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Tax Alert

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New business continuity test – Inland Revenue releases guidance

By Campbell Rose, Vyshi Hariharan and Himo Salgado

Inland Revenue has issued guidance on how the main aspects of the recently enacted business continuity test (the **BCT**) will apply, in the form of draft interpretation statement - Loss carry-forward – continuity of business activities (**Draft IS**). The Draft IS provides valuable detail about how Inland Revenue sees the BCT operating in practice, including guidance on the meaning of various elements of the BCT, as well as the quantitative and qualitative factors to be considered when applying the test.

In this article we have briefly commented on the key areas covered by the Draft IS, and have included observations on other aspects that could usefully be addressed once the Draft IS is finalised.

What is the Business Continuity Test?

The BCT supplements the existing shareholder continuity tax loss carry forward rules with a new "major change" test. It allows losses to be carried forward to future years unless there has been a major change in the nature of business activities carried on, subject to meeting certain requirements. In most cases, taxpayers are required to assess whether there has been a major change from immediately prior to a breach in shareholder continuity, until the earlier of (a) all losses being used, and (b) the last day of the income year in which the fifth anniversary of the breach in continuity occurs.

How to describe the nature of a company's business activities?

A crucial first step in applying the BCT is establishing the nature of the company's business activities carried on. This sets the scene for any subsequent analysis of whether there has been a "major change" to the nature of those business activities within the prescribed period.

The Draft IS explains the meaning of "nature" and "business activities". It notes that 'the rule is concerned with the basic or inherent features, qualities, or character of the company's business activities'; with "business activities" meaning 'any action taken in the pursuit of one or more businesses that the company may carry on for income tax purposes'.

An obvious challenge here is that there are differing levels of granularity which can be used to describe the nature of a company's business activities. The Draft IS also helpfully addresses this, outlining the following three levels (noting that description 2 below is the level of granularity Inland Revenue considers to be appropriate):

1. *Very broadly (e.g. Agriculture, manufacturing, construction, retail, or professional services)*
2. *More narrowly (e.g. sheep farming, clothing manufacturing, house construction, book retailing, or architectural services)*
3. *Very narrowly (e.g. merino sheep farming for fine wool, hosiery manufacturing, kitset house construction, children's book retailing, or residential architecture).*

What is a major change?

Whether a change in the nature of business activities is a major change requires consideration of how significant the change is in the context of the operations of a company. The Draft IS outlines the relevant quantitative and qualitative factors to be considered as part of this analysis.

The extent to which the assets used in deriving the company's assessable income have remained the same or similar over the continuity period is one factor that must be taken into account in determining whether a major change has occurred. The Draft IS provides a useful interpretation of "assets", usually being those recorded in a statement of financial position, but noting that internally generated goodwill, brands, customer lists and early-stage intangibles should also in appropriate businesses be included in the analysis (but not people, generic business processes or generic know-how). The Draft IS also observes that the most appropriate way of assessing changes in assets depends on the context (e.g. number/different type of asset, area/floorspace and value – noting this could be at historic cost, book value, replacement value or market value as appropriate to avoid distortionary results).

Is a major change a permitted major change?

A company will be able to carry forward tax losses despite a major change, if the major change is a "permitted" major change. In this regard the Draft IS notes that, depending on the facts, it may be easier to first consider whether a change is a permitted major change – as opposed to analysing whether the change itself is major. The parameters of "permitted" major changes appear, in some cases, to be less complex to evaluate – so this observation from Inland Revenue is helpful in endorsing what is effectively a short-cut in the BCT analysis.

The Draft IS provides enlightening practical examples for each category of the permitted major changes, outlining various measures that should be considered for each carve-out.

One of the permitted major change carve-outs is satisfied where the "same, or mainly the same" assets are used to produce or provide a new type of product or service. When considering the meaning of "mainly", the Draft IS notes that, 'on balance it is considered that an interpretation that equates (in numerical terms) to approximately 75% is appropriate' in the context of the BCT. However, as stated in the Draft IS and as noted above, there are a number of ways that assets can be measured and the approach to be taken will depend on the context.

Cessation

A tax loss cannot be carried forward if, before the beginning of the prescribed period, the business activities of the company have ceased and not been revived; or if the company ceases to carry on business activities during the prescribed period.

The Draft IS discusses the difference between "temporary cessation of business" and "cessation with the possibility of recommencement", noting that a temporary cessation will not constitute a cessation of business activities for the purposes of the BCT, whilst a cessation with the possibility of recommencement will constitute a cessation.

Matters not addressed in the Draft IS

The Draft IS contains a brief statement regarding the application of the BCT to groups of companies – namely that companies forming part of the same group immediately before and immediately after an ownership breach occurs (for each of the companies) are treated as a single company for the purposes of the BCT. The analysis underlying the application of the BCT to groups of companies can be complex. We hope that Inland Revenue will include further guidance and practical examples in the finalised statement, as it is a common scenario to have a group of companies (comprising the same/similar, or quite different businesses) acquire a target business. It would be helpful to address a scenario where the acquiring group itself is relying on the BCT.

The Draft IS provides enlightening practical examples for each category of the permitted major changes, outlining various measures that should be considered for each carve-out.

Practically, major changes are unlikely to align perfectly with balance dates, and are more likely to occur part way through an income year. The Draft IS does not include any discussion (or examples) which provide guidance on the approach to be taken in a part-year scenario. Inland Revenue should include further guidance and practical examples in the finalised statement, including illustration of how the part-year rules will apply in a BCT context.

The Draft IS does not consider the targeted anti-avoidance provisions which were introduced as part of the BCT. Broadly, these are aimed at dormant companies, and include anti-injection/anti cost-shifting rules similar to what is included in the Australian regime. The measures seek to prevent loss trading, including by ensuring that income cannot be diverted into an acquired loss company to utilise losses quicker than would otherwise the case; and that expenses cannot be transferred out to another group member for no charge (again, to use up losses more quickly). Inland Revenue have noted that 'due to the significant overlap with the current revision of the s BG 1 interpretation statement' the Draft IS does not comment on these provisions. We understand that separate guidance will be issued by Inland Revenue in relation to these targeted anti-avoidance provisions in due course. In the interim, taxpayers should ensure they appropriately consider the anti-avoidance provisions, as they are a critical part of ensuring compliance with the BCT. We are not so sure that the overlap is as significant as Inland Revenue suggests given the targeted nature of the measures, but in the meantime taxpayers can refer to the commentary released when the BCT was enacted for guidance. For completeness it would seem sensible to at least include the specific anti-avoidance rules in the appendix, so that the new BCT legislation in its entirety is located within the Draft IS for readers' convenience.

Finally, it would be helpful to understand whether there will be any limitations on what aspect(s) of the BCT Inland Revenue will rule upon – as securing certainty in relation to application of the BCT in a capital-raising, innovation/pivot, M&A or other relevant context will be critical.

Submissions on the Draft IS close on 28 June 2021. If you would like to make a submission or to understand the impact of the BCT rules in more detail, please get in touch with your usual Deloitte advisor.

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Intra-group service charges – are your group's processes up to date?

By Bart de Gouw, Julian Bryant and Georgia Fsadni

Intra-group service charges are commonplace but an often overlooked area of transfer pricing. Most cross- border charges are for relatively routine activities and calculations simply rolled forward from one year to the next. We set out in the article a word of caution on the approach of simply rolling forward calculations. The reasons for this caution include:

- Increased tax authority scrutiny of management fees;
- Increasingly digital, borderless and remote business models;
- Changing of Inland Revenue and OECD guidance on routine service charges and high-value services;
- Abnormal costs incurred during the COVID-19 pandemic;
- Impact of government COVID-19 subsidies on service fee calculations.

In a cross-border context, transfer pricing rules generally require an arm's length charge to be made for intra-group services. As the particular business context in respect of which services are performed may change from year to year, and the rules and guidance in this area evolve, it is important to regularly revisit the internal processes applied to ensure that tax rules are complied with. We have described below a number of current considerations and frequently seen issues in this area.

Increased Inland Revenue scrutiny

Inland Revenue's 2020 International Questionnaire contained a new requirement to disclose the amount of management fees and service charges paid to non-resident associated persons, suggesting a current Inland Revenue focus in this space.

Are all services being appropriately identified?

As digital and "borderless" business models and remote working become more commonplace, the scope of employee roles may change, expand, or cover wider geographies. There are also increasing trends towards centralisation of key activities. It is therefore important to review transfer pricing policies regularly and ensure that all intra-group services are appropriately identified each year. Relevant activities may include:

- A head office providing support to subsidiaries, such as management, administrative, and technology support.
- An employee of one subsidiary assisting with projects of another subsidiary.
- An employee of a remote subsidiary fulfilling an important headquarters role, or engaging in other group-wide matters.

In the context of remote workers choosing to be situated in a new location different to their historical place of work, wider tax issues may also arise as covered in previous Tax Alert articles.

Are intra-group charges being made on an appropriate basis?

Under transfer pricing rules, it is necessary to support the arm's length nature of charges made through the application of an appropriate transfer pricing method. The methodology applied should generally also be documented.

In the context of routine services, the mechanism applied to calculate a service fee is commonly based on the relevant costs incurred plus an arm's length mark-up. Issues to consider include:

- Have all relevant costs been included? A reasonable allocation of indirect costs should generally be included, such as office overheads, depreciation, etc.
- Has an appropriate mark-up been applied? Generally, transfer pricing rules require a benchmarking exercise to be undertaken in order to determine the pricing that would be applied in an arm's length context. There is guidance and simplification measures that can apply, depending on the value of the services. This is discussed further below.
- Where services are performed for the benefit of multiple group entities, have service fees been charged to each entity on a reasonable basis, proportionate to the level of benefit received? Depending on the nature of the service, a particular allocation key such as revenue or headcount may be appropriate.

Do the transfer pricing approaches adopted reflect the "value" of the services?

To limit taxpayer compliance costs, the Organization for Economic Cooperation and Development (OECD) has previously introduced an elective, simplified approach for pricing low value-adding intra-group services. Qualifying services (being services which are supportive in nature, not part of the core business activity and do not involve unique and valuable intangibles or the assumption of or control of significant risk by the service provider) may be priced at cost plus a 5% mark-up without the need to undertake benchmarking analysis (see further in a previous Tax Alert article). This approach was initially adopted by Inland Revenue with a NZ$1 million total cost threshold, but this threshold has been removed for income years commencing after 1 April 2021. The removal of the threshold is favourable and will allow larger service transactions to be dealt with in way consistent with the OECD guidelines. It should be noted that the applicable rules in any counter-party jurisdiction would also need to be considered, as these may differ from New Zealand's approach.

Where services are not "low value" qualifying services per the guidance, further consideration is needed in relation to the appropriate mark-up to be applied. Furthermore, to the extent that services relate to important strategic or risk management functions (e.g., the activities of the group CEO based in a different location to the group's headquarters), special care would need to be taken to ensure that the pricing approach appropriately reflects the value of activities performed. In some circumstances, it may be appropriate for such high value services to be remunerated through a sharing of profits and losses of the group, rather than charging a routine service fee based on costs incurred. High value services can be complex and require careful analysis.

Are any abnormal features factored appropriately?

During periods impacted by the COVID-19 pandemic, there may be various changes to the nature and magnitude of costs incurred by group entities. If costs are incurred relating to business disruptions and/or changes to working models, it would be necessary to consider whether and how such costs relate to any services under consideration, and how they should be treated in calculating service fees. Furthermore, special care should be taken in the context of government assistance programmes (for example the wage subsidy), which, depending on the accounting treatment applied, may impact the level of net employee costs recorded in entity accounts, and potentially distort service fee calculations (see further in a previous Tax Alert article).

If you would like to discuss the above with us, or require any assistance with reviewing service charge methodologies in your group, please contact the Deloitte transfer pricing team.

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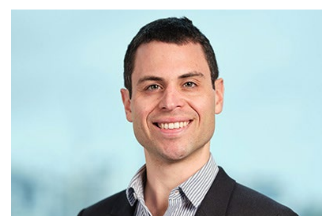

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The wage subsidy debate continues… over a year on, was the scheme a success? And are you safe from audit?

By Robyn Walker and Blake Hawes

For some of us it may feel like it was just yesterday, for others it's a distant memory – either way in March we marked an entire year since New Zealand entered one of the world's strictest lock-down to stop the spread of COVID. That also means more than an entire year has passed since the introduction of the Government's original wage subsidy, the financial lifeline that kept thousands of businesses afloat and many more Kiwi's employed.

While there were many critics of the wage subsidy it was considered overall a huge success in its aim to get cash out to support businesses quickly. Now, as the dust settles a year later, the success and downfalls of the Wage Subsidy have been reviewed. On 4 May 2021 John Ryan, the Auditor General of New Zealand, published a report on the [management of the Wage Subsidy Scheme].

The report provides an unbiased review of the three wage subsidies rolled out during 2020 (the wage subsidy, wage subsidy extension, and the resurgence wage subsidy) including the set-up and administration of the wage subsidy, the integrity of such a high trust scheme and its monitoring and management.

Overall the report is positive, it provides deserving recognition to the many public servants who worked countless hours in setting up one of New Zealand's biggest social welfare systems practically overnight. The report also applauds the Government for the efficiency and speed with which payments were made to applicants. The average number of days it took to make a wage subsidy payment to an applicant was 3.48 days, with the average number of days to make payment for the resurgence wage subsidy being as low as 1.82 days. This was an element of the scheme that was applauded by many during 2020 and was a key factor in jobs being saved.

Further statistics are provided which paint a picture of who claimed the wage subsidy and where the support was actually provided. Of the 735,111 payments made across the three wage subsidies, more than

99% were for less than $1m. In respect of the original wage subsidy, of the 99% of claims that were for less than $1m the average payment was only $19,882 with these numbers being massively impacted by the high number of claims being made by the self-employed. While some big payments were made, a significant proportion of the $14billion spent on the wage subsidy went to small businesses.

While these statistics are impressive, the report does bring to light that the eligibility criteria for the three wage subsidies were not always clear. An example of this was the uncertainty around what constituted "active steps to mitigate the impact of COVID-19".

One step further from the comments regarding "vague" and "ambiguous" criteria, the report specifically notes that there were clearly cases of fraudulent behaviour, evidenced by certain pre-payment review procedures and post-payment audits. It is noted in the report that the complaints process and publishing the names of recipients aided in detecting fraud and encouraging repayment from claimants who were not eligible.

In this respect the report sets out two broad recommendations:

1. Ensure that criteria are sufficiently clear and complete to allow applicant information to be adequately verified; and
2. Put in place robust post-payment verification measures, including risk-based audits against source documentation, to mitigate the risks of using a high-trust approach.

In relation to point two the report specifically recommends:

In relation to the Wage Subsidy Scheme, we recommend that the Ministry of Social Development prioritise remaining enforcement work, including:

- *seeking written confirmation from applicants (which could be targeted towards larger or risk-indicated applicants) of compliance with the eligibility criteria and the obligations of receiving the subsidy; and*
- *pursuing prosecutions to recover funds and/or to hold businesses to account for potentially unlawful behaviour.*

The recommendation by the Auditor General of New Zealand to seek written confirmation from all applicants indicates the importance that is being placed on the mitigation of fraud. If you made a wage subsidy application at any point last year and didn't fully prepare documentation verifying your eligibility to your claim, now might be a good time to do this. An earlier article written by Deloitte provides steps and procedures that can be taken to document your eligibility.

When reviewing a wage subsidy claim many people will recall the most prevalent and objective of the eligibility criteria being:

- The revenue decline test – note, that while applications could be made on the basis of the predicted revenue drop, this needed to subsequently be verified as having actually occurred; and
- Paying your employees at least 80% of the ordinary salary and wages, or if not possible, passing through the entire value of the wage subsidy.

However some may forget the more subjective, and commonly overlooked, requirement which was to "take active steps to mitigate the impact of COVID-19". While not an exclusive list, the eligibility criteria included drawing from cash reserves, making insurance claims and proactively engaging with the bank. This requirement of applicants is specifically noted in the report as one that was not clearly defined and likely to have been overlooked.

If you are reviewing a wage subsidy claim made last year we recommend thoroughly checking the claim against every part of the eligibility criteria, which can still be found online here.

As the New Zealand Government looks to pay down the debt that arose from the frantic COVID-19 spending and at the same time fund the various initiatives in the recent Budget, securing Government revenue becomes more crucial than it has ever been.

If you think you may need to review your claim from last year now is the time to do so. In the heat of the moment, and in the height of the COVID-19 pandemic, making a claim may have seemed like the right option at the time, but now looking back perhaps that wasn't the case. Instructions on how to make a wage subsidy repayment are available here.

For more insights or advice, please contact your usual Deloitte advisor.

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Advantage sports: being a team player can reduce your tax bill

By David Watkins and Emma Marr

New Zealand employees stranded in Australia for long enough to trigger an Australian tax liability may now find themselves at a newly-created relative disadvantage to professional sports people, with an Australian Budget announcement that would ensure New Zealand continues to have a primary taxing right over members of its sporting teams and support staff notwithstanding COVID-19 related travel restrictions. This is an interesting development for sports teams and their staff, however does not provide any good news for anyone else who has inadvertently created a tax presence in Australia in the last year, or expects to in the next year. The measure creates a relative tax advantage for a very small and specific group of New Zealanders in Australia.

The Australian Budget announcement stated that the Australian Government would amend their tax law to ensure New Zealand can exclusively tax members of its sporting teams and support staff, if they spend enough time in Australia to trigger Australian income tax or fringe benefits tax liabilities. The rule will apply if the individuals spend more than 183 days in Australia for certain cross-border sporting competitions because of COVID-19 related travel restrictions, and applies to the 2020-21 and 2021- 22 income and fringe benefits tax years. Legislation has since been introduced to bring this change into law.

The Australian Government viewed this as necessary to ensure that the double tax treaty between New Zealand and Australia "operates as intended" for such team members. It's not clear from the announcement why this concession should be limited to members of sports teams competing in cross-border sporting competitions.

Current position

There are two Articles in the double tax treaty (DTA) between New Zealand and Australia that potentially apply to New Zealand sportspeople who spend time in Australia. One applies to income from employment and one applies to entertainers and sportspersons. Both allow Australia to tax a sportsperson's income, however the employment income Article includes a 183-day exemption so that Australia cannot tax income arising from a short stay in Australia.

The Article that taxes entertainers and sportspersons generally takes priority over the employment income Article. However, if the sportsperson plays in a recognised team (other than a national representative team), that regularly plays in a league competition played in both New Zealand and Australia, the employment income article takes priority instead – meaning that

the 183-day exemption applies (as long as the employer doesn't have a permanent establishment (PE) in that country).

This is intended to apply to club-level rugby, netball, basketball and soccer competitions which take place in both countries. A New Zealander who is taxed in Australia on their salary or wages is effectively subject to tax at the higher of the prevailing rates in Australia and New Zealand, and receives a tax credit in New Zealand for tax paid in Australia. If Australia can't tax the sportsperson the income will only be taxed in New Zealand, where marginal tax rates are generally lower.

In other words, having the 183-day exemption is important for New Zealand sportspeople competing in Australia. Before 2020, sportspeople would typically be in Australia for regular short stay visits, amounting to less than 183 days in any twelve-month period. This meant the salary and wages they earned for their work in Australia would be taxed in New Zealand, not Australia.

Due to COVID travel restrictions, some of the New Zealand based teams in such competitions have been required to remain in Australia for prolonged periods in both the 2020 and 2021 calendar years.

Effect of Australian Budget announcement

The announcement modifies the 183-day test for members of eligible sporting teams, so that even if they exceed 183 days in Australia, New Zealand maintains exclusive taxing rights over the salary and wages (as long as the sportspersons employer hasn't created a PE in Australia. Although spending six months in a country might usually be considered "permanent", there are exemptions that apply to a presence required due to COVID.)

The intended outcome under the announcement is particularly beneficial for the NZ resident players given the higher marginal rates that apply in Australia as compared to the marginal rates that apply in New Zealand (foreigners are taxed progressively in Australia, starting at a 32.5% rate from the first dollar earned). Instead their income will be subject to tax only in New Zealand.

Observations

This targeted measure is a tax equivalent of a free-kick, but for New Zealanders in Australia, the proposed amendment only applies to members of eligible sporting teams. The effect of COVID-related travel restrictions goes much wider than New Zealand resident professional sportspersons. There will be many other cases where non-resident businesses have found themselves with people or equipment stranded in Australia for extended periods of time, potentially resulting in the creation of a PE in Australia.

While the existence or otherwise of a PE may be able to be managed, the 183-day test for non-resident employees in Australia is not similarly flexible. Once the bright-line test is met, New Zealanders will be subject to Australian tax on their salary and wages. In many cases, this will be at higher rates than in New Zealand, and the individuals will need to claim a foreign tax credit when they file their tax returns. This seems like an oddly specific exemption for the Australian Government to provide, and creates an un-even playing field for other business operating in Australia.

If you have any concerns about your tax liability in Australia, contact your usual Deloitte tax advisor.

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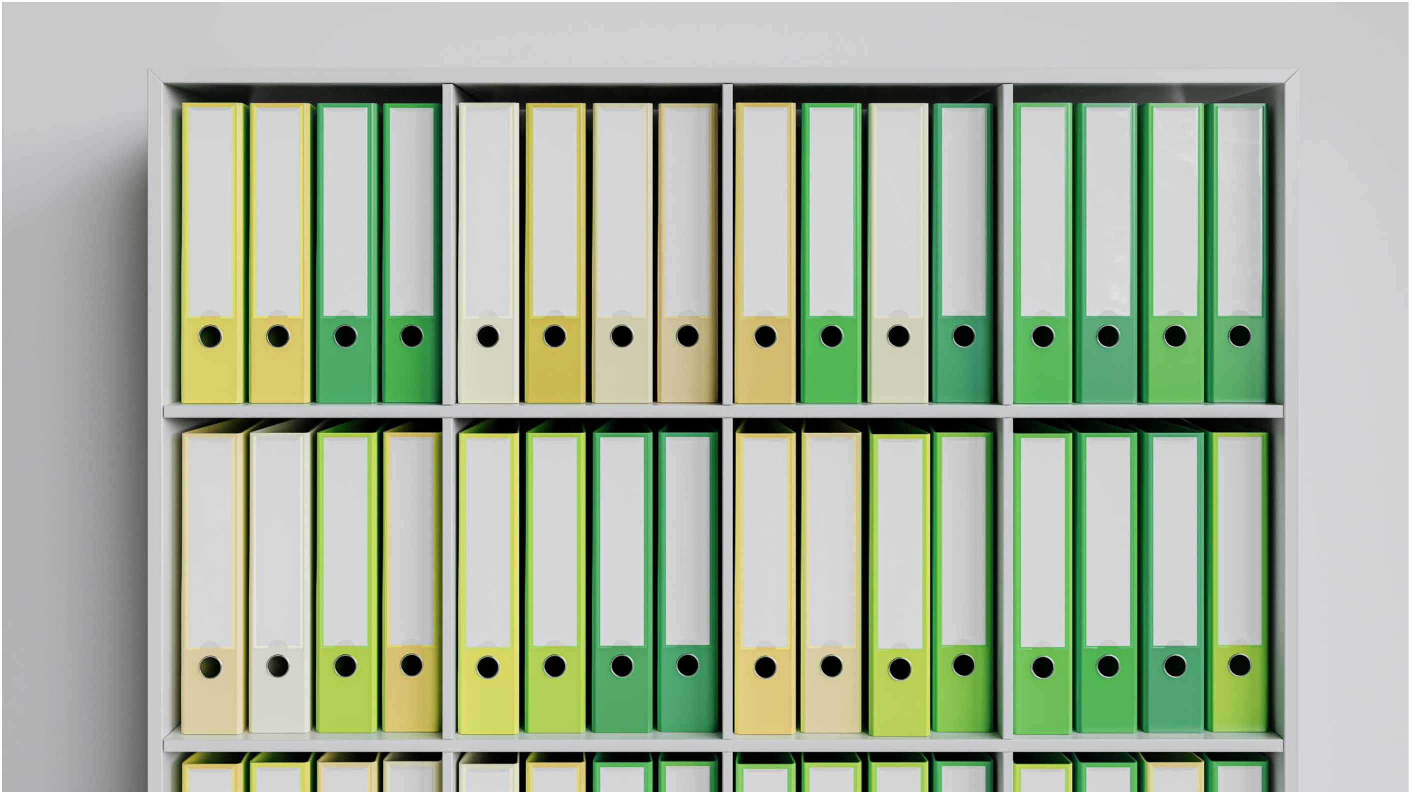
Are your records up to standard?

By Bridget O'Meara and Anna Zhang



As business are becoming increasingly digitalised, agile and environmentally sustainable, business records are no exception to these developments. Inland Revenue has recently issued guidance regarding the retention of business records. There are a number of points to recap on below, to ensure you are complying with these requirements.

What's new?

While there are numerous legislative requirements under company and corporate law imposed on businesses to hold appropriate business records, the Inland Revenue's standard practice statement relates to the documentation requirements under New Zealand tax law.

The key requirement remains that businesses are required to keep sufficient business records to allow its tax compliance with tax laws to be readily ascertainable by the Commissioner. They must be kept for a period of seven years after the end of the income year to which they relate.

Standard Practice Statement 21/02 "Retention of business records in electronic formats, application to store records offshore and keeping records in languages other than English or te reo Māori" applies from 6 May 2021 and replaces its predecessor issued in 2013.

What language are your records in?

Previously, applications had to be made to hold business records in te reo Māori. Now the Commissioner has confirmed that as te reo Māori is an official language of New Zealand, alongside English, no application is required for records to be held in te reo Māori (note, certain phrases required by the Goods and Services Tax Act 1985 are still required to be in English).

An application can be made to keep records in an alternative language for tax purposes. This can include approval for some or all of the business records. Such an approval is not a relaxation in the standard of record keeping, nor does it mean the IR will communicate in that alternative language. The law is silent on which language is to be used when completing tax returns. The statement provides that the Commissioner will accept returns in the prescribed format, in either English or te reo Māori language with numbers entered using Arabic numerals.

Do you store your records in the cloud?

As businesses move towards being paperless and increasing digitalisation, records may not be held in their traditional physical form. Records stored electronically, either in or outside New Zealand, in either your own system or an outsourced provider, must meet the requirements of the Contract and Commercial Law Act 2017 (CCLA). As such, the integrity of the information in the records is to be maintained and readily accessible for future reference. Further conditions to retain records under the Inland Revenue Acts are provided in the Contract and Commercial Law (Electronic Transactions) Regulations 2017. The statement sets out the Commissioners view when these requirements and conditions are met.

Where are the records?

The default position may be that records are stored in New Zealand, however the Commissioner accepts that businesses may have reasons to store their business records outside of New Zealand. Where this is the case, they can apply to Inland Revenue for authorisation. The Commissioner may authorise storing records offshore or a third party to hold records offshore, if the storage does not impact on the Commissioner's compliance activities.

An applicant will be required to demonstrate that the storage method complies with the legal requirements. The Commissioner decides on the merits of each case, including the compliance history of the business. In addition conditions may be attached to the authorisation.

Have you outsourced to a third party provider?

The good news is that taxpayers are not required to submit an application if their third party providers are already an Inland Revenue approved third party. You can review this online here.

Where authority is obtained for third party providers to store the business records, the statement is very explicit that such outsourcing does not replace the businesses responsibility to meet the record keeping requirements.

As part of any third party application, the Commissioner will consider whether the third party carries on business in, or through, an establishment in New Zealand, and will also consider the processes that the third party has for data should they cease to hold records for the relevant taxpayer.

Governance

The Commissioner continues to emphase in the statement that internal controls must be adequate to ensure that all business transactions executed electronically are completely and accurately captured. Depending on where your business is in its digitalisation journey, it is vital that the governance around these processes are robust to ensure the information in the records is complete and accurate. It would be timely to review your tax policies and processes to ensure appropriate controls are in place to mitigate both financial and reputational risks. See our earlier article on how we can help with adopting best practice tax governance.

If you have any questions about managing your business records or need assistance making an application, please reach out to your usual Deloitte advisor.

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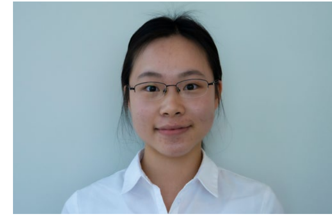

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Mileage reimbursement rates – what you need to know

By Andrea Scatchard

Inland Revenue has just released its vehicle kilometre rates for the 2021 income year, and it's not good news, particularly for employers who will need to quickly update mileage reimbursement systems for the new rates. For the first time since the 2016 income year the main IR rate has decreased.

The rates have come down because of lower fuel costs experienced because of COVID-19 and reduced interest and maintenance costs.

The IR kilometre rates are relevant in the following circumstances:

- Working out the amount of vehicle expenses a self-employed business person can claim;
- Working out the amount of vehicle expenses that can be claimed by a close company that meets certain criteria, in relation to vehicles provided to shareholder-employees; and
- Working out how much an employer can pay tax free to an employee to reimburse for work-related use of the employee's personal vehicle.

	2020 year		2021 year	
Vehicle type	**Tier One rate**	**Tier Two rate**	**Tier One rate**	**Tier Two rate**
Petrol or diesel	82 cents	28 cents	79 cents	27 cents
Petrol hybrid	82 cents	17 cents	79 cents	16 cents
Electric	82 cents	09 cents	79 cents	09 cents

Of course, self-employed people or employers are not required to use the IR kilometre rates, other methods are allowed, but the IR kilometre rates provide what is intended to be a simple, cost effective method of calculating these amounts.

As a reminder, the Tier 1 rates (which reflect the fixed and variable costs of running a vehicle) can be used for the first 3,500km of business travel, or the business portion of the first 14,000 of total travel in the vehicle. After these limits, the lower Tier 2 rates (which only reflect variable costs) apply.

We have written several articles in the past on the practical problems with the two-tier kilometre rate method in particular for reimbursing employees and suffice to say these still exist where employees are reimbursed for high levels of work related travel. If you'd like to refresh your memory on this method, we wrote about the practical issues with introduction of the two-tier system in August 2018, and updated it with new developments in September 2019.

What does this change mean for you?

Self-employed and close companies
If you are a sole trader or qualifying close company and use the kilometre rate method to claim business vehicle costs, this new rate applies for the 2021 year – the year ended 31 March 2021 if you have a standard balance date. The decrease in the rate will reduce the amount of vehicle costs you can claim when you file your 2021 tax return. If you have already filed your 2021 income tax return, and relied on the 2020 kilometre rates, then strictly speaking the amount of deductible vehicle expenses must be recalculated. Depending on the amount of the difference between the two amounts you will either need to request an amendment to your 2021 income tax return, or you may be able to self-correct the difference in your 2022 income return.

Employers
If you are an employer and are reimbursing employees for work related travel, the reduced rates apply to reimbursements made from the date that they were issued – 27 May 2021 - and you need to review your reimbursement policy. When the rates have increased in the past a lag in updating rates paid to employees, while potentially disadvantageous to employees, did not cause a PAYE problem. However, a decrease in the rates does require immediate attention.

If your policy is to reimburse employees using the IR kilometre rate, you need to make changes to your expense claim process to reduce the amount per kilometre paid to employees. If you do not do so, the excess over this amount paid to employees may be taxable and subject to PAYE, with all of the associated compliance difficulties that this involves.

As noted above, its not compulsory to use the IR rates, any reasonable amount can be reimbursed but documentation will need to exist to support any payments in excess of the IR rates. If you have separately negotiated reimbursement rates with employees, you need to review these to determine whether the amount paid to employees could now be in excess of the updated kilometre rates allowed by IR.

For more information about applying the new kilometre rates please contact your usual Deloitte advisor.

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Snapshot of recent developments

Tax legislation and policy announcements

Budget 2021

On 20 May 2021, Finance Minister Hon Grant Robertson delivered Budget 2021. Given the already significant number of tax measures from the Labour Government, it was a relief to many that tax announcements were missing from the budget. However we did get a glimpse of what may be to come, with the detailed Budget documents providing the following insights:

- Inland Revenue has been allocated $5m over two years to "collect information on the level of tax paid by high-wealth individuals and their related entities."
- A Digital Services Tax is not yet off the table and remains in the wings in the event that the OECD does not make sufficient progress on finding a multilateral solution to international tax.
- The government books do not yet include an estimate of any revenue gain from removing interest deductions from residential rental property. The documents note: "the fiscal impact of this policy has not yet been quantified as this depends on final policy decisions."
- On a related note, the budget documents note: "Tax settings will continue to be broadly stable and predictable. ... The Generic Tax Policy Process shall be used to develop and consult on tax policy where practicable."

Check out the Deloitte Budget Hub for further commentary.

Remedial Tax Act

On 20 May 2021, the Taxation (Budget 2021 and Remedial Matters) Act 2021 was introduced and passed through all stages. On 24 May 2021, the Act received Royal Assent. The Act increases the minimum family tax credit (MFTC) threshold from $30,576 to $31,096 from 1 July 2021 and ensures that low-income working families will be better off working and receiving the MFTC, than they would be on a main benefit, on an annual basis.

Extending due dates for R&D Tax Incentive

The Minister of Revenue has recently agreed to extend due date for years one and two of the R&D Tax Incentive (RDTI). Specifically extending:

- year one (2019-20 income year) supplementary returns to 31 August 2021 for all businesses; and
- year two (2020-21 income year) general approvals and criteria and methodologies (CAM) approvals to 31 August 2021 for all businesses.

Amendments to give effect to these extensions will be included in the next tax omnibus bill due to be introduced in the second half of the year. As such, any claims made under the above extensions cannot be processed until the relevant bill is enacted.

Public consultation on Transport Emissions Green Paper

On 14 May 2021, Ta Manatū Waka (the Ministry of Transport) released a green paper Transport Emissions: Pathways to Net Zero by 2050, which seeks feedback on options to accelerate the transport sector meeting the draft advice and recommendations of the Climate Change Commission, and moving to a net zero carbon transport system by 2050. The paper includes tax-related suggestions to reduce fringe benefit tax on zero emission vehicles, reduce GST on the purchase of zero-emission vehicles, offer refundable tax credits on the purchase of zero-emission vehicles, replace the road user charges exemption for electric vehicles with an upfront subsidy, and increase tax depreciation for electric vehicles. More information on the release can be found here. Submissions close on 25 June 2021.

Conference of the Parties to the MLI approve an opinion on interpretation and implementation

On 3 May 2021, the Conference of the Parties to the Multilateral Instrument (MLI) approved an opinion that sets out a series of guiding principles for addressing questions about the interpretation and implementation of the MLI.

Inland Revenue statements and guidance

Employee share schemes – employer expenditure or loss income

On 18 May 2021, Inland Revenue published finalised QB 21/04 – When an employer is party to an employee share scheme, when does an employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arise? The Commissioner's position in the finalised statement has remained the same as in the draft statement. This Question We've Been Asked is relevant to any employer who is party to an employee share scheme where the employee receives a benefit under the scheme within 20 days of the end of the employer's income year or a breach of shareholder continuity in the employer. This statement does not consider arrangements that may be subject to the application of ss BG 1 (tax avoidance) or GB 49B (employee share schemes).

Application date for depreciation of commercial buildings

On 25 May 2021, Inland Revenue released draft Questions We've Been Asked ED0230 - The application date for the depreciation of commercial buildings. This consultation item clarifies that the new rules for depreciation for commercial buildings apply from the beginning of the 2020-21 income year for all taxpayers, rather than from 1 April 2021. Submissions close on 11 June 2021.

GST - definition of a resident

On 28 May 2021, Inland Revenue released draft interpretation statement PUB00390 - GST - definition of a resident. This consultation item provides guidance on how to determine whether a person is a resident for GST purposes. Submissions close on 9 July 2021.

GST - registration of non-residents

On 28 May 2021, Inland Revenue issued finalised interpretation statement IS 21/03 - GST - registration of non-residents under section 54B, with the Commissioner's position remaining unchanged from the previous consultation item. Section 54B of the Goods and Services Tax Act 1985 allows non-resident businesses that do not make supplies to end consumers in New Zealand to register for GST and recover GST input tax on goods and services acquired in New Zealand. Since section 54B was introduced, there have been legislative changes that treat certain supplies by non-residents as being made in New Zealand. These changes include the supply of remote services and low value goods. This means a greater number of non-residents must register under the standard registration provision and fewer non-residents are eligible to register under section 54B. This item provides guidance on whether a non-resident is eligible to register under section 54B.

Variation to the effective date of a notice of election to imputation group

On 28 April 2021, Inland Revenue published Determination COV 21/02 - Variation to section FN 7(5) of the Income Tax Act 2007. This variation recognises that some taxpayers who did not take steps to address a debit balance in their imputation credit account before 31 March 2020 could have used a tax pool or other option to reduce the balance subsequently, but the impact of COVID-19 on their profits has been such that these options will adversely affect their cashflow. Hence, eligible taxpayers will be able to give a notice of an election to form an imputation group between 28 April 2021 and 30 September 2021 that will be effective from the start of the tax year ending 31 March 2020, allowing use of the credits of the related company to reduce the debit balance.

Negative interest and withholding taxes

On 30 April 2021, Inland Revenue issued a finalised Question We've Been Asked QB 21/02 – Whether "negative interest" payments are subject to withholding taxes. In short, the answer is no. It explains the application of the resident withholding tax (RWT) and non-resident withholding tax (NRWT) rules to situations where negative interest is charged on an advance of money or a loan. The Commissioner has been asked this question by banks and financial institutions because they wish to have appropriate processes in place should the RWT and NRWT rules apply to negative interest payments and they are required to withhold tax.

Tax treatment of cryptoassets received from an airdrop and a hard fork

On 3 May 2021, Inland Revenue released consultation documents PUB00405 - Income tax - tax treatment of cryptoassets received from an airdrop and PUB00405 - Income tax - tax treatment of cryptoassets received from a hard fork. In short, these two draft statements state that if a person has a cryptoasset business, or acquired the cryptoassets as part of a profit-making undertaking or scheme, then the receipt of cryptoassets from an airdrop or a hard fork will be taxable; if a person has a cryptoasset business or disposed of the cryptoassets as part of a profit-making undertaking or scheme or acquired the cryptoassets for the purpose of disposing them, then the disposal of cryptoassets that were received from an airdrop or a hard fork will be taxable. Submissions closed on 25 May 2021 for both consultation items. Our comments on an earlier consultation document were covered in the February 2021 Tax Alert.

Charities business exemption - business carried on in partnership

On 7 May 2021, Inland Revenue issued finalised QB 21/03 - Charities business exemption - business carried on in partnership. This statement states that income derived by a charitable entity from a business can be exempt under s CW 42 of the Income Tax Act 2007 if the business is carried on by a charitable entity in partnership with a non-charitable entity, subject to other requirements (such as the control and territorial restrictions) are satisfied.

2021 CPI updates

On 12 May 2021, Inland Revenue updated the following statements to reflect the annual CPI adjustment to the following amounts for the 2021 income year.

- DET 19/01 - standard-cost household service for private boarding service providers. The updated weekly standard-cost per boarder is $194.
- DET 09/02 - standard-cost household service for childcare providers showing. The updated hourly standard cost (per child) is $3.75 and annual fixed administration and record keeping standard-cost is $367.

- DET 19/02 - standard-cost household service for short-stay accommodation providers. The updated daily standard-cost for each guest for owned dwelling is $52 and for rented dwelling is $47.
- OS 19/03 - Square metre rate for the dual use of premises. The updated square metre rate is $44.75 which has increased by $2 compared to the previous tax year.

National average market values of specified livestock

On 26 May 2021, Inland Revenue published NAMV 2021 - National Average Market Values of Specified Livestock Determination 2021. This determination is made under section EC 15 (determining national average market values) of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2020-2021 income year.

A type of attributing interest in a FIF for which a person may not use the FDR method

On 12 May 2021, Inland Revenue issued Determination FDR 2021/02 - A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (The Colchester Global Bond Enhanced Currency Fund NZD Hedged Accumulation Class - Z Shares). The determination states that any investment by a New Zealand resident investor in the NZD Hedged Accumulation Class Z-Shares of the Colchester Global Bond Enhanced Currency Fund is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest.

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

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