosexual, lesbian or bisexual orientation.
9. The key questions in assessing whether discrimination under section 19 exists are:
 - (i) Does the legislation draw a distinction based on one of the prohibited grounds of discrimination?
 - (ii) Does the distinction involve disadvantage to one or more classes of individuals?
10. If these questions are answered in the affirmative, we consider that the legislation gives rise to a *prima facie* issue of "discrimination" under section 19(1) of the Bill of Rights Act. Where this is the case, the legislation falls to be justified under section 5 of the Bill of Rights Act.

Clause 14 - New subpart S inserted into Part E

11. Clause 14 inserts a new subpart ES into the Income Tax Act. The proposed new subpart provides that tax deductions will be deferred [\[1\]](#) where a financial arrangement:
 - results in the allowable tax deductions being greater than the gross income; and
 - involves money that the investor is not at risk of having to repay.
12. Where the proposed new subpart ES applies, an investor and an affected associated person are required to pay (jointly but not severally) tax on an

amount deemed to be gross income by subclause ES 3(2)(a) or (b). For the purposes of the new subpart, the term "associated person" (a standard term used throughout the Income Tax Act for the purposes of anti-avoidance provisions) includes a married partner but excludes both opposite-sex and same-sex de facto partners. [2] As a result, the subpart distinguishes between married persons and de facto partners. The proposed new subpart appears to place de facto partners at a financial advantage because they may be eligible for tax deductions in respect of financial arrangements. Married persons investing in similar financial arrangements may not be eligible for such deductions and consequently will be at a financial disadvantage.

13. Furthermore, we note that - while the proposed new subpart results in a financial advantage to a taxpayer in a de facto relationship - it may also be seen as socially disadvantaging these taxpayers as their relationships are not given the same degree of recognition as married relationships. This disadvantage is arguably stronger for people in same-sex relationships because they are not able to marry. The proposed new subpart ES therefore gives rise to issues of direct discrimination on the ground of marital status, and indirect discrimination on the ground of sexual orientation.
14. Where a provision is found to be *prima facie* inconsistent with a particular right or freedom, it may nevertheless be consistent with the Bill of Rights Act if it can be considered a "reasonable limit" that is "justifiable" in terms of section 5 of that Act. The section 5 inquiry is essentially two-fold: whether the provision serves an important and significant objective; and whether there is a rational and proportionate connection between the provision and that objective. [3]
15. We understand that the proposed new subpart ES is intended to combat aggressive tax arrangements that provide taxpayers with excessive tax advantages. The consequences of such arrangements include a loss of revenue to the government, [4] an inefficient use of IRD's resources and individual investors in these arrangements can be exposed to unexpected interest and penalties on any resulting unpaid tax. By providing greater certainty as to the application of tax laws, the proposed new subpart is expected to increase protection for taxpayers from avoidable shortfall penalties and interest.
16. The proposed new subpart ES treats taxpayers in a marital relationship differently from other taxpayers in order to recognise the financial interdependence between married persons due to the nature of their relationship and prevent married persons from using their relationship to gain an inequitable tax advantage. It is our understanding that the underlying assumption of this differential treatment is that taxpayers who have a close relationship with each other are more likely to enter into transactions on a non-arm's length basis and thereby avoid tax liabilities.
17. In our view, the above objectives are important and significant. In particular, distinctions made on the basis of a marital relationship that have the objective of ensuring the tax system take into account the financial peculiarities of such relationships appear to us to be legitimate. Accordingly, the proposed new

subpart ES meets the first limb in the inquiry under section 5 of the Bill of Rights Act.

18. While we recognise the importance and significance of the objectives behind the new subpart ES, we do not consider that there is a rational and proportionate connection between the discrimination identified and these objectives. The presumption that married persons are, to some degree, financially interdependent on each other is a common thread throughout legislation and social policy. However, in general, people involved in de facto relationships are likely to have a similar degree of financial interdependence as married persons. In fact, we note that for the purposes of many other areas of social policy the interdependence (including financial) of de facto relationships is clearly recognised. [5] It appears anomalous that taxpayers in de facto relationships are able to gain a tax advantage where a married person is unable to do so when both groups of taxpayers are in substantially the same position.
19. We accept the proposed new subpart will apply only in situations where a number of specified and targeted criteria are met. However, given the underlying objectives for the treatment of people in relationships as discussed in paragraph 16 above, this approach does not appear to be a rational one. If it is necessary or desirable to treat people in marital or marital-type relationships differently from single people, due to the assumed nature of their finances, then all people in relationships of that nature should be treated the same unless there is a rational basis for not doing so. We recognise the administrative difficulty in proving the existence of de facto relationships, however, we consider that this problem is not insurmountable as proving the existence of de facto relationships is currently achieved under the social security regime. Arguably, the issue is compounded by the fact that the current tax regime treats opposite-sex couples the same as married couples for some purposes and not others.
20. Accordingly, we have concluded that the proposed new subpart ES cannot, in terms of section 5 of the Bill of Rights Act, be considered a reasonable and justified limit on the right to freedom from discrimination.

On-Going Policy Process

21. As noted above, the government is currently considering the rationalisation of the treatment of same-sex couples in all areas of law and has agreed that, in general, same-sex couples should be treated in the same way as opposite-sex couples. As part of this process, IRD is currently working with the Ministry of Justice to address issues relating to the treatment of de facto and same-sex couples in taxation legislation. However, IRD has advised that it does not consider the Bill to be the appropriate vehicle to make the amendments necessary for the equal treatment of these couples.
22. Nevertheless, we consider that the exclusion of de facto couples (whether of the opposite-sex or same-sex) from the coverage of this Bill cannot be justified on the basis of proposals for reform that have yet to be realised. [6]

We have not been made aware of any contextual issues that justify the ongoing lack of recognition of these relationships in the meantime.

CONCLUSION

23. We consider that clause 14 of the Bill appears to be inconsistent with the right to be free from discrimination as affirmed by section 19(1) of the Bill of Rights Act. We do not consider that this inconsistency can be justified in terms of section 5 of the Bill of Rights Act.
24. Accordingly, we attach for your consideration a draft section 7 report in relation to the Bill. If you agree with this report, we will prepare it for tabling in the House as soon as practicable.
25. In accordance with your instructions, we attach a copy of this opinion for referral to the Minister of Justice. A copy is also attached for referral to the Minister of Inland Revenue, if you agree.

Val Sim Cheryl Gwyn
Chief Legal Adviser Deputy Secretary

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Footnotes

1. Tax deductions will be deferred to the extent the loans are outstanding.
2. Clause ES 2(1) of the Bill defines "associated person" as meaning associated persons as defined in any provision of section OD 7 or OD 8(3) Income Tax Act.
3. See *Moonen v Film and Literature Board of Review* [2000] 2 NZLR 9, and *R v Oakes* (1986) 26 DLR (4th) 200.
4. The explanatory note to the Bill states that the income tax at stake to date in the arrangements of which IRD is currently aware is in the order of \$400 to \$450 million. This could continue to increase in the absence of a targeted response.

5. Social Security Act 1964; Injury Prevention, Rehabilitation, and Compensation Act 2001; and Property (Relationships) Act 1976.
6. See our advice on the Social Security (Residence of Spouses) Amendment Bill 2001 and the War Pensions Amendment Bill (No.2) 2001.