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Tax Alert

May 2023

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Wealth report – a fruit salad of information

By Robyn Walker

Tax has been front of mind for the general population since the release of Inland Revenue's High-Wealth Research Project (the Report) and the companion piece prepared by The Treasury looking at Tax and Transfer Progressivity in New Zealand. Given the size of the work produced and the speed with which the media cycle works, the attention inevitably goes towards the numbers conveniently included within the 2 page press release or highlighted by the Minister of Revenue Hon David Parker in a speech, and those become the commonly accepted 'facts' – "the 'rich' 311 family units surveyed only pay 8.9% tax", "only 7% of their income is personal income", "their average wealth is $276 million and have total wealth of $85 billion", "the 'average New Zealander' pays 20.2% tax".

Reading the headlines, and then reading the report, can leave an 'average New Zealander' desperately trying to recall high school statistics lessons and thinking of that famous quote 'lies, damned lies, and statistics'. So let me put this on the table, I am not a statistician, but I am someone who likes cold-hard facts and being able to analyse data, and to use another statistics idiom, 'compare apples to apples'.

With that in mind, this article is a presentation of some of the information from the Report. But first, a statistics refresher:

The **'mean'** is the average when the sum of a collection of numbers is divided by the count of numbers in the collection.

The **'median'** is the middle result when all pieces of data are placed in order from smallest to largest.

Which is better, well it depends on context, but comparing a median result to a mean result is a bit like comparing apples to oranges, or to use another fruit analogy, cherry picking. The ability to misuse the mean when the median may be more appropriate is helpfully illustrated by the joke "Bill Gates walks into a bar, and everyone inside becomes a millionaire, on average" – here the use of the mean artificially inflates the wealth of the population in the bar.

Before getting into the detail, it's worth noting upfront that frustratingly the Report does not clearly present data to allow readers to form opinions. Some data is only provided for certain years, some data has absolute numbers, some only has percentages, some have a mean but not the median, some has the median but not the mean, and some of the data has been presented only in bar graph format without totals (Inland Revenue have subsequently supplied me with some of this data) – it's a fruit salad of approaches. Ultimately the presentation of the Report means that it

is necessary to read the narrative to get the fullest possible picture rather than just looking at a series of numbers in a table and jumping to conclusions - possibly a good thing, provided you're not time poor.

Net worth

In the interests of privacy, the Report does not provide information on the wealth of any individual/family group, but it is very clear from the data that there is a significant range of net worth's, and one can only assume there must be some significant outliers – to play on the joke above, Bill Gates walks into a bar of 311 millionaires, and everyone inside becomes a billionaire, on average.

Net worth distribution

Net worth	2015		2018		2021	
Less than $50 million	137	44%	93	30%	85	27%
$50 million - $250 million	138	44%	158	51%	149	48%
Above $250 million	36	12%	60	19%	77	25%

Median total net worth

Median total net worth	2015	2018	2021
	$60,326,151	$86,445,743	$106,090,022

Mean net worth

Mean total net worth	2015	2018	2021
	$205,880,807	$237,739,905	$275,970,588

Those who are interested in juicy details about New Zealand's wealthiest families will be disappointed, there is no information about the highest net worth, or how many billionaires are included in the population.

So, from the above you can ascertain that total wealth (mean x 311) was $64 billion, $73.9 billion and $85.8 billion in 2015, 2018 and 2021 respectively.

You can also conclude:

- that wealth is increasing, with the population moving up the distribution bands between 2015 and 2021;
- that 75% of the sample population has less than $250 million wealth in 2021;
- that using the median total net worth in 2021 of $106 million presents a more accurate presentation of 'average' net worth than the mean of $276 million.

It should also be noted, for the record, that the methodology used in the Report uses a mix of actual data and assumptions, so none of the numbers above are precise numbers, they are approximations. The growth in wealth in this population is, unsurprisingly, heavily made up of unrealised gains – some of which will be attributable to inflation (which is unadjusted, hence the gains include inflationary gains).

While not factored into any calculations, Inland Revenue asked the survey population to provide 50 years of information about inheritances. Over 50 years, an estimated total of $411 million was passed down within sixty-six family units; with the mean inheritance being $6.2 million and the median $1.3 million. The inference you can take from this data is other than some potential outliers with significant inheritances, the surveyed population is largely made up of 'self-made' millionaires.

Economic Income

The Report focuses on determining what is total economic income in order to quantify the effective tax rate (ETR) of the survey population. The Report notes that annual economic income for the project population varied between $1 billion in 2017 to $14.6 billion in 2021. The Report does not provide a clear breakdown of economic income, rather the data is provided through a bar graph at figure 12.1; the "All income values for project population" breakdown below has been supplied by Inland Revenue.

The Report notes that in 2018 the median family economic income is $8 million, and the mean family economic income is $22 million. Again, this indicates that economic income is skewed by outliers in the dataset.

The Report notes that income in 2021 is "relatively high" due to a combination of higher payments of dividends and salaries and buoyant asset prices. This is an understatement, as when you sum the 'all-income' amounts across the survey period, 2021 makes up 47% of all income. It seems

All income values for project population

	2016	2017	2018	2019	2020	2021
Base income	$316m	$289m	$312m	$315m	$302m	$668m
Trustee income	$354m	$332m	$429m	$433m	$449m	$1,048m
Property income	$764m	$831m	$665m	$714m	$968m	$1,933m
Portfolio	$453m	$160m	$648m	$709m	-$18m	$1,923m
Business entities	$2,908m	-$588m	$4,754m	-$899m	$517m	$9,013m
All-income plus imputed rent	$4,799m	$1,050m	$6,802m	$1,276m	$2,218m	$14,585m

that it's all peaches and cream in 2021, but the dataset ends before the economy started to upset the apple cart in 2022.

When reading the table above, it needs to be noted that the process of building up to economic income is complicated and is focused on increases in asset values. In most cases, asset values are estimated based on assumed annual growth rates rather than verified information/actual data (the only exception is significant holdings of listed company shares), as such the Minister's comment that "[f]or the first time, we have hard data confirming fundamental unfairness in our tax system" may over-estimate the hardness of that data.

Business Income

The Minister noted in his speech that "[t]he financial affairs of the very wealthy are often complex and can involve partnerships plus hundreds of companies and multiple trusts." While the Minister is talking in generalisations, the Report notes:

- Total entities (which includes companies and trading trusts) included within 'business income': 2,695 (this results in a mean of 8.66 per responding family)
- Total trusts: 1,279 (this results in a mean of 4.14 per responding family)
- Total partnerships: 88 (this results in a mean of 0.28 per responding family)

Of the 2,695 business entities, it is acknowledged that the number could be higher, this figure only includes companies with gross assets and/or taxable income of greater than $1 million, or trading trusts with over $100,000 of income. However, these numbers don't support the complex web of affairs portrayed by the Minister.

The Report notes that about 55% of businesses are owned via a trust.

The Report acknowledges that business income can be volatile, noting that business entity income ranged from -$899m in 2019 to $9,013 million in 2021.

Included within business income are non-taxed distributions (e.g., returns of capital) to shareholders and estimated capital gains (calculated by estimating the equity value of unlisted entities using either a multiple of EBITDA, a revenue multiple or a multiple of asset values; with a 25% illiquidity discount applied). Data was collected on business sales, but the report writers decided not to include any data about actual realised capital gains; therefore, all amounts in the table are speculative.

Business entity income value

	2016	2017	2018	2019	2020	2021
All business entities	$2,908m	-$588m	$4,754m	-$899m	$517m	$9,013m
Percentage of income over survey period	19%	-4%	30%	-6%	3%	57%

Property

The Report provides data about the average amount of property owned on a collective basis; being 5,107 residential properties and 1,879 non-residential properties; no data is provided about the mean or median number of properties owned by family unit. The value of the mean investment in property increased from $24.6m in 2015 to $43.3m in 2021. The calculation of asset values varied depending on whether the property was residential or non-residential. Residential properties have generally been valued using third-party automated property valuation services. Non-residential properties have been valued by taking the 2015 rateable value and applying an annual growth rate:

- Forestry: 13.2%
- Farms: 0.7% - 19.4%
- Commercial: 5.4% - 21.1%
- Industrial: 7.1% - 15.9%

Considering the growth rates being applied, the Report notes that 59% of calculated capital gains comes from non-residential property. Property gains have been calculated using the automated valuations rather than actual sales data due to concerns with mixing actual sales prices with automated valuation information from 2015. As such no data on actual realised gains is provided for property. Data in the Report, extrapolated from Table 9.3, indicates that approximately 32% of capital gains for property are realised, with the remainder being unrealised gains.

Portfolio Investments

Portfolio financial assets are investments in equity and debt instruments. The Report applies a variety of methods to attribute capital gains to different investment types, all of which apply a rate of return rather than actual data.

Listed Company Investments

45 members of the survey population were identified as having significant holdings in listed companies. Because data in relation to share prices is more readily available, the value of shareholdings was tracked for a 17-year period from 1 April 2004 to 31 March 2021. Over this period, total capital gains were $6 billion, with only $1.7m being realised capital gains; noting that capital losses arose in 2008-2009 and 2015-2016. A significant portion of gains occurred in 2021 alone.

Tax Paid

The Report presents a summary of the ETR for the survey population, which starts with base income (essentially what is taxable under the Income Tax Act) and then contrasts this to all-income (essentially all forms of economic income):

Type of ETR	Weighted mean[1]	Median
Base income	32.1%	30.1%
All-income	9.9%	9.3%
- All-income plus imputed rental ETR	9.8%	**8.9%**
- All-income plus imputed rental netting transfers	9.7%	8.6%
- All-income plus imputed rental and GST ETR	10.1%	9.5%

[1] Note, the effective tax rate calculations in the Report use an 'income weighted-mean' rather than a 'simple mean'.

The Report was designed with a specific purpose in mind, being to understand the wealth of a population of families. While it aims to be objective, the objectivity of the report may have been better served by clearer data and less "sound bite" selections of data.

The bottom three rows of the table adjust tax on economic income to factor in the benefit of living in your own home compared to the cost of having to rent it, superannuation benefits (note, the median population age was 68) and GST. The statistic chosen to be focused on is the median 'all-income plus imputed rental ETR' of 8.9%, which is interesting as the Minister himself said "I prefer estimates of income that exclude imputed rents and capital gains on the owner-occupied home, at all income and wealth levels."

What does this translate into actual amounts of tax paid? Again, the Report does not clearly present this information, with the Tax paid by source breakdown supplied to me by Inland Revenue. The years 2016-2020 were broadly similar, with 2021 having a large increase in tax due to the increase in the top personal tax rate which took effect from the 2022 tax year.

Tax paid by source

	2016	2017	2018	2019	2020	2021
Personal	$98.7m	$88.6m	$96.2m	$98.9m	$97.5m	$226.5m
Company	$161.9m	$161.7m	$129.4m	$216.7m	$211.2m	$98.1m[2]
Trust	$176.7m	$150.0m	$181.7m	$205.8	$201.8m	$439.7m
GST	$14.5m	$14.5m	$14.5m	$14.5m	$14.5m	$14.5m
Total	**$450.9m**	**$414.8m**	**$421.8m**	**$536.0m**	**$525.1m**	**$778.8m**
Mean	$1.45m	$1.33m	$1.36m	$1.72m	$1.69m	$2.5m

[2] This is lower because company tax has been attributed to individuals trusts due to dividends paid, not because companies paid less tax.

There is no year-on-year data provided about the median value of tax paid per year by family group.

In relation to GST, it is worth noting that the estimates of GST paid specifically exclude any GST paid on purchases of motor vehicles or housing stock because the amounts are large and purchased infrequently. The Report also notes that some high-wealth families reported spending in excess of their taxable income, but neglects to join the dots with the median survey respondent age being 68 (despite the Report highlighting that retirees spend their savings in retirement).

What statistics are missing

The Report was designed with a specific purpose in mind, being to understand the wealth of a population of families. While it aims to be objective, the objectivity of the report may have been better served by clearer data and less "sound bite" selections of data. This would have reduced the risk of the report being seen as directed towards a particular outcome

and avoided any question about the political neutrality of the Inland Revenue.

While not called out, the Report indirectly highlights some of the key issues that a capital gains tax design would need to address (if one was to be progressed as some commentators are now calling for): critically the subjectivity of valuations, the volatility in economic cycles and the treatment of unrealised gains and losses.

As a snapshot, while it is undeniable that the survey population has a lot of wealth (which, in reality, may actually bear little resemblance to the data in the report), that is just one side of the story. The volatility of the business income also serves to highlight the personal risk-taking of these individuals, with history showing us that fortunes can be lost a lot easier than they are made.

The research also didn't extend as far as to understand the impact of these hard-working individuals on New Zealand; for example, the value that those businesses bring to the economy and society through building infrastructure or creating the goods and services we need and want, the number of employees working in their businesses (and the tax paid by those employees), the philanthropic activities and charitable donations made – often in a modest way.

As a snapshot, while it is undeniable that the survey population has a lot of wealth (which, in reality, may actually bear little resemblance to the data in the Report), that is just one side of the story.

So, what is next? Now it's down to politics.

In next month's Tax Alert, we'll take a closer look at the Treasury Reports.

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Recapping Deloitte's April 2023 FBT and employment taxes webinar

By Stephen Walker

I'm sure that those of you who tuned in to Deloitte's annual FBT and employment taxes webinar at the start of April are feeling fully refreshed and confident on all things FBT as you get stuck into your end- of-year FBT returns (due 31 May). But for those of you who couldn't make it (or perhaps for those of you that did but were multi-tasking and missed the vital piece of information you were hoping for to help you complete your FBT return – you know who you are), do not panic for here follows a quick round up of the key issues that were covered, and some of the insights gleamed from the polls conducted during the session.

FBT refresher

What is a fringe benefit

A fringe benefit exists where a benefit is provided to an employee in connection with their employment and it is not specifically exempt from FBT. Benefits that employer's often provide, that are captured within FBT, include:

- Private use of motor vehicles
- Low or nil interest loans
- Free or discounted goods/services
- Gym memberships
- Free or discounted clothing
- Private use of business assets
- Life and health insurances
- Vouchers/gifts/flowers
- Off-site car parking
- Fuel cards

So if you know your employer provides these types of benefits and is not returning FBT on them, there could be a FBT shortfall.

Common FBT exemptions

That said, some of the common benefits listed above may be exempt from FBT depending on the circumstances under which they are provided. Common exemptions from FBT include:

- Benefits provided on premises
- Business tools
- Charitable exemption
- Work related vehicles
- Distinctive work clothing
- Health & safety
- Unclassified benefits de-minimis exemption

As with many things in tax, the 'devil is in the detail', so if you think one of the above exemptions could apply to any of your fringe benefits, it's important to be sure of how and when these exemptions apply, and whether or not they will in your particular case. Please get in touch if you would like to discuss your staff benefits and those that might be taxable or exempt.

Motor vehicles often represent the majority of an employer's FBT cost. It is also often the area with the most errors.

FBT vs PAYE vs entertainment

I'm often asked where the divide is between FBT, PAYE and entertainment. Based on the examples and polling conducted during the webinar, it seems that this is still an area of confusion for some employers, with about 20% of respondents getting the distinction between FBT, PAYE, and entertainment incorrect, even after a refresher on the rules.

In terms of the FBT vs PAYE divide, the general 'rule of thumb' is to follow the contractual arrangement. If the contract for the provision of the benefit is between the employer and the benefit provider, then the benefit will generally be subject to FBT. Take the example of gym memberships; if an employer enters into a contract with the gym to provide access/membership for one of its employees, the cost of that access/membership will be subject to FBT. However, if the employee enters into a contact directly with the gym for their membership, and the employer reimburses them for their membership cost or pays it on their behalf, the cost will be subject to PAYE and not FBT.

In terms of entertainment (broadly the provision of food and drink in this context), items will generally fall into this category if the employee does not have a choice as to when or where to enjoy the entertainment. So, for example, a bottle of wine gifted to an employee will generally be subject to FBT as they can choose when and where to consume it (even if their colleagues pressure them to open it with them after work), but a bottle of wine at a team dinner (and the dinner itself) will be subject to the entertainment regime as there is no choice on the part of the employee as to when and where to enjoy it.

FBT on motor vehicles

Motor vehicles often represent the majority of an employer's FBT cost. It is also often the area with the most errors. Common errors seen in relation to FBT on motor vehicles include:

- Failure to appreciate that FBT applies to vehicles based on availability for private use, and not actual use.
- Incorrect understanding as to what constitutes private use, especially the work commute.
- Failure to use the GST-inclusive motor-vehicle cost.
- Incorrect calculation of the taxable value.
- Incorrect calculation of exempt days.
- Incorrect application of the work-related vehicle exemption, and/or failure to maintain appropriate documentation in support of this exemption.

So, if any of your employees are allowed to take company vehicles home, and you've not had your FBT position in relation to motor vehicles reviewed for a while, you should consider getting it reviewed by one of our FBT specialists, even if you think the vehicles are FBT exempt. Since I'm yet to undertake a FBT review with no errors in relation to motor vehicles, I would put money on your FBT positions in relation to motor vehicles being incorrect if you've not had a FBT review for a few years.

FBT calculations and cost savings from attribution

FBT costs will have increased for many employers from 1 April 2021 with the introduction of the 39% marginal tax rate for individuals, and so with it the increase in the top rate of FBT to 63.93% (from 49.25%). Attributing benefits to each employee and ensuring they are taxed at the marginal FBT rate that corresponds to their marginal tax bracket is the best way to ensure you minimise the rate of FBT paid on fringe benefits.

Pre April 2021 many employers may have considered and discarded attribution, most likely on the basis that many of their employees were earning close to or more than $70,000 per year and so any difference in FBT payable between attributing or not would have been minimal and may not have outweighed the compliance costs of attribution. Employers in this position would likely have adopted the single rate FBT calculation method, with all benefits taxed at a flat 49.25%.

From 1 April 2021, applying the same approach means the same benefits become taxed at 63.93%. However, because under attribution the top FBT rate of 63.93% applies to those earning more than $180,000 per year, and there are typically only a small proportion of the employee population with annual salaries above this top threshold, performing an attribution calculation for most employers is now more likely to result in FBT savings that do outweigh any additional costs of attribution.

Our poll, conducted during the webinar, showed that about 20% of respondents were still using the single rate attribution method. Again, I'm willing to put money on these employers being able to save on their FBT costs if Deloitte were to perform an attribution calculation for their 2023 quarter 4 FBT return, even taking into account our fees for doing so. As mentioned earlier, the 2023 quarter 4 FBT return isn't due to be filed until 31 May so if you were one of the 20% still using the single rate, it's not too late to access the FBT savings from attribution and I encourage you to reach out so you can start saving on your FBT costs now. Even if you have already filed your 2023 quarter 4 FBT return, it's not too late to approach Inland Revenue to request an amendment to the calculation method so please get in touch if this applies to you.

Hot FBT topics

New FBT exemption for bikes and public transport

Please refer to our recent tax alert article here on the changes to these rules, and some of the practical issues in terms of accessing these new exemptions.

Electric vehicles

Unlike Australia, New Zealand is yet to see any FBT exemptions in relation to electric vehicles. Until we do, we're left trying to apply existing FBT rules to their use. This not only includes the private use of an electric vehicle under the motor vehicle FBT rules (which were designed with fuel cars in mind), but also extends to the power used to charge the vehicles.

In the context of an employer owned/leased electric vehicle made available for an employee's private use, issues to consider from an FBT perspective include:

- An increase in FBT costs for the employer since most electric vehicles cost significantly more than fuel cars and FBT liabilities on vehicles are largely driven (no pun-intended!) by their cost.
- An employer charging the vehicle at home which arguably constitutes a contribution to the taxable value of the private use of the vehicle for FBT purposes, reducing the amount of FBT to pay. How do employers put a value on this employee contribution in practice? There are also arguably corporate income tax and GST considerations associated with the employee contribution in the form of power. From a practical perspective, are employers going to bother to capture this? Probably not.
- Employers paying to install vehicle charging units in the employee's home, and the FBT treatment of this.

In the context of an employee's own electric vehicle, if the employer allows the employee to charge the vehicle on work premises, this would be a taxable fringe benefit. Could it be exempt under the on-premises exemption? Well since this exemption applies only where the benefit is "used or consumed by the employee on the premises of the employer" there could be an argument that this exemption does not apply as the power is consumed by the employee on the road and off-premises. An alternative view could be that the power is "consumed" on premises by virtue of the battery being charged.

Hopefully we will see further announcements/guidance on these issues and possible concessions around electric vehicles from policy officials in due course, as these vehicles become more and more prevalent on our roads and within employer vehicle fleets. For now, if you have electric vehicles in your fleet and would like to discuss the above issues, please reach out.

Summary

So, if you're still using the single rate FBT calculation method or you allow your employees to take company vehicles home, and you've not had a FBT review within the past three years, I recommend you get in touch with me or one of our FBT specialists as it is likely there will be some FBT errors as well as FBT cost savings available to you. Now's the perfect time to get your FBT positions reviewed, so that adjustments can be made prior to the filing of the 2023 quarter 4 return due on 31 May. Even if you have already filed this return, there's still time to submit adjustments, even if they are to your advantage so don't let this stop you.

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Inner-city bolthole? Tenants funding your OE? Inland Revenue sets straight the main home exclusion to the bright-line test

By Viola Trnski and Robyn Walker

Do you own, and use as a residence, two or more homes? Have you been absent from your main home during the bright-line period? If the answer is yes, you may have tax to pay if you sell your home within a bright-line period. Inland Revenue has released two pieces of draft guidance to assist homeowners facing these questions.

Consultation on both items runs until 30 May 2023:

- QWBA – If a person has two or more homes, which home is their main home for the purpose of the main home exclusion to the bright-line test?
- IS – Income tax – How absences affect the main home exclusion to the bright-line test

The bright-line test

The bright-line test taxes residential land sold within a certain period from the date of acquisition ('the bright-line period'). The bright-line period is five years for land acquired from 29 March 2018 to 26 March 2021 and ten years for land acquired on or after 27 March 2021 (or five years for new build land acquired after 27 March 2021).

The main home exclusion

A person's main home is not subject to tax if it is sold during the bright-line period ('the main home exclusion').

Parliament made it clear that a person can have only one main home – and that this home must be used as a residence. What remained unclear, however, was how to determine which home is the main home if a person uses two or more homes as a residence, or if they are absent from their home. Fortunately, we are here to break down Inland Revenue's latest guidance on the matter.

Is the property 'used as a residence'?

For the main home exclusion to apply the property must be 'used as a residence'. Inland Revenue adopts the ordinary meaning of these words. A dwelling is

'used as a residence' when it is customarily or repeatedly used as a place where a person resides on a permanent basis. It is the seat of their domestic life and interests. Actual physical use is required, not intention or emotional connection.

It is irrelevant if there are reasons beyond the control of the taxpayer that meant they could not use the dwelling as a residence. For example, if a house is flooded and requires extensive renovations where a person must leave for more than 12 months, the main home exclusion may not apply for the full period of the absence, depending on when the property was acquired.

If you are absent, can it still be your main home?

The rules determining how the main home exclusion applies to absences will be different depending on when you acquired the property.

For land acquired from 29 March 2018 to 26 March 2021 (the five-year bright-line test)

The main home exclusion will apply if the dwelling on the land was used as the main home for most of the bright-line period. 'Most' means more than 50% of the time – and Inland Revenue draws a hard line: if the land was used as a residence for half of the bright-line period or less, the main home exclusion does not apply at all. No adjustments can be made to recognise periods where the dwelling was used as a residence. On the plus side, provided the property was used as a main home for more than 50% of the time, the property will be fully exempt under the main home exclusion regardless of any period spent living elsewhere.

For land acquired on or after 27 March 2021

Unfortunately for homeowners with newly acquired properties who have post-pandemic itchy feet, the rules are more complex.

Here the main home exclusion applies when all days in the bright-line period are 'main home days'.

The concept of 'main home days' initially seems fitting. Confusingly, however, it also includes days when the land has not been used as a main home – if these days do not exceed 12 months. An absence exceeding this 12-month buffer period

It is irrelevant if there are reasons beyond the control of the taxpayer that meant they could not use the dwelling as a residence. For example, if a house is flooded and requires extensive renovations where a person must leave for more than 12 months, the main home exclusion may not apply for the full period of the absence, depending on when the property was acquired.

is a strong indicator that the dwelling is not used by that person as a residence.

The Commissioner considers that an absence exceeding 365 days does not represent typical use of a dwelling as a residence, although, the exact outcome will be fact dependent. A friend house-sitting while you're backpacking around Europe is one thing but relocating to London for two years and renting it out is another. If a person relocates and stays in their home whilst visiting twice a year, this would not constitute a fixed or permanent presence, nor would it be typical use of a residential dwelling. The main home exclusion would not apply.

However, an adjustment is allowed for periods where the dwelling was used as a residence (for land acquired on or after 27 March 2021). To put this in a simple example, if a property was acquired in mid-2021, the taxpayer lived in the property until mid-2022 and left for a 2-year OE to London, returning to the property in mid-2024, if the property was then sold in mid-2026, then the main home exemption could apply for 3 years, but would not apply for 2 years; that is, 40% of any income from the property would be taxable under the bright-line.

If you have two or more residences, which is your main home?

The statute reads that, if a person has two or more homes they 'use as a residence', their main home will be the one they have the 'greatest connection' with.

'Greatest connection'? How do I know!?

The 'greatest connection' test is objective and requires an overall assessment of the person's circumstances. A person may not, based on emotion (or tax purposes), arbitrarily decide which of their properties they have the 'greatest connection' with when applying the main home exclusion.

If you have a family home and a holiday home, you don't need to worry – the test does not apply because the holiday home is not, typically, 'used as a residence' in Inland Revenue's view.

Inland Revenue has listed several factors to consider:

- the time the person has occupied the home,
- where the person's immediate family lives,
- where the person's social ties are strongest,
- where the person's employment, business interests and economic ties are located, and
- where the person's personal property is located.

None of these factors alone can determine whether a property is a person's main home, but they can indicate which dwelling the person has the most significant or important bond with.

For example, a person may spend most of the working week in a central city apartment and join a sports club nearby, but their immediate family and possessions are at another property in the country. An overall assessment tends to indicate the country home is likely to be their main home. Factors like their immediate family and personal possessions being there carry more weight. The person probably spends holidays at the country home and has more social ties there as that is where their family is based.

If a person is a New Zealand tax resident, the bright-line test may apply to their overseas properties as well. Therefore, if they spend time overseas and own more than one property, they may also need to consider which home they have the greatest connection with.

Property transactions can be tricky. There have been frequent changes to the bright-line test since it was introduced, we therefore recommend you seek tax advice before selling a property that may be subject to the bright-line. If you have any questions, please contact your usual Deloitte advisor.

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Earlier access to cash for some R&D Tax Incentive applicants

By Simon Taylor, Brendan Ng and Alex Song

The Research and Development Tax Incentive (RDTI) has continued to be improved since it was reintroduced in 2019/20. The RDTI now has 1779 businesses enrolled (compared with just over 500 in the first year of operation), with $265 million of tax incentives having been paid by the Government. This has supported private sector investment in R&D of $1.77 billion so far.

Eligible taxpayers will now be able to receive payments for their Research and Development (R&D) during the year under a new in-year payment scheme, allowing quicker access to cash. Previously certain claimants would have to wait until the year had ended to prepare, file and wait for their R&D Supplementary Return to be assessed by Inland Revenue, before receiving any cash benefit from the RDTI regime.

Key features of the new regime include:

- Ability to access up to 80% of RDTI tax credit/refund during the claim year through an interest-free loan;
- Requires approval of activities in place through General Approval process;
- Loan application requires details of eligible R&D expenditure;
- Loan is ordinarily repaid as part of R&D Supplementary Return filing process.

Under the new scheme, during the year a taxpayer can receive an interest-free government loan for the amount of tax credit/refund that a taxpayer would be eligible for in that period, with the Supplementary Return process used at year-end as a 'wash up', to cover any underpayments or overpayments. The introduction of this scheme follows the Ministry of Business, Innovation and Employment's (MBIE) announcement last year, which is covered in a previous Deloitte Tax Alert article, and the scheme will be administered by Tax Management NZ (TMNZ).

Who is most likely to benefit from RDTI in-year payments?

Businesses that will benefit the most will be those that have no provisional tax to pay or businesses operating at a tax loss (or having losses carried forward) and in some cases profitable businesses whose RDTI tax credit exceeds any provisional tax due. Taxpaying companies can factor in the RDTI tax credit in their provisional tax payments to obtain a cash benefit during the year

(by paying less tax throughout the year to Inland Revenue). This is an option that is not available to taxpayers with losses or who do not have a provisional tax obligation.

Businesses that are operating at a loss or businesses that have no provisional tax to pay can only obtain a benefit from the RDTI at the end of the year when their Supplementary Return is processed and their RDTI tax credit refunded in cash. However, the in-year payment scheme allows these businesses to get a cash loan throughout the year.

The cash loan will be based on a taxpayer's eligible RDTI claim for each instalment period i.e., their actual R&D costs for the period. The loan will be capped at 80% of the actual R&D expenditure in the period (as a conservative measure) and a taxpayer can claim as much or as little of its R&D expenditure in each period (up to the 80% cap). At the end of each year the taxpayer will still be required to file a Supplementary Return, at which point the remaining R&D expenditure can be claimed (such as the remaining 20% of R&D expenditure and any other R&D costs not captured earlier).

The in-year payments application and process

To be eligible for the new in-year payments a business must be a going concern and be performing R&D activities that have been approved as eligible for the RDTI (i.e., a business will need to have an approved General Approval (GA) application). To fully benefit from the new scheme, it is advised that GA applications should be filed at the earliest convenience to have access to the in-year payment scheme. GA applications can be lodged from the start of the relevant financial year, up to the 7th day of the second month after year-end (7th May for 31st March balance dates) or may be covered by multi-year approvals from prior years.

What the process will look like:

- Get an approved GA application for the relevant period.
- Register on the TMNZ website for the in-year payment scheme, which includes:
  - Going through Anti Money Laundering (AML) and Due Diligence (DD) checks.
  - Granting TMNZ the authority to access your Inland Revenue RDTI account to check R&D activities and expenditure details.

Businesses that are operating at a loss or businesses that have no provisional tax to pay can only obtain a benefit from the RDTI at the end of the year when their Supplementary Return is processed and their RDTI tax credit refunded in cash. However, the in-year payment scheme allows these businesses to get a cash loan throughout the year.

Once this has been completed and a business has been approved for the in-year payment scheme, they are eligible to make a payment request. In the given income year, a business can request up to three payments at regular intervals. The dates of these payments/requests have not yet been announced. The information that a business provides may be subject to audit by MBIE, so it is crucial the information that is submitted is accurate and can be backed with evidence.

In each payment request, a business will be asked to record all actual eligible expenditure they wish to claim. It is up to the business to determine which expenditure they wish to include, which flows through to the size of the loan that the business wishes to take out. Given it is a loan, some businesses may wish to keep their loan within a certain limit to manage loan exposure and the ability to repay the loan. If a business is intending to offset an amount of provisional tax, this will have to be advised in the payment request. If a business has more than one GA application approved, it will have to include the expenditure associated with each GA application on the same loan.

When is the loan repaid?

The loan will be due to be paid back on the earliest of either:

a) One month after IR has approved or declined a Supplementary Return (SR), or

b) Six months after the due date of the business's RDTI SR.

If a business fails to repay the loan at the relevant due date above, interest will accrue on the loan at the rate of Inland Revenue's Use of Money Interest rate at the time. The business will also be ineligible to receive another loan until the outstanding loan has been repaid.

Example of Loan Payment calculation:

A business with an income year ending 30 June 2022:

- Has an approved GA application; and
- Requests a payment based on actual eligible expenditure of $300,000; and
- Advises that it intends to offset $25,000 of its anticipated RDTI tax credit against provisional tax due during the period covered by the payment.

	$
Actual eligible R&D expenditure	300,000
RDTI tax credit @ 15%	45,000
Less amount offset against provisional tax	25,000
RDTI tax credit eligible for RDTI in-year payments	20,000
Loan payment @ 80%	16,000
Total benefit to the business	41,000
(provisional tax offset of $25,000 plus the RDTI in-year payment of $16,000)	

What should I do next?

If in-year payments of the RDTI tax credit are something your business may be interested in, there are a number of considerations that need to be worked through, particularly the need to have General Approval(s) in place to cover the activities claimed. We recommend that 2024 income year General Approvals are prepared and lodged as soon as possible if you wish to benefit from the in-year payments regime. If you think your business is eligible and will benefit from the introduction of in-year payments, we recommend you get in touch with the specialist Deloitte R&D team or your usual Deloitte advisor.

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When Cash is King, consider checking your approach to GST

By Sarah Kennedy, Hana Straight and Sam Hornbrook

With financial times getting tougher, make cashflow easier by considering these 10 simple ways that GST can help improve your cashflow.

1. Acceleration of input tax credits

For those on the invoice basis, if "taxable supply information" (previously "tax invoices" - see recent changes, in this article terms taxable supply information and invoices are interchangeable) is received after the accounting system is closed for the current GST period but relates to a supply in that GST period, input tax can still be claimed in the current period's GST return, it does not have to be claimed in the later period. This can allow a one-off permanent cash flow injection. For example, if the GST time of supply was triggered in April, but the invoice details were only received in May, the GST can still be claimed in April.

When implementing this it is important to track which input tax is claimed 'early' to prevent double claiming.

2. Earlier Filing for Refund Returns

Where a GST return is in a refund position, cash can be freed up by filing the GST return as soon as possible after the period ends rather than waiting for the due date.

If being in a refund position is not usual for your business, having a few lines explaining why the return is a refund and attaching any supporting documents in myIR can help to speed up Inland Revenue processing.

If you are in a GST refund position and Inland Revenue sends a "section 46 request", please contact a Deloitte Indirect Tax team member before responding. We can help streamline the process and increase the speed at which your refund is released. Above all, don't just ignore the request.

3. GST Periods/Basis

Periods

If your GST returns are in a payable position, consider whether you can move to less frequent filing, reducing the number of payments due and increasing the time between payments.

If your returns are in a refund position, a more frequent filing frequency will assist with allowing you to receive the refunds sooner.

Payments Basis

If you are struggling with customers being unable to pay their accounts, moving to the payments basis can help.

Under the payments basis, output tax is generally not due to be returned/ paid to Inland Revenue until you have received payment from your customers.

However, equally, you need to have paid your suppliers to claim an input tax deduction. The payments basis is only available for taxpayers with sales under $2million.

4. Input Tax Support

Tax invoices are no longer required to support input tax claims, instead, taxable supply information is required. Taxable supply information can be across multiple documents. As this is a new requirement ensure your accounts payable team is aware of the changes and not denying input tax claims because of the lack of tax invoices if you otherwise have the taxable supply information in another form.

5. Bad debts

If certain criteria are met it is possible to obtain a deduction for the GST on bad debts, i.e., debts that are objectively bad and have been written off for accounting purposes. It is best practice to write off bad debts throughout the year, rather than just waiting for the end of the year.

6. Disputed amounts (invoice basis)

Where a supplier's invoice to you is being disputed, it is possible to claim the full amount of GST included in the taxable supply information. Any adjustments will be made in a future GST period if there is ultimately a reduction in the amount of the invoice.

7.GST Grouping

Transactions between GST group members are ignored when completing the GST return. Forming a GST group can therefore give rise to a cashflow benefit where the members in the GST group are filing returns on differing frequencies or can help 'smooth' GST where one entity is in a payable position, and another is in a refund position.

There are specific conditions that must be met to allow GST grouping and consideration needs to be given to the benefits and disadvantages before an election to form a GST Group is made.

8. Entities that make exempt supplies

If you make exempt supplies (including holding shares in some instances) and do not currently have a B2B election you should file one. This election allows some exempt supplies to businesses to be turned into zero-rated supplies, allowing input tax to be claimed.

Now is also a great time to review apportionment calculations to maximise GST recovery.

9. GST offsets on asset transfers

Where an asset transfer takes place that does not include land, the purchaser can transfer the GST credit on the purchase to the vendor's GST account to reduce the cash needed. There are some steps involved in this process, but it can be a great cashflow saving approach.

10. Filing GST Returns and Making Payments:

If you think you may need to defer your GST payment to Inland Revenue (or other tax payments) you should contact Inland Revenue and proactively manage this through an instalment arrangement.

If you would like more information or assistance implementing any of the suggestions above, please contact a member of the Deloitte Indirect Tax team or your usual Deloitte advisor.

Tax invoices are no longer required to support input tax claims, instead, taxable supply information is required. Taxable supply information can be across multiple documents. As this is a new requirement ensure your accounts payable team is aware of the changes and not denying input tax claims because of the lack of tax invoices if you otherwise have the taxable supply information in another form.

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Cross-border and remote workers – NRCT reporting rules out, taxpayer favourable rule changes in.

By Jayesh Dahya and Mila Robertson

Cross-border and remote working arrangements can lead to New Zealand tax liabilities for both employees and employers. Our experience shows that these liabilities are often misunderstood or are not clear up front.

These tax liabilities can take the form of NRCT (Non-Resident Contractor Tax), PAYE, fringe benefit tax (FBT) on employer provided benefits, and employer superannuation contribution tax (ESCT) on contributions to employees' superannuation schemes, etc.

Our Tax Alert article from September 2022 highlighted the proposed changes to simplify the complexities involved with cross-border work and after consultation and submissions, the following changes have now been enacted with varying application dates.

PAYE Simplification:

Recognising that foreign employers may not fully understand their tax obligations in New Zealand, which can result in backdated tax obligations, the following changes have been made in relation to cross-border workers:

- Introducing a 60-day grace period: Employers now have a 60-day grace period to correct their PAYE obligations if they have taken reasonable care to manage their employment obligations. This change aims to assist employers who have employees present in New Zealand where there has been a breach of the 92-day rule that exempts employment income derived by non-resident employees.
- Ability to apply for bespoke PAYE arrangements: Employers can now apply for bespoke PAYE arrangements in "special circumstances." Although Inland Revenue has yet to develop guidance on what constitutes "special circumstances," this change is expected to benefit employers who have cross-border work arrangements in place, such as business travellers with irregular travel patterns, to settle their taxes more efficiently.
- Repeal of the PAYE bond system: The PAYE bond system, which was rarely used, has been repealed.

These changes are positive and introduce a degree of pragmatism that has been missing for many years. This should result in reduced compliance costs for employers of cross border workers.

Remote Workers:

For non-resident employers who do not have a requirement to register for PAYE, FBT, or ESCT, the obligation to account for PAYE falls to the employee, who pays tax by registering as an IR56 taxpayer.

Originally, it was proposed that the FBT and ESCT obligations would be transferred to the employee, requiring them to prepare FBT calculations, which can be complex and time consuming process.

After receiving submissions around the impracticalities of having employees preparing FBT returns for their employers, the following changes have been enacted:

- Non-resident employers will now be expected to register as an employer if they provide their employees with fringe benefits or make contributions to a superannuation scheme, unless it is agreed with the employee (in writing) that the employee will meet the tax obligations.
- If an agreement is made, the employer must provide the employee with the relevant information to complete the FBT or ESCT obligations and in this instance:
  - Fringe benefits are treated as taxable income and will be taxed at the employee's marginal tax rate, rather than the FBT rates.
  - Contributions to superannuation schemes can be taxed under the PAYE regime or the ESCT regime.
    - Where an employee treats these amounts as PAYE, they should note that this will result in increased taxable income and would be included for assessing working for families tax credits, child support, independent earner tax credits, and any student loan payments etc.

Safe Harbour for Non-Resident Employers:
A safe harbour provision has been introduced for non-resident employers who have incorrectly determined that they do not have a sufficient presence in New Zealand and accordingly have not registered as an employer. To be eligible for the safe harbour, the non-resident employer must meet the following criteria:

- Have 2 or fewer employees present in New Zealand at any point in the income year, or be liable to pay $500,000 or less of gross employment-related taxes in New Zealand for the income year; and
- Have taken reasonable measures to manage their employment-related tax obligations within 60 days of the failure.

If these criteria are met, the non-resident employer will be protected from penalties and interest charges on unpaid tax.

NRCT - No Increased Reporting Requirements!
As a result of numerous submissions on the workability and significant compliance costs of the proposed NRCT reporting requirements, Inland Revenue agreed with submitters that sticking with the status quo is the best option for now.

As a result of numerous submissions on the workability and significant compliance costs of the proposed NRCT reporting requirements, the Finance and Expenditure Committee determined that the proposed changes would be removed from the Bill.

Taxpayers can breathe a sigh of relief that the already complex NRCT regime won't yet be burdened by onerous reporting requirements. However, NRCT reporting continues to be a matter of interest to Inland Revenue who have gone back to the drawing board to undertake further consultation on this topic.

In the meantime, the following changes have been made in relation to NRCT:

- A 60-day grace period for a payer to meet or correct their NRCT obligations where at the time a payment is made, it is not clear that NRCT withholding is required and a liability to NRCT subsequently arises. This will operate in a similar manner to the grace period for PAYE discussed above.
- Allowing nominated taxpayers to meet the NRCT obligations of a non-resident contractor. This is intended to simplify compliance for non-residents who may have activities in New Zealand through different businesses. Each person, however, would be jointly and severally liable for the amount of tax due under such an arrangement. For the purposes of obtaining certificates of exemptions, a nominated person can establish a good compliance history for the non-resident contractor.
- Allowing certificates of exemption to have retrospective effect by allowing payments made before the exemption is issued to be covered. This would only apply to payments made 92-days before the person applied for an exemption.

Concluding Comments
The changes should simplify the complexities involved in cross-border work and provide relief for taxpayers. The introduction of a 60-day grace period for PAYE and NRCT, the ability to apply for bespoke PAYE arrangements, and the safe harbour provision for non-resident employers are expected to assist employers in complying with their tax obligations more efficiently.

Remote workers in New Zealand should familiarise themselves with the changes in relation to fringe benefits and ESCT to ensure compliance with the new tax rules.

As always, if you have any questions on how the changes above impact you or could benefit your business, please contact your usual Deloitte advisor.

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Income tax and GST treatment of grants clarified

By Robyn Walker and Joe Sothcott

In the last month, Inland Revenue has released some helpful draft Interpretation Statements on the tax treatment of grants and subsidies. PUB0044: Income Tax – Government payments to businesses (grants and subsidies) considers how sections CX 47 and DF 1 of the Income Tax Act 2007 apply to grants and subsidies for the purposes of income tax. Meanwhile, its sibling PUB00425: GST – Section 5 (6D): Payments in the nature of a grant or subsidy looks at how section 5(6D) of the Goods and Services Tax Act 1985 applies to grants and subsidies for the purposes of Goods and Services Tax (GST).

Both draft statements provide welcome clarifications on several issues that have caused confusion.

Income Tax

In the Income Tax Act, sections CX 47 and DF 1 (the provisions) work together to make sure grants and subsidies are tax neutral — meaning there is no tax incentive or disincentive when grants or subsidies are applied for. Section CX 47 treats grants and subsidy payments as non-taxable, whilst section DF 1 treats business expenses funded by grant or subsidy payments as non-deductible.

To qualify as a grant or subsidy, one or more of the following characteristics is required:

- It is paid gratuitously (without obligation) out of public funds by the Crown or another public body
- It is paid to further objectives in the public interest
- It is often made to public, charitable, or private bodies to confer benefits on third parties
- It is made to promote or encourage an industry or enterprise
- The provisions apply when all of the following criteria are satisfied:
- A payment is from a local authority, public authority, or public purpose Crown-controlled company.
- The payment is to a person for a business that the person carries on.
- The payment is in the nature of a grant or subsidy or is a grant-related suspensory loan. A grant-related suspensory loan is made by a public authority, not designated as a specific suspensory loan, and must include the term that the liability of the borrower may be wholly or partly remitted or must have been granted by the Rural Banking and Finance Corporation of NZ (now ANZ) as a West Coast drainage or irrigation suspensory loan
- The corresponding expense is one for which the business would be allowed a deduction if section DF 1 did not apply. The term 'corresponding' is to be understood in its ordinary meaning in the context or purpose of the grant provisions. Income subsidies remain taxable because the payments do not correspond to a deductible expense.

Excluded payments include loans under the Small Business Cashflow Scheme, loans under the Research & Development Loan Scheme, Research & Development tax incentive transition support payments, and Research & Development tax loss credits granted under subpart MX of the Income Tax Act.

The draft interpretation statement has been, in part, issued to address four areas of uncertainty. First, when the grant or subsidy payment is not for any specific expenditure. Second, when the payment is not spent in the year it is derived. Third, when funds are left over after all the expenses the payment was made for have been spent. Fourth, the question of when the provisions apply.

General v specific expenditure

On the first point, the Commissioner acknowledges that grant or subsidy payments can be made for specific or general expenses. The conclusion reached is that as long as the payments and the expenditure it funds correspond to each other (meaning there is a relationship between the two), then sections CX 47 and DF 1 apply. This means the payment can be made for specific or general expenditure, provided the payment is used to fund deductible or depreciable expenditure.

Timing of the expenditure

On the second point, the Commissioner considers that it doesn't matter if a grant or subsidy payment is derived in one year but not spent until a later year. The provisions still apply as long as the expenditure corresponds with the payment. It is noted that the Commissioner expects the expenditure to be incurred within a reasonable timeframe, and it is perhaps unfortunate that there is no further discussion on what is considered a reasonable timeframe.

The provisions can also apply to payments reimbursing expenditure. However, when a deduction has already been claimed on this expenditure, earlier assessments must be amended to reverse out these deductions.

Surplus funds

On the third point, section DF 1 states that the amount of the deduction denied is equal to the amount of the payment received. If the expense exceeds the payment amount, a deduction is still allowed for the excess. But suppose there are surplus funds not spent on the relevant expenditure that corresponds with the grant or subsidy payment. In that case, the Commissioner expects that the surplus will be spent on other deductible expenses or depreciable property. Therefore, deductions will be denied on these deductions to the full value of the surplus payment.

When are the provisions applicable?

On the fourth point, the Commissioner believes that sections CX 47 and DF 1 apply to make a grant or subsidy payment non-taxable when it is derived, with derived generally meaning the moment the business can keep the payment. When payments are made conditionally, a business does not derive the payment until the conditions are met, although obligations that do not require repayment if not met are not included.

Finally, keeping good records showing how the payment has been spent and that the deductions corresponding to the payment have been denied is good practice. Keeping the payment in a separate account may assist with this.

The deadline for consultation on this issue statement is **16 May 2023.**

Finally, keeping good records showing how the payment has been spent and that the deductions corresponding to the payment have been denied is good practice. Keeping the payment in a separate account may assist with this.

GST

Under section 5(6B) of the Goods and Services Tax Act 1985, if a grant or subsidy is paid to a person in respect of their tax liability, then that payment is deemed to be a consideration for a supply of goods and services as part of the taxable activity. If the person is GST-registered, they must account for output tax on this amount.

For section 5(6D) to apply, the payment must meet the following criteria:

- There must be a payment in the nature of a grant or subsidy; and
- The payment must be made on behalf of the Crown or by any public authority; and
- The payment must be made to either:
  - A person in relation to or in respect of that person's taxable activity; or
  - A person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity

There is some crossover between the two statements. Notably, the legislation refers to a payment "in the nature of" a grant or subsidy, meaning payments that are not technically grants or subsidies can be captured under section 5(6B). The same is true of sections CX 47 and DF 1 in the Income Tax Act.

Exclusions include social welfare benefits, payments made for a person's personal use and benefit, payments declared by an Order in Council not to be a taxable grant or subsidy for the purposes of section 5(6D), and anything that appears on a Schedule to the Goods and Services Tax

(Grants and Subsidies) Order 1992 list of payments that are not taxable grants or subsidies for the section's purpose.

The payment must be made in relation to or in respect of that person's taxable activity. The Commissioner expects the Court would interpret this link widely, although does not believe it to be a significant issue because the accountability requirements on the Crown and public authorities will make it clear if there is a link.

Under section 5(6D)(b), the section will apply if a person is receiving funds on behalf and for the benefit of a third party. If the recipient of the payment is not the intended beneficiary, the ultimate recipient will have to account for GST. The challenging part is determining if a person is receiving funds on behalf of and for the benefit of a third party, which will vary depending on the specific facts of the case. The outcome will likely differ under section 51 in the case of separately registered branches or divisions of a person registered for GST.

An important thing to note is that if a person who is not GST-registered receives an amount from a grant or subsidy, and this receipt means they cross the GST registration threshold of $60,000 per annum, they will need to register for GST and pay output tax on the payment. This is generally a "backwards-looking" test from the end of a month where the total value of supplies in that month and the preceding 11 months exceeds $60,000. However, a proviso may apply if the grant or subsidy was a one-off payment, and the Commissioner does not believe the value of supplies in the next 12 months will exceed $60,000. In this case, there is no need to register for GST, and the person is not liable for GST output tax.

Another proviso may apply when a person spends the grant or subsidy payment on replacing any plant or capital asset used in their taxable activity. Whilst the person is still deemed to have made a supply upon receiving the grant or subsidy, if the proviso applies the supply may not be considered towards the GST threshold. This is conditional on being able to prove the grant or subsidy was paid on the sole condition that it was used to replace a plant or capital asset.

One final thing to note is that while PUB00425 replaces several previous statements on the application of section 5(6B), statements relating to Treaty of Waitangi settlements are not replaced.

The deadline for consultation on this issue statement is **23 May 2023.**

Given the Government has paid out significant amounts in grants, both related to COVID-19 and the recent North Island flooding the advice contained in these two draft statements will be helpful clarification for many taxpayers. Now is a good time to stop and check that any grants or subsidies received have been treated correctly.

Your usual Deloitte advisor would be happy to help if you have any questions.

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Turning the compliance screws on FATCA and CRS

By Troy Andrews, Vinay Mahant and Vicky Yen

As a reminder, the due date for New Zealand Financial Institutions (NZFIs) to submit their annual FATCA and CRS reporting information for the year ended 31 March 2023 to Inland Revenue is **30 June 2023.**

By way of background, the FATCA and CRS regimes were introduced to improve cross-border tax compliance. They require NZFIs to conduct due diligence on their account holders and to report certain information about their US/non-resident account holders to relevant tax authorities.

In light of increased audit activity, which to date has included on-site reviews and questionnaires covering a number of risk-based questions, the focus of NZFIs has been on expanding their internal risk and governance functions and monitoring their ongoing compliance. To date Inland Revenue's focus has been to review compliance of "large" NZFIs however we expect they will naturally expand these review actions to cover a wider population/smaller NZFIs as the next phase of this process.

An additional governance step initiated by Inland Revenue has been to develop a high-level annual FATCA and CRS disclosure that has recently been distributed to many NZFIs. Though most of the questions are areas that we would expect NZFIs to normally work through as part of their annual reporting, there are a few questions that may require additional thought including whether an NZFIs internal systems document/capture the total number of accounts with changes in circumstances/are treated as excluded accounts and questions in relation to procedures in place to identify avoidance schemes. The information provided will assist Inland Revenue to better understand the business and operating models of NZFIs and the quality of data submitted. Please note that the annual disclosure is also due by 30 June 2023. NZFIs that have not received a disclosure for 2023 year may still benefit from reviewing/considering the questions asked as part of their governance measures to ensure their policies and procedures remain up to date (while also noting that the disclosure is expected to be more widely distributed next year). Please let us know if you would like to discuss the disclosure questions with us.

Inland Revenue has also recently published a year-end checklist (set out below) to highlight issues NZFIs could review to ensure their systems remain fit for purpose. A number of these items are also included in Inland Revenue's new annual FATCA and CRS disclosure and previous risk-based questionnaires. We are increasingly seeing NZFIs complete health check reviews of FATCA and CRS compliance to identify and address any gaps/remediation required as an action to demonstrate and maintain comfort of governance/compliance ahead of any potential Inland Revenue review activity. This checklist sets out a very useful framework of questions that could be worked through as part of such an exercise. Please contact your usual Deloitte advisor if you have any questions, would like assistance with your annual reporting or would like to discuss how we can help you complete a health check review of your FATCA and CRS compliance.

Inland Revenue: year-end checklist for financial institutions

1. Does your enterprise-wide tax governance process cover sufficiently the CRS system (including reporting to senior management or the board of directors)?
2. Are your CRS policies, procedures and controls documented fully and periodically tested or reviewed for any changes that have taken place?
3. Have you maintained technical training (especially of new staff members with responsibilities pertaining to CRS work) and retained subject matter experts to answer the more difficult issues that arise?
4. Do you have back-up plans where there is considerable reliance placed on one or two key individuals?
5. Do you maintain quality controls when CRS system functions are outsourced offshore, especially given that New Zealand financial institutions have ultimate responsibility for complete and accurate CRS record-keeping, due diligence, and reporting?
6. Do you maintain documentation as to steps undertaken and evidence relied upon for performance of CRS due diligence procedures, including the identification and actions taken in respect of false certifications?
7. Are self-certifications obtained every time a new account is opened, and their reasonableness confirmed?
8. Are you still monitoring effectively for changes in circumstances in relation to the identity or reportable status of account holders and/or controlling persons?
9. Are you collecting tax identification numbers, dates of birth and full addresses for account holders (and controlling persons) as well as making reasonable efforts to collect TINs and DoBs for pre-existing accounts not already in your records?
10. Are trusts (including family trusts) properly classified and reported (including the reporting of account holders and controlling persons of the trust)?
11. Are undocumented accounts properly classified, reported and reducing in volume?
12. Are you keeping a watchful eye for potential CRS circumvention arrangements when opening a new account, such as the misuse of citizen/residence by investment schemes?

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Snapshot of recent developments

Tax Legislation and Policy Announcements

Business Payment Practices Bill
On 26 April 2023, the Select Committee reported back on the Business Payment Practices Bill. The Committee was unable to agree whether the bill should pass, but recommended a number of amendments to the bill, should the House determine the bill be passed. Background on the proposed bill can be found in our December 2022 Tax Alert article.

Tax Administration (Extension of Due Dates) Order 2023
On 11 April 2023, an order was enacted to extend specified timeframes under the Income Tax Act 2007 that relate to receiving a bad debt deduction and distributing beneficiary income. The new date to perform these actions is 31 May 2023. The order only applies to flood-affected taxpayers.

ACC levies set for 2023, 2024 and 2025
The ACC earners' levy rates have been set by regulation. The rates for each tax year are 2022-23: 1.46%; 2023-24: 1.53%; and 2024-25: 1.6%.

Child support pass-on bill introduced
On 28 March 2023, the Child Support (Pass On) Acts Amendment Bill was introduced. The Bill proposes that child support collected by Inland Revenue will be passed on to sole parents receiving a main benefit from July 2023.

Inland Revenue statements and guidance

Inland Revenue incorrectly cancels some direct debits
On 21 April 2023, Inland Revenue apologised for incorrectly cancelling some direct debits. Direct debits set up for instalment arrangements will not be affected. For any one-off payments, if the bank account is not available, you'll need to add a new direct debit mandate before the direct debit is requested.

Interpretation Statement: 5-year bright-line test: Certain family and close relationship transactions
On 20 April 2023, Inland Revenue issued a finalised statement IS 23/02 on the bright-line test under section CZ 39 of the Income Tax Act 2007 which applies to land that is not a main home purchased on or after 29 March 2018 but before 27 March 2021. If all the requirements of section CZ 39 are met, the bright-line test applies to a disposal from:

- Parents to their child;
- A company (not an LTC), where the parents are shareholders, to their child;
- Parents who are trustees to their child who is a beneficiary;
- One partner to themselves and their new partner (to the extent of the new partner's share);
- Two partners to a third party; and
- Beneficiaries under a will or rules governing intestacy to a third party to the extent that the disposed interest are not the same as the original shares acquired.

If the amount derived from the disposal is below the market value of the residential land, the sale will be taxed on the market value of the land (including gifts).

Deductions are allowed for the cost of the residential land.

Draft Public Ruling: GST treatment of payments made by parents to state and state integrated schools

On 12 April 2023, Inland Revenue released PUB00446, which is substantially the same as Br Pub 18/06 which it replaces.

The ruling confirms there is no GST chargeable where payments are made by parents or guardians to assist the school with the cost of delivering the education that the student has a statutory entitlement to receive free of charge.

GST is chargeable on payments made for supplies of other goods or services not integral to the supply of education to which the student has a statutory entitlement to receive free of charge, where those supplies are conditional on the payments being made.

The new ruling will apply from 21 June 2023 for an indefinite period. The deadline for comment is 24 May 2023.

CRS applied standard determinations

On 12 April 2023, Inland Revenue issued CRS 2023/01 and CRS 2023/02 which cancelled 2019 Excluded Account Determinations relating to the Asteron Superplan and Asteron Retirement Savings Plan due to the relevant scheme having closed.

Draft Interpretation Statement: Interest limitation rules and short-stay accommodation

On 4 April 2023, Inland Revenue published PUB00441 which considers how the interest limitation rules apply to interest incurred for property used to provide short-stay accommodation, and what other rules may be relevant to any interest that is deductible.

The rules in subpart DH of the Income Tax Act 2007 deny all interest deductions for disallowed residential property (DRP) acquired on or after 27 March 2021, and progressively deny deductions for grand-parented residential interest.

DRP does not include land to the extent that it is 'excepted residential land' i.e. a person's main home, the main home of a beneficiary or trust (if the owner is a trustee and the principal settlor has a different main home), or farmland (including dwellings on the land).

The new build land exemption may also apply, in which case the interest limitation rules do not apply. The rules may apply to one part of a piece of land, in which case land must be apportioned. The rules override all other deduction rules. The deadline for comment is 16 May 2023.

Inland Revenue releases three special reports on the new legislation

On 4 April 2023, Inland Revenue published three new special reports containing detailed information on new rules in the Taxation (Annual Rates for 2022-23, Platform Economy and Remedial Matters) Act 2023:

- Special report on GST apportionment and adjustment rules
- Special report on tax relief for North Island flooding events
- Special report on build-to-rent exclusion from interest limitation rules

Technical Decision Summary: Timing of income and expenditure

On 3 April 2023, Inland Revenue issued TDS 23/03 which concerned a Taxpayer whose business involved leasing assets to customers and maintaining the leased assets in good repair. The amount charged, described as 'rental', was partly for the lease, and partly for maintenance costs. The issue was to determine when the Taxpayer derived the maintenance component of the rental.

The Tax Counsel Office held that the taxpayer derived the rental under the leases when and to the extent they met their contractual obligation to supply assets in good repair and operating condition and was entitled to issue an invoice. The Taxpayer did not incur the maintenance expenditure at the time the leases were entered into.

Technical Decision Summary: Assessability of unexplained amounts, interest deductions and shortfall penalties

On 29 March 2023, Inland Revenue issued TDS 23/02. The Tax Counsel Office determined that unexplained deposits were business income (as the Taxpayer was unable to prove they were not), the Taxpayer was not entitled to interest deductions on their family home, and that penalties should be increased due to evasion, gross carelessness, and obstruction.

'Questions We've Been Asked': Payments made by parents to childcare centres

On 31 March 2023, Inland Revenue released two QWBA's:

- QB 23/03 Income Tax – Donation tax credits and payments made by parents to childcare centres
- QB 23/04 Goods and Services Tax – Payments made by parents to childcare centres

Inland Revenue completes 6th Common Reporting Standard (CRS) reporting year

On 31 March 2023, Inland Revenue completed the 6th reporting year for the CRS in New Zealand. Inland Revenue has compiled a checklist of twelve issues worth revisiting by financial institutions to ensure systems continue to remain fit for purpose.

Determination: International tax disclosure exemption 2023

On 31 March 2023, Inland Revenue issued ITR 34 which details the scope and application of the 2023 international tax disclosure exemption. The scope of the 2023 exemption is the same as for 2022, and the exemption applies for the income year corresponding to the tax year ended 31 March 2023. The new exemption removes the requirement for a resident to disclose:

- An interest in a foreign company if the resident has an income interest of less than 10% in that company and either that income interest is not an attributing interest in a FIF, or it falls within the $50,000 de minimis exemption.
- If the resident is not a widely held entity, an attributing interest in a FIF that is a direct income interest of less than 10% if the foreign entity is incorporated (in the case of a company) or otherwise tax resident in a treaty country or territory.
- If the resident is a widely held entity, an attributing interest in a FIF that is a direct income interest of less than 10% (or a direct income interest in a foreign PIE equivalent) if the FDR or CV method is used for the interest. The resident is instead required to disclose the end-of-year NZ dollar market value of all such investments split by the jurisdiction in which the attributing interest in a FIF is held or listed.
- For non-resident and transitional residents, the requirement to disclose interests held in foreign companies and FIFs has been removed.

Tax Information Bulletin Vol 35 No 2

Inland Revenue has published a Tax Information Bulletin for March 2023.

Global tax news

OECD Updates

OECD report: Communication and engagement with SMEs

The latest report in the Supporting SMEs to Get Tax Right series examines effective communication strategies that tax administrations can use to assist SMEs in fulfilling their tax obligations.

Inventory of Tax Technology Initiatives

The OECD Forum on Tax Administration has developed this tool to provide insights into digitisation projects and initiatives implemented by over 75 tax administrations.

Income-based tax incentives for R&D and innovation

On 18 April 2023, the OECD released a paper on the design features of income-based tax incentives for R&D and innovation. The paper describes the key design features of tax incentives available in all OECD and EU countries.

Note: The items covered here include only those items not covered in other articles in this issue of Tax Alert.

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