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Tax Alert

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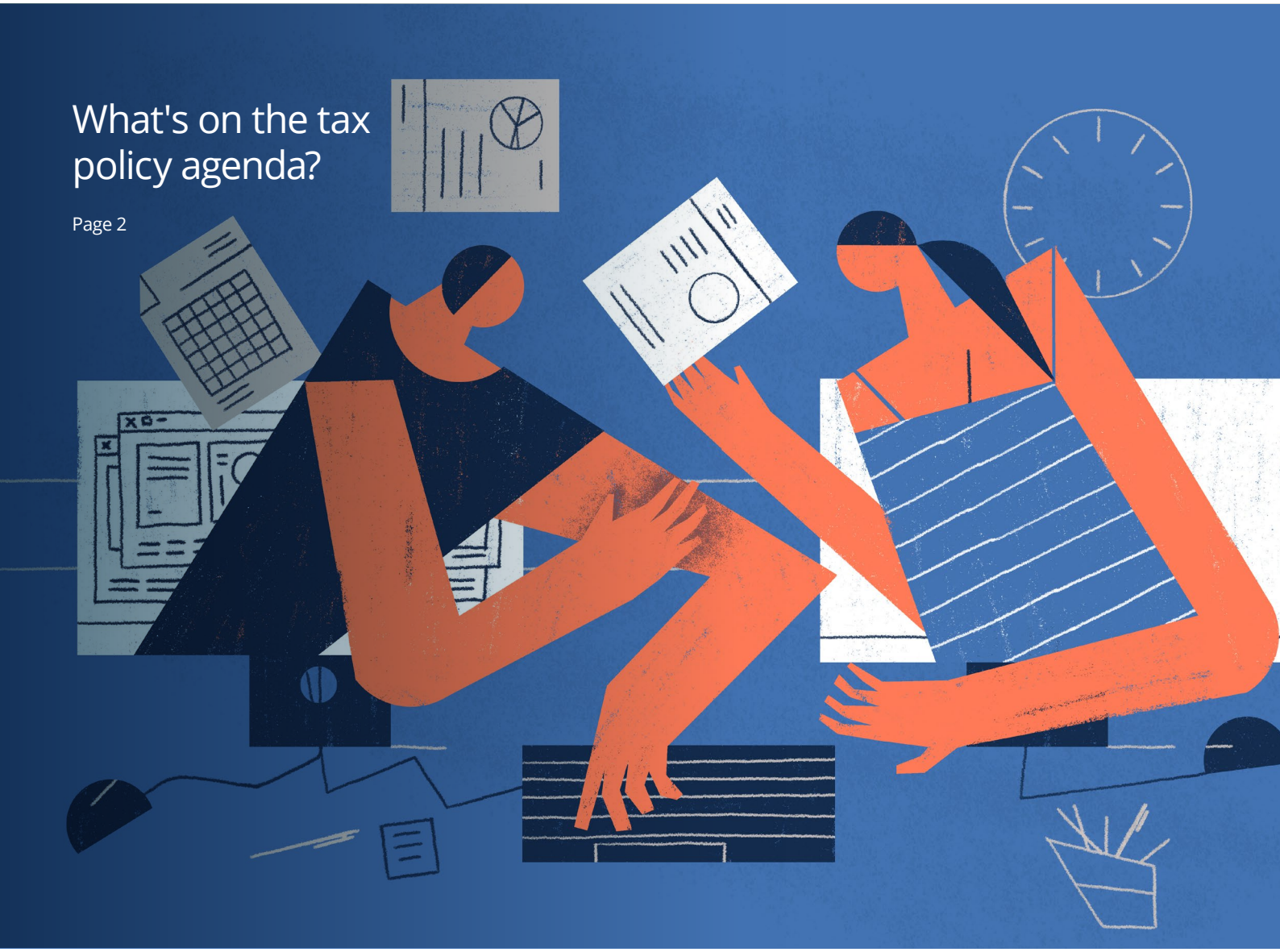

What's on the tax policy agenda?

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What's on the tax policy agenda?

By Robyn Walker

What do residential properties, fringe benefit tax, free trade agreements, COVID-19, multinational corporations, social unemployment insurance and wealth all have in common? They're all included on the Governments freshly released Tax Policy Work Programme ("the work programme").

The release of the work programme signals to stakeholders in the tax system what changes may be coming over the next 18 months. As is standard, the work programme includes more work than can reasonably be achieved, and carries over a number of items from the last work programme which had not been completed.

What to expect

The general theme of tax reform since the 53rd New Zealand Government was formed has been one of tax increases and integrity measures, and that is set to continue through this work programme.

Prior to Christmas 2020 we saw a new 39% tax rate introduced for individuals, which took effect from 1 April 2021, and increased disclosure requirements for trusts. In the work programme, resources are to devoted to "integrity measures to support the 39% tax rate and data collection of trust information" as well as "research work by Inland Revenue involving the collection of information on the level of tax paid by high wealth individuals".

Also under the integrity workstream, the work programme proposes work on a new "Tax Principles Act" which is intended to establish "a reporting framework against a set of principles to measure fairness of the system".

In March 2021 announcements were made about a raft of changes to the taxation of property. Unsurprisingly the work programme will have many resources devoted to designing and legislating these rules. The work programme confirms the timelines for this work: "the final policy design of the interest limitation rules and the legislation will be released publicly before 1 October 2021 and enacted into law by 31 March 2022".

The progress at the OECD in reaching consensus on the taxation of the digital economy will have a consequential effect of draining New Zealand's tax policy resources to implement the two-pillar OECD tax package. Also included within the International Tax workstreams is continued consideration of a digital services tax, double tax agreement negotiations (New Zealand is currently negotiating with a number of countries), taxation of the gig and sharing economy and a review of tax for cross-border workers (we expect something soon on this last item).

With Inland Revenue's Business Transformation project almost at an end, consideration is now being turned to maximising the benefits of the computer system. To this end, work will be undertaken preparing a "Green Paper" on Tax Administration. We understand this paper is likely to be published in the first half of 2022.

Inland Revenue will be undertaking a stewardship review of the Fringe Benefit Tax (FBT) regime. This review will consider whether the FBT regime is still fit for purpose and will inform decision making about whether policy changes may be required.

The Accounting Income Method (AIM) of paying provisional tax has had extremely low uptake since it was introduced in 2018; most likely due to its high complexity (despite only applying to small taxpayers). The work programme includes the continuation of a project from the last work programme, being to review and simplify AIM.

With the Minister of Revenue, Hon David Parker, also being the Minister for the Environment, it perhaps no surprise that the work programme proposes work on the impacts of tax on the environment. Included within this workstream is a review of existing tax provisions to ensure they are not biased against environmentally-friendly investment and behaviour.

Inland Revenue will be undertaking a stewardship review of the Fringe Benefit Tax (FBT) regime. This review will consider whether the FBT regime is still fit for purpose and will inform decision making about whether policy changes may be required. Given the issues arising from the top FBT rate increasing to 63.93%, the confusion around how FBT applies to utes and other common issues with the regime we agree it is time this tax was given a makeover.

The tax system doesn't work in isolation, and tax can touch many things, so the work programme reflects that tax policy resource will be spent on other Government policies and priorities, including:

- Welfare reform
- A social unemployment insurance scheme
- Any necessary COVID-19 response measures
- Local government reform
- Three waters project
- R&D tax credit
- Free trade agreements
- Tax consequences of deposit takers
- Charities review

In addition to the above, the work programme includes some resource to be spent "maintaining the tax system". This means dealing with remedial tax issues as they arise, correcting errors and responding to changing technology and business practices.

What's missing?

With the Crown financial position and additional debt taken on due to COVID-19 being top of mind, it is perhaps not surprising that many of the items above seem likely to ultimately result in an increase in tax collections. However, while the need to increase tax revenues is inevitable, what the work programme seemingly lacks is an ambition to make life simpler for taxpayers. The previous work programme included a wide range of business-friendly initiatives and acknowledged that reducing compliance costs directly impacts (positively) on productivity. Subject to where the conclusions on the FBT review land, there seem to be very few measures which seek to reduce compliance costs and grow tax revenue through improved productivity, instead the focus remains on continuously expanding what is in the tax base.

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Extra tax could be payable on Australian software sales

By Emma Marr

The Australian Tax Office (ATO) has released a Draft Ruling on the treatment of certain payments for software that could have an impact on New Zealand businesses selling software or SaaS solutions into Australia via a re-seller or distributor. Anyone potentially affected should consider how it might apply to payments they receive from the distributor, and the resulting effect on cashflow, tax filings, transfer pricing adjustments and distribution agreements.

Deloitte Australia has produced a very helpful summary of the Draft Ruling, including diagrams to illustrate the eight examples in the Draft Ruling. The ATO proposes that when finalised the Draft Ruling may apply retrospectively in some circumstances. The previous ruling has been withdrawn with effect from 1 July 2021.

Who does the ruling apply to?

New Zealand businesses selling software or SaaS solutions to Australian customers have a few options of how to structure their operations. The most common are to sell directly to the end-user, or to sell via a re-seller or distributor. (Although generally in the software context the Australian entity would be a reseller, the ATO refers to distributors, and we have generally done the same). The distributor could be a third-party agent, or it could be an Australian subsidiary or branch of the New Zealand business. There are various reasons for setting up a separate Australian entity, including if the business in Australia has reached a size or complexity that requires a greater in-country presence – for example sales or support staff, or software developers. That level of activity may trigger a permanent establishment, meaning that standing up a separate entity to fence off the tax liability is the best approach. The previous ATO ruling concluded that the payment for a licence for the simple use of software wasn't a royalty, whether the payment was made by the end-user or a distributor, but given the age of the previous ATO ruling, it didn't specifically anticipate some of the newer online platform and SaaS based models.. "Simple use" refers to the right to use the software as designed, with limits on the ability to do anything else (modify, distribute, make copies and so on).

The bad news is that the ATO has drawn a distinction between these two methods of operating, and in its simplest form, having a distributor will, in some circumstances, now mean that payments from the distributor to the New Zealand business that owns the intellectual property (**IP**), will be treated by the ATO as royalties, and will now be subject to withholding tax in Australia even if the distributor's rights are limited to simple use. The default rate of tax is 30%, which may be reduced by the double tax agreement (**DTA**) between New Zealand and Australia to 5%. In all cases, businesses should confirm how the definition of a "royalty" in the context of the treaty applies to the specific transaction. The New Zealand business might get a foreign tax credit for the tax in New Zealand, and this is something we are in discussions with Inland Revenue on currently. In any event, the impact of the inconvenience and delay in cash-flow, or indeed potentially not receiving the credit altogether, should be factored into operating models, forecasts, and intercompany agreements.

To explain a little further, the key is the ATO's analysis of the meaning of "copyright" under domestic Australian legislation. Under that law a right to reproduce, adapt, or communicate software is an exclusive right of a copyright holder, as is the right to 'authorise' a person to do such an act. The right to reproduce or adapt software is consistent with OECD commentary and with DTAs generally, including those entered into by Australia However, the right to communicate software or authorise a person to perform any of those acts can be seen as extending the meaning of "copyright"

beyond the normal boundaries of that word. "Communicating" software, in the ATOs view, includes sending it via electronic transmission (such as would happen when software is downloaded, possibly via a distributor) or making it available via the Cloud (generally by the end-user ie, SasS). As the Deloitte Australia analysis explains:

> "For example, merely making software "accessible to or … used by an end user via cloud based technology such as software-as-a-service … without being downloaded on the end user's computer or device" is considered sufficient in the Draft Ruling to communicate software, while in a digital download model, the distributor is considered to 'authorise' the end user to reproduce the software as part of the process of installing the software."

The ATO considers that the copyright holder alone has the exclusive right to licence its software, and that granting the right to sub-licence software (such as may be granted to a distributor) even where this right is limited to simple use without the right to modify is itself a "use" of the copyright, so any payment for this right is a royalty.

Of the eight examples in the Draft Ruling, examples four and five may cause the most concern to New Zealand software businesses.

- Example Four: A New Zealand business (**NZ Parent**) distributes software to Australian end-users via an Australian subsidiary (**AU Sub**). The distribution agreement with AU Sub does not allow the software to be reproduced or modified. The end-user has a non-exclusive, non-transferrable right to download software for simple use, under an end-user licence agreement with AU Sub, and pays AU Sub for this licence.
- Example Five: NZ Parent provides Cloud-based Software as a Service (**SaaS**) services, and enters into an agreement that allows AU Sub to enter agreements with Australian end-users, that specify the terms on which end-users can use NZ Parent's software.

In both cases the payments from AU Sub to NZ Parent are considered by the ATO to be a royalty, on the basis that NZ Parent (as the creator and owner of the copyright) has the exclusive right to licence their software, and the fee paid by AU Sub for the right to sub-licence the use of software is a royalty. The ATO takes the view that, when the distributor enters into an agreement with the end-user, it is "standing in the shoes" of the copyright owner and exploiting the copyright in the software, by granting licences to end-users. Any payment for such exploitation is therefore a royalty. The ATO appears to view an end-user licence agreement with the owner of the copyright differently, and doesn't consider a royalty arises in two examples in the Draft Ruling where this is the case (albeit that one doesn't have a distributor at all, and one involves packaged software sold in retail outlets, so both have other differences).

In either case, if NZ Parent sold the software or services direct to the Australian end-users, the ATO considers the payment from the end-user to the NZ Parent would not be a royalty. Oddly, the ATO considers that if AU Sub were selling packaged games at retail stores, payments from AU Sub to NZ Parent would not be a royalty. In a world where downloaded and cloud-based software dominates software sales, the distinction seems to be of vanishing relevance.

When does the ruling apply?

The exact date hasn't been set yet, but the ATO has withdrawn its prior ruling with effect from 1 July 2021, and proposes that the Draft Ruling, when finalised, will apply both before and after its date of issue. Previous settlements of a dispute with the ATO on related issues would not change, and the prior ruling can continue to be applied to historic positions taken before it was withdrawn. However, as that ruling is now withdrawn, and there may be a gap before the position is finalised, retrospective application of the new ruling could mean that taxpayers have unpaid withholding tax by the time the new ruling is finalised.

What should I do now?

The ATO's position appears to be out of step with OECD commentary, DTAs, and other countries own practices (including New Zealand's). Nevertheless, if the ATO does finalise the Draft Ruling without changes, some New Zealand businesses are likely to have a withholding tax cost on payments from Australian distributors. The parties also need to be clear as to whether the New Zealand / Australia DTA will allow any tax relief on a withholding tax deducted by Australia.

As noted above, assuming Inland Revenue honours a foreign tax credit claim, this may result in less New Zealand tax being paid to offset the additional Australian tax. However, if the business is in tax losses or the New Zealand tax payable on the income is less than the withholding tax there could be an immediate cost. Even if a full foreign tax credit is available, there will be a reduction in imputation credits which could ultimately result in shareholders suffering double taxation.

You should seek advice if you think this is likely to impact your business, to clarify whether it will apply, how to deduct and pay the tax, and to evaluate the impact on cashflow, forecasts and transfer pricing adjustments. This would also be an opportune time to consider your operating and distribution model, and any necessary modifications. Get in touch with your usual Deloitte advisor if you would like assistance.

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New OIO rules require acquisition structure and other tax-related information to be provided up-front

By Campbell Rose, Matthew Scoltock & Greg Mitchell

The Overseas Investment Amendment Act (No. 3) 2021 ("Amendment Act") received Royal Assent on 24 May 2021, and contains a new requirement for commercially significant tax-related information to form part of certain applications for Overseas Investment Office ("OIO") consent.

Regulations under the Amendment Act have been a long time coming (we published a high-level summary of their likely content in mid-2020), and were publicly released on 1 July 2021. They apply to certain applications for OIO consent made on or after 5 July 2021. The regulations represent a material change to deal processes involving OIO consent, requiring acquisition structure and other tax-related information to be provided at the time of applying for consent. Read on for a summary of what this means in practice.

Summary of the Regulations

Regulations 69C and 69D require a relevant investor to disclose:

- A short description of the investor's plan for the acquired assets over the three-year period from completion, including information as to any significant capital expenditure likely to be made or needed. Inland Revenue expects that this will include a brief summary of material new investment, expansion/divestment of assets, integration with other assets, or any major restructuring.
- The tax residence of the investor and, if relevant, of its immediate holding company and its ultimate holding company.
- The investor's capital structure, including the likely level of debt funding, equity funding, and whether or not the investment is likely to involve a hybrid arrangement or hybrid entity.
- The likely nature and extent of any inbound or outbound arrangements that are likely to be subject to New Zealand's transfer pricing laws (e.g., goods, raw materials, administration and/or management services, technical services, research and development, commissions, rents, royalties, licence fees, interest, guarantee fees, insurance premiums/recharges, etc.).
- Any "relevant" tax treaty (which, we understand, Inland Revenue considers to be any tax treaty between New Zealand and any country or territory to or from which there are likely to be significant flows of funds).
- Whether or not an application is likely to be made to Inland Revenue for a ruling or advance pricing agreement in respect of any aspect of the investment.

Encouragingly, the tax information prescribed by the regulations has largely aligned with the high-level list of tax information that the OIO previously indicated was likely to be required.

Interestingly, the scope of the regulations is limited to "... overseas investment in significant business assets...", and does not appear to extend to overseas investment in "sensitive land" (although the enabling legislation does seem to permit the regulations to cover the latter).

The tax information must be accurate at the time it is disclosed. It must be disclosed in a separate tax-specific section of the application for OIO consent, and must be accompanied by a signed statement by the investor (or its duly authorised representative) verifying that, to the best of its knowledge, the tax information is accurate.

To facilitate (and, presumably, simplify and standardise) the complete disclosure of tax information, Inland Revenue has issued a new form, IR 1245 (and related information), which allows for the use of "reasonable estimates" based on the likely facts and circumstances as of the date of the overseas investment.

Comment

When the prospect of new regulations was first raised, we flagged in a May 2020 Tax Alert article the need for a balance to be struck between protecting the integrity of New Zealand's tax base, and ensuring that the disclosure of tax information is not unreasonably onerous.

Encouragingly, the tax information prescribed by the regulations has largely aligned with the high-level list of tax information that the OIO previously indicated was likely to be required. The regulations also do not – on their face – demand the same granularity of disclosure that we have seen in Australia, where the Australian Taxation Office and the Foreign Investment Review Board can require the interest rate on cross-border related-party debt to be disclosed, resulting in detailed transfer pricing analysis and a self-assessed risk rating.

It is also helpful that Inland Revenue has – to some extent – eased the compliance burden created by the new tax information disclosure, by issuing IR 1245.

While we expect that it should generally be a straightforward exercise to complete the disclosure itself, it will need to be underpinned by up-front thinking on the key features of acquisition structuring and related matters; some of the tax information may require greater depth of analysis prior to the OIO consent application being submitted than has been the case to date. Deloitte is well placed to assist with every aspect of the tax information disclosure – and with tax structuring more broadly – including by helping to identify a suitable country/territory for the immediate holding company. We can also advise on the potential application of New Zealand's transfer pricing or "hybrid mismatch" laws to ensure that all relevant issues have been considered as appropriate given that all information is passed on to Inland Revenue.

As noted above, with the new regulations, it will be critical that the acquisition structure is considered far earlier in the M&A lifecycle than has ordinarily been the case, and that it is known (or largely known) at the time of the application for OIO consent. For any overseas investment in "sensitive New Zealand assets," it will be critical that the investor engages with its New Zealand tax advisor as early as possible so that that the most tax-efficient investment structure can be finalised before applying for OIO consent. If an investment structure is not well considered, or if the information disclosed on the IR 1245 is incomplete, OIO consent is likely to be delayed.

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Balancing risk and control in a COVID-19 world

By Bart de Gouw, William Dawson & Chanelle Stoyanov

The economic impact of COVID-19 has had a catastrophic effect on many global industries. From a transfer pricing perspective, a key question to be addressed is whether (or to what extent) group subsidiaries that did not control the risks that gave rise to losses, should now be required to bear these losses.

The answer is complex and fact dependent but revenue authorities are very likely to question any arrangement that involves large losses being borne in entities where the amount of profit (pre-COVID-19) was limited by the application of a group transfer pricing policy.

The rationale for these positions by revenue authorities is guided by the work of the OECD. The OECD's recent transfer pricing work has centred around "*aligning transfer pricing outcomes with value creation*", which suggests that an entity that undertakes key decision-making roles (a "Principal") controls the assumption of risk, and should receive residual profits or bear resulting losses. By contrast, entities that perform routine functions under direction and oversight of a Principal entity are expected to earn low yet stable profits.

As a result of this guidance many groups with centralised management structures adopted transfer pricing policies that targeted a low but stable profit outcome for group subsidiaries that operate without substantial local management, rather than pricing discrete transactions.

Following the impact of COVID-19 on the economy, such transfer pricing policies are coming under pressure in situations where customer revenues drop away to such an extent that local subsidiary costs are not covered. Accordingly, a "top-up" payment may be required by a Principal to achieve the set profit outcome.

In these instances, tax authorities may challenge the deductibility of the top-up payments for a Principal entity on the grounds that it has not been incurred in carrying on its business / deriving income

	Functional characterisation of subsidiary	Economic state of the group	Transfer pricing policy applying to subsidiary
Pre-COVID	Limited risk – no control over risk	Group highly profitable	Limited profit (e.g. retaining only a small percent of sales as profit)
Post-COVID	Limited risk – no control over risk	Significant and sustained drop in group revenues	Amended transfer pricing may need to be implemented to limit the amount of losses borne due to the COVID economy.

of the Principal, or that it was in fact not in control of the risks that caused the loss. This issue may be more prominent in a post COVID-19 context, particularly as revenue authorities of headquarter jurisdictions are unlikely to consider additional outbound payments to group subsidiaries appropriate while heavy losses are already being sustained at home.

Government assistance

As a result of COVID-19 many governments offered assistance programs (e.g. the New Zealand wage subsidy) to keep businesses afloat and workforces employed throughout lockdowns and periods of economic uncertainty.

The prevailing OECD guidance (endorsed by Inland Revenue) on the treatment of such payments is that third parties (acting at arm's length) would not gift away the benefit of these subsidies. On this basis payments should be retained in-country and not "transfer priced out". However, the OECD guidance does not touch on the implications of control over risk in these situations. For example, if a decision to obtain the wage subsidy in lieu of actioning redundances was made outside of New Zealand, should the entity exercising control of that decision be entitled to the benefit? If the Principal entity had known it would not have been entitled to the benefit would this have influenced its decision to retain the staff or not?

Conclusion

As you prepare your tax returns and supporting information for COVID-19 impacted years, you will need to carefully consider these issues, including the deductibility of top-up payments by Principal entities, as well as the loss profile of the group. Please contact your usual Deloitte advisor if you would like any help with considering the impact of COVID-19 on your transfer pricing policy and payments.

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Are you shovel-ready?

By Liz Nelson, Troy Andrews & Sam Hornbrook

During last year's first lockdown, the Government put out a call for shovel-ready projects, being infrastructure projects that were ready (or near ready) for construction and could be deployed as part of a stimulus package.

The focus was on immediate job creation and public confidence that economic activity was underway in the midst of the pandemic. At the time, there were forecasts of an 8% contraction in economic activity and job losses of more than 250,000 in the year to March 2021.

Applicants had 2 weeks to put together a "project information form" to enable a decision to be made about what projects should be eligible for Government funding.

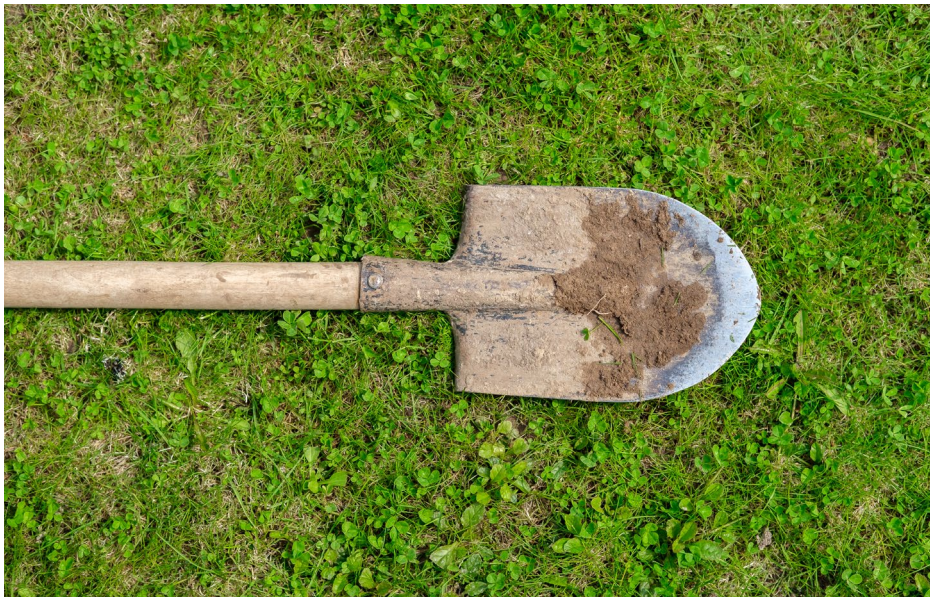
A total of 1,926 projects were submitted, with a total Capex spend of $134 billion. Once these were initially filtered, there were 802 eligible projects with a total Capex spend of $51 billion, seeking $33 billion in funding or financial support. These were shortlisted and on 18 August 2020 it was announced that a total of 147 shovel-ready projects with a total value of $4 billion would be eligible for funding support of $2.3 billion.

While much of the funding went to government agencies such as Waka Kotahi (NZTA) and Kāinga Ora, a significant portion went to the private sector and local government. Crown Infrastructure Partners (CIP), a Crown-owned company, was given responsibility for managing the funding to the private sector and local government.

Now that the dust has settled, and the funding is being delivered, we have a look at some of the tax issues associated with the shovel-ready program.

What was received?

The first point to consider is what support is being received under the shovel-ready program. Support may be financial or non-financial. Financial assistance could be in the way of a grant, a concessionary loan, a commercial loan, equity, or a guarantee. We understand the majority of the financial assistance provided is by way of grants or low / no interest loans, or a combination of the two.



Grants

Government grants to businesses can be excluded from income tax, where they relate to an expense that is otherwise deductible or a depreciable asset. In that case, the effective receipt of the grant should be tax neutral (i.e. the receipt is not income, and a deduction cannot be claimed when it is spent).

However, to be excluded from income tax, government grants must come from a local authority or a public authority. There is some complexity around who is delivering the grant and whether they meet this criteria, and this is an area that Inland Revenue has been focusing on.

If the grant does not come from a local authority or public authority, or is otherwise funding expenditure that will not be deductible or depreciable, then the grant may be taxable. It gets more complicated when the grant is funding infrastructure. What is the asset that is being created? Does it relate to expenditure in future years? Is it depreciable? Is the grant a capital receipt? There are complexities here that will need to be worked through on a case-by-case basis.

Concessionary loans

An example of a concessionary loan under the shovel-ready program is an interest-free loan over a term of 10 years.

For accounting purposes, a long-term loan with no interest may be recognised at fair value, being the present value of future cash payments discounted using prevailing interest rates for a similar term and credit rating. For accounting the difference between the fair value of the loan liability and the cash received may be recognised in the Profit & Loss Statement ("P&L"). After initial recognition, the loan may be measured at amortised cost (with an interest/ financing expense in the P&L each year).

However, the outcome is quite different for tax purposes. As there is no interest under the loan, there should be no deduction for interest expense. Under the relevant financial arrangement spreading method, interest free loans typically do not allow a deduction for interest expense or recognise income for other amounts allocated to equity, other comprehensive income ("OCI") or the P&L when the loan is entered into.

There may potentially be other spreading methods available (particularly for taxpayers that do not follow IFRS), however over the term of the loan the outcome should be the same: there should be no interest expense for tax purposes.

If you have received an interest free loan under the shovel-ready program you should be aware that the accounting and tax treatment may be quite different, and will likely give rise to deferred tax implications and complexity in your tax calculation.

Loan forgiveness

In some cases it may be contemplated that the concessionary loans will be forgiven. Again, it will be important to navigate how this loan forgiveness is treated for tax purposes. When a debt is forgiven it typically gives rise to taxable income for the borrower.

However, certain government loans in which the terms include a provision that the debt may be wholly or partially remitted (described as "grant-related suspensory loans") should not give rise to taxable income for the borrower, and are instead treated like a government grant (described above).

The treatment depends on the terms of the loan, and who is administering the loan, so it will be important to work through the detail.

What entity to use?

In the past, there might have been a preference towards using Limited Partnerships for new infrastructure projects, as the tax attributes flow through to the relevant partners, meaning that any losses incurred by the partners wouldn't be jeopardized by new partners joining the project. The new business continuity test could make this structure less compelling, as it allows losses to be carried forward by a company provided there is no "major change" in business.

If the shovel-ready funding does include an equity component, you should consider what structure works best for all parties, bearing in mind the new rules that make shareholder continuity less vital.

What about GST?

This can also be complex as the GST treatment can vary considerably depending on the type of funding being delivered, the GST status of the project owner / recipient of the funding, and also the nature of the project being funded. The project owner is responsible for determining the GST treatment, therefore it is important to work through these issues and seek advice.

GST should generally apply to grants received by GST-registered project owners that are not public authorities (provided the grant is received in relation to the project owner's taxable activity) on the basis that a deemed supply is created for GST purposes. There can also be situations where grants paid to public authorities may also be subject to GST if the grant is for the benefit/on behalf of another person. Where a deemed supply occurs for GST purposes, the recipient should return output tax on the grant.

There should not be any GST charged on loan amounts, so loan recipients should not need to return output tax on funding amounts received in the form of a loan.

Inland Revenue has noted that there is often confusion around applying the correct GST treatment, therefore, care should be taken.

It is possible that financial assistance may be terminated, for example if the recipient does not meet the terms of the agreement (for example timing and delivery). In this case, if a grant is to be returned, there are added GST complexities and timing/tax invoice documentation issues to work through.

There may be interesting considerations in terms of the GST time of supply, particularly if the grant is payable in instalments. Again, the specific terms of the agreement will need to be worked through.

As you can see, there are a number of things to think about when receiving support under the shovel-ready program (or any other grant, for that matter). There will also be non-tax considerations, like the accounting treatment, or financial modelling of the project and funding. If you would like to discuss the receipt of financial assistance under the shovel-ready program, or for more information, please contact your usual Deloitte tax advisor.

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Can I claim my lunch as a tax deduction?

By Andrea Scatchard & Mihiri Nakauchi

Next time you grab a coffee or a meal at your local café in between back-to-back client meetings and think about claiming this as an expense because you are self-employed and it's just part of your work day, think again. Inland Revenue has confirmed that these expenses are not deductible for self-employed taxpayers in all but very limited circumstances.

In recent years Inland Revenue has been working at clarifying the boundary between private and work related expenditure – we have seen statements on when tax deductions can or can't be claimed for telecommunication costs, vehicle expenses for home to work travel and accommodation costs.

The most recent of these is Interpretation Statement IS 21/06 – Income Tax and GST - Treatment of Meal Expenses. Over 37 pages the interpretation statement considers and concludes on the deductibility of these expenses if incurred by a self-employed person, and also comments on how a different outcome arises for employee meal costs.

While certain meal costs may have a business-driven purpose, a tax deduction is not allowed where the cost is a private expense for the taxpayer. Food is a private or domestic expense for a self-employed person due to the need to eat to stay alive, therefore meal costs for the individual self-employed taxpayer are primarily considered not deductible.

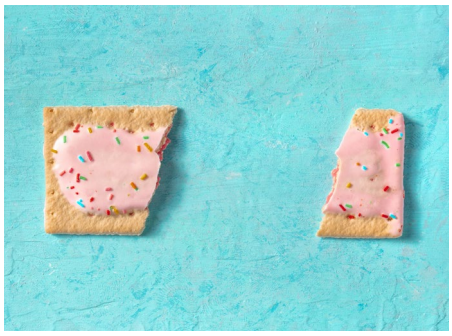
An exception is made for costs where the private element is incidental to a wider business purpose – for example when entertaining a client, the self-employed person's costs are treated as initially deductible along with the cost of the client's meal, but both elements are subject to 50% non-deductibility under the entertainment rules.

The same principles apply to individual shareholders of look-through companies or partners in partnerships. Because of the flow through nature of these entities the shareholders or partners are deemed to incur the costs themselves for tax purposes.

Contrast this outcome with an employer paying for an employee's meal cost for entertaining a client or while on business travel. These costs are deductible for the employer because they are not private when viewed from the employer's perspective, they are just a tax deductible staff cost.

This distinction, and the interaction with the entertainment rules where these apply, can lead to some interesting outcomes and possibly more questions than answers. To illustrate these differences we have shown some examples below:

Scenario	Are the costs tax deductible?
Self-employed individual incurs costs for own meals	No
Self-employed individual incurs costs for meals for self and an employee	Likely outcome is that only the costs relating to the employee are deductible, entertainment or FBT rules may also apply. However, if the purpose for the cost is primarily business (such as a team celebration) the private element may be considered incidental.
Self-employed individual incurs costs for meals for self and a client	Private element may be incidental and all costs deductible but subject to the entertainment rules
Self-employed individual pays for meals of employee while employee working out of town	Yes
Self-employed individual pays for meals for self while working out of town	No, except in very limited circumstances such as where there are no practical or realistic alternatives for meals (e.g. where a supermarket is not nearby and it is unrealistic for the individual to prepare their own meals). The costs on top of what the individual would typically spend may be deductible.
Company incurs costs for meals for employees (including shareholder employees) and/or clients	Yes, entertainment or FBT rules may also apply



The statement notes that the GST treatment will generally follow the income tax treatment. If the costs are considered personal and not tax deductible, no GST can be claimed.

The moral of the story here is that it is crucial for affected taxpayers to keep accurate records of the purpose of any food and drink related costs so that they can be correctly classified for tax purposes. We recommend you seek advice from your local Deloitte advisor if this has made you question whether you are treating meal expenses correctly.

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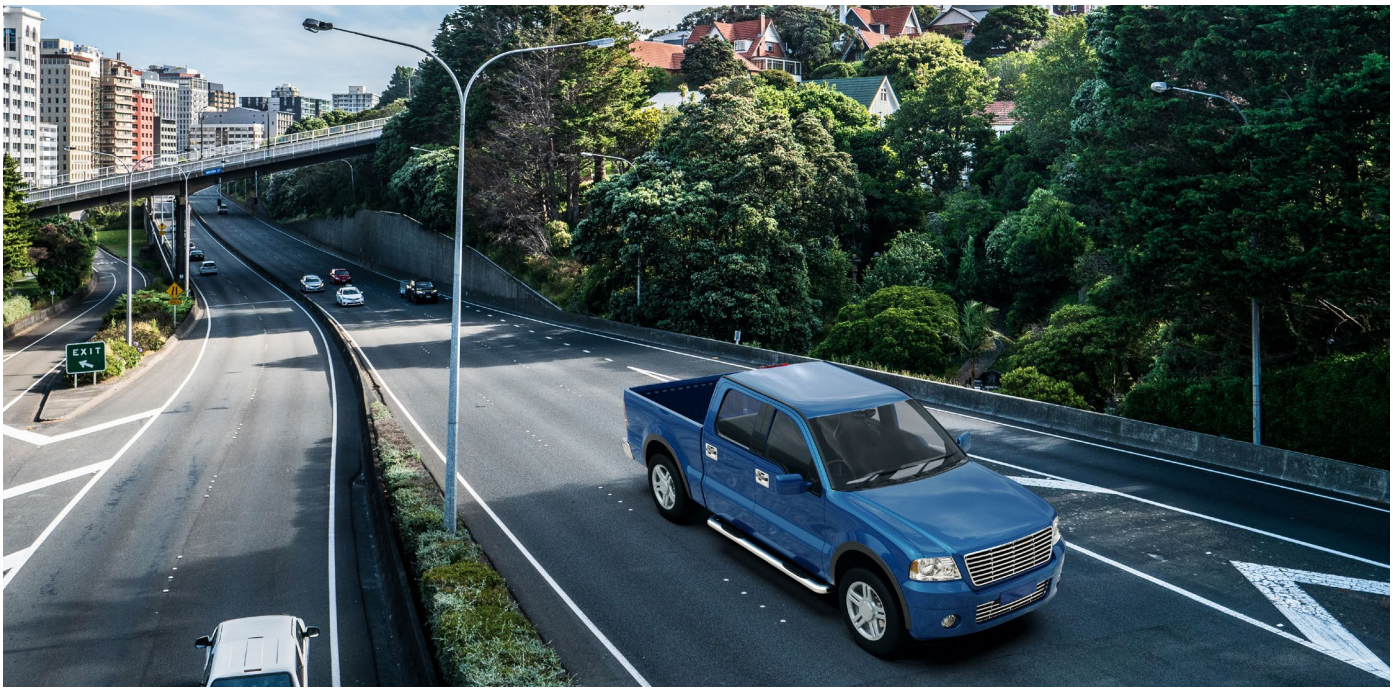
The great ute FBT debate

By Robyn Walker



The Clean Car Discount has well and truly reignited the debate about how Fringe Benefit Tax (FBT) applies to vehicles, and in particular whether there is a tax exemption incentivising the growing number of double-cab utes on New Zealand streets. In this article we explain the difference between a car, a ute and a work-related vehicle.

What is subject to FBT?

A motor vehicle fringe benefit arises when an employer makes a motor vehicle available to an employee for their private use, in connection with the employment relationship. It is irrelevant whether a vehicle is actually used, unless an exemption applies. The exemptions are:

- Work-related vehicle ("WRV") exemption
- Emergency call exemption
- Business travel exceeding 24 hours exemption

In this article we focus on the work-related vehicle exemption.

What is a work-related vehicle?

The WRV definition has several layers to it, which can cause confusion.

A vehicle is only exempt from FBT on a day in which it is satisfies all of the WRV criteria; FBT will apply on any day that the criteria is not satisfied, most notably the prohibition on private use.

A WRV is a motor vehicle that:

1. Prominently and permanently displays on its exterior the employer's identification (e.g. it is branded / features logos, and the logos are permanent, they cannot be magnets); and
2. Is not a "car"; and
3. Is not available for the employee's private use, except for private use that is:
   - Travel to and from their home that is necessary in, and a condition of, their employment; or
   - Other travel in the course of their employment during which the travel arises incidentally to the business use.

A "car" means a motor vehicle designed exclusively or mainly to carry people; it includes a motor vehicle that has rear doors or collapsible rear seats. Most vehicles will be cars, however if a car has had its rear seats removed or permanently bolted down (meaning it is not used mainly to carry people), then the vehicle will not be a car for the purposes of the WRV exemption.

Inland Revenue's view in relation to double-cab utes is: "This vehicle is designed equally for carrying people and for carrying goods. The front half of the ute comprises the cab which has two rows of seats for carrying people. The back half of the vehicle is the tray, which is used for carrying goods. This vehicle is not a car."

Is a sign-written double cab ute automatically exempt from FBT?

No, there is a common misconception that all utes are exempt from FBT. However, a sign-written ute can qualify for the WRV exemption if private use is restricted to home to work travel and any incidental private use which occurs while the vehicle is being used for business purposes (for example stopping at the supermarket on the way home).

In order to qualify for the WRV exemption an employer should have a private use restriction in place, ideally a letter issued to the employee or a specific clause in an employment agreement.

Compliance with the private use restrictions should be regularly checked by the employer; Inland Revenue recommends checks are done every quarter and could include checking petrol purchases and logbooks.

As the WRV exemption applies on a daily basis an employer can allow private use at certain times and just pay FBT in relation to those days. For example, an employer may restrict private use Monday to Friday and allow private use on Saturday and Sunday; in this case the employer would pay FBT for 2 days each week (regardless of whether the vehicle is actually used by the employee on the weekends).

Can any ute use qualify?

One of the WRV criteria mentioned above is that the travel between home and work must be "necessary". What is this intended to mean? Essentially this is looking at why the vehicle is provided. Inland Revenue's view on this is best articulated in this extract of its interpretation statement on FBT on motor vehicles:

"The definition of "necessary" suggests there must be a direct or needed relationship between the employee's travel to and from home and their employment. This may not necessarily be "essential", but must certainly be "required or needed" in their employment .... If the travel is not necessary in the employee's employment, then the travel will be subject to FBT. For example, if a receptionist is given a vehicle to travel between home and work, the employer would not be entitled to the benefit of the private use exclusion in s CX 38(3)(a), because the travel to and from home is not necessary to the receptionist's role."

Whether something is "necessary" will depend on the facts and circumstances of a particular situation. While conceptionally it may be reasonable to say that a receptionist has no need to be provided with a ute, the receptionist may have a requirement to regularly pick up work supplies on the way to or from work, or alternatively there may be a requirement for a vehicle to be taken home due to a lack of secure parking at the workplace.

What if you've been doing it wrong?

Tax rules are usually very specific, and if you're not into the detail of tax it can be easy to get it wrong. It's quite common to hear things like "my accountant said we should get a ute for the business because there is no tax" with no knowledge of the additional criteria. As outlined above, it's not as simple as just buying a ute, all the WRV criteria need to be satisfied on every day of the year in order for the ute to be outside of the FBT net. If your ute isn't permanently and prominently sign-written, the ute isn't "necessary", or you don't have a private use restriction in place then the ute is subject to FBT.

If FBT hasn't been paid in the past the first step is to get your FBT positions correct going forward. The next step is to make a voluntary disclosure to Inland Revenue in relation to the past error. If a voluntary disclosure is made prior to Inland Revenue seeking to audit a business any shortfall penalties will generally be remitted in full.

If you're uncertain about how FBT applies to your vehicles, get in touch with your usual Deloitte advisor.

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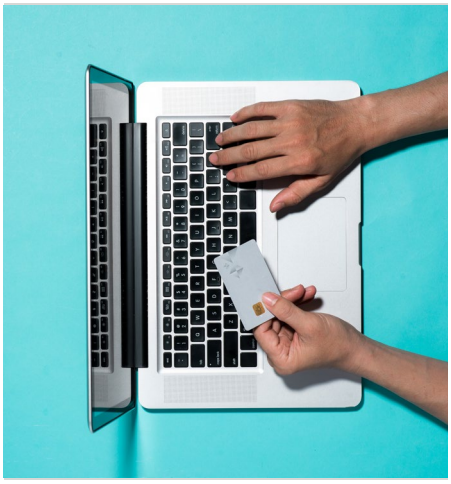
Government moves to collect more bulk data from payment service providers

By Troy Andrews & Vicky Yen



Inland Revenue will soon be using its powers to collect regular bulk datasets on electronic payments from banks and other payment service providers.

New regulations have been proposed in a government Discussion Document released on 6 July 2021, "Regular dataset collection from payment service providers", requiring payment service providers to report prescribed information on electronic payments between customers and merchants to Inland Revenue on a quarterly basis. Failure to provide the information may be an offence with criminal penalties ranging from fines to imprisonment.

The information will include aggregated transactions and account information for each merchant (each entity or person that is engaged in a business activity). Individual customer transactions and payment data will not be collected or identifiable, however merchants' identification and personal information may be collected, including bank account numbers, phone numbers, addresses, IRD numbers, and date of births.

Inland Revenue previously only had the power to request this information on an ad hoc basis; now Inland Revenue is able to collect this information continuously.

These proposals will allow for collection of the same information on a regular basis and from more payment service providers, subject to only a few limited exemptions (reporting is not required from payment service providers who have subcontracted to another provider, and information does not need to be reported in relation to "large" merchants with over $30 million in payment values, nor on bank-to-bank payments such as direct debits, which will be subject to a separate round of consultation). Officials have communicated that the information collected will only be used by Inland Revenue to verify business income, however given the broad-reaching nature of the proposals we believe Officials should provide further assurance that the data collection process will be appropriately targeted and the information used only for clear, specified purposes.

The proposals are intended to provide more certainty and transparency on the types of information being shared with Inland Revenue, and allow Inland Revenue to offer improved services and support. Examples of benefits referred to in the Government Discussion Document include the ability for Inland Revenue to notify businesses to promptly register for GST once they reach the turnover threshold (based on payment data), and to establish industry benchmarks which can trigger investigations and prevent tax avoidance from being a competitive advantage for certain players in the market.

However, the additional frequency and volume of data sharing may give rise to significant compliance costs for payment service providers, including on the set up and maintenance of appropriate data collection, reporting, and security related processes. Some of the additional compliance costs may inevitably be passed on to private businesses.

There appears to have been limited consultation on the proposals to date, with various payment service providers now unexpectedly facing additional compliance costs and the threat of potentially disproportionate penalties for non-compliance. It is hoped that from here onward Officials will engage in wider consultation to ensure the proposals do not introduce unnecessary compliance burdens, and that affected parties will be allowed sufficient time to prepare and update their systems.

As mentioned above, this round of consultation relates to the first use of Inland Revenue's enhanced data collection powers, we expect more industries may also find themselves being on the receiving end of information requests in due course.

The Government Discussion Document sets out more detail on the proposals, and invites submissions on the proposals to be made by 20 August 2021.

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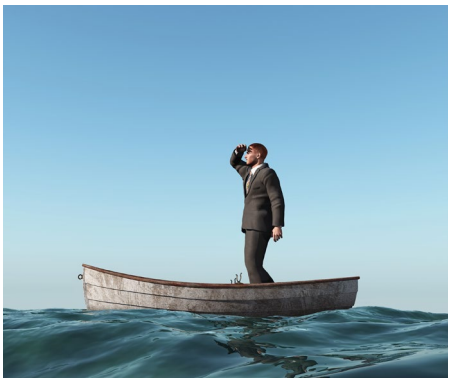
The Inland Revenue FIF calculator still missing in action

By Sam Mathews & Vicky Yen



You may have seen recent media articles (including on stuff.co.nz and NewstalkZB) where Inland Revenue (IR) has conceded that its Foreign Investment Fund (FIF) income calculator is faulty.

Avid readers of Tax Alert (and/or FIF enthusiasts) will recall our November 2020 article which highlighted this issue. To briefly recap the issue, there is a problem with the way IR's FIF calculator is calculating income under the Fair Dividend Rate (FDR) method where there is a "quick sale". A "quick sale" occurs where a FIF interest is bought and later sold in the same income year.

IR has acknowledged the calculator has been faulty since April 2020, meaning there were approximately 15 months where it wasn't working properly. This means that taxpayers who relied on the calculator during this period to calculate FDR income and who had a "quick sale" may have overpaid or underpaid tax. The 2020 and 2021 income years are the periods that will most likely be impacted.

IR has released communications targeted at tax agents to highlight this issue and encourage return positions taken by clients to be checked and reassessed if they were wrong.

We make the following observations:

- We first raised the issue with IR back in September 2020. The calculator was taken down briefly and then put back online in December 2020 along with a statement from IR saying "...we can now confirm that it is working correctly". However, when we tested a range of scenarios it was not working correctly. We advised IR of this early this year.
- We have worked through examples where the result of using the IR's FIF calculator would have resulted in an over-payment of tax, in some examples it would result in an under-payment of tax. The issue does not appear to be confined to losses on "quick sales" not being offset against gains, as has been suggested by Inland Revenue.
- While it is great that IR make resources like this available for taxpayers, we think they have a duty of care to ensure the resource is 100% accurate.
- IR has noted that they will be reasonable with customers who have difficulty meeting filing deadlines because of this issue, which is obviously great, but what is also needed is guidance on what taxpayers who have relied on the calculator in filing their tax returns and have overpaid/underpaid tax as a result should do. While the ultimate responsibility for the positions taken in a tax return sits with the taxpayer, we would expect IR to process any reassessments quickly and grant requests for penalties and interest charges to be waived if they arose from reliance on or unavailability of the calculator.

With increased access to global share markets (including the ease in which buying and selling activity can occur), and the FDR method being the default and most common FIF method for listed portfolio FIF interests, we suspect that there may be a number of impacted taxpayers.

When investing in international equities, taxpayers should ensure they fully understand the tax consequences of these investments, including the need to file annual tax returns. The rules around these investments are complicated – perhaps best illustrated by the trouble IR is having with its calculator. Deloitte has developed FIF calculation software that automates FIF calculations under the FDR method and the comparative value method. This is particularly useful where there are a number of transactions involving FIF interests during the year, including "quick sales".

Please contact your usual Deloitte adviser if you would like to discuss this issue, including how we can assist with reviewing or preparing FIF calculations.

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Snapshot of recent developments

Tax legislation and policy announcements

Q&A on interest limitation rule and additional bright-line rules

Following on from the Design of the interest limitation rule and additional bright-line rules discussion document, on 26 July 2021, Inland Revenue released a Questions and Answers document which provides some answers to various questions they encountered through the consultation process, including scope of the exemptions, development exemption, new build exemption, rollover issues and interest allocation. A quick recap on the discussion documents' details can be viewed in our June Tax Alert article.

Inland Revenue statements and guidance

Administration of imported mismatch rule

On 30 June 2021, Inland Revenue released finalised operational statement OS 21/02 - Administration of the imported mismatch rule - section FH 11. This Statement is intended to clarify the Commissioner's expectations as to how taxpayers will meet their self-assessment obligations when applying the imported hybrid mismatch rule in s FH 11 of the Income Tax Act 2007 to payments to members of their control group, and how the rule will be administered by Inland Revenue in relation to such payments. The Commissioner's view remains unchanged from the draft version, however emphasis has been added to clarify that this statement is not intended to provide a safe harbour, meaning that compliance with this statement does not guarantee that there will be no deductions disallowed under s FH 11, but will reduce the likelihood of lack of reasonable care penalties being imposed where an imported mismatch is later found to exist.

Depreciation rates for brake test rollers

On 1 July 2021, Inland Revenue published finalised determination DEP107 - General Tax Depreciation Rates for brake test roller. The estimated useful life and depreciation rates for brake test rollers remain unchanged from the draft version.

Inland Revenue exercises discretion for affected taxpayers in the West Coast, Tasman and Marlborough regions

On 18 July 2021, the Government declared a medium-scale adverse event for the West Coast, Tasman, and Marlborough regions. To assist farmers and growers, Inland Revenue is exercising discretion to allow early withdrawals from the income equalisation scheme.

Non-cash dividends

On 22 July 2021, Inland Revenue published Interpretation Statement IS 21/05 - Non-cash dividends. This statement considers when a transfer of company value from a company to a shareholder is treated as a dividend for tax purposes. It focuses on the types of non-cash transactions that are often entered into between small and medium-sized companies and their shareholders.

COVID-19

Wage subsidy reviews

When the Office of the Auditor General (OAG) reviewed the Wage Subsidy Scheme it recommended that the Ministry of Social Development (MSD) seek written confirmation of compliance with the eligibility criteria from wage subsidy applicants. The MSD has now started a project which is currently focusing on larger employers. A random sample of about 1,000 recipients who had applied for the Wage Subsidy between 4pm 27th March 2020 and 8th June 2020 have been contacted by email survey to confirm their business met the eligibility criteria and their compliance with obligations for the subsidy received.

Recipients who have made a full repayment and those whose eligibility is part of ongoing checks have been excluded from selection. Further details of the OAG review and the wage subsidy eligibility criteria can be found here.

OECD updates

The OECD published the following key publications during July:

• On 21 July 2021, the OECD released Revenue Statistics in Asia and the Pacific 2021 which provides an overview of the main taxation trends from 1990 to 2019 in 24 economies, including New Zealand. The report also includes a special feature on the emerging challenges for the Asia-Pacific region in the COVID-19 era and ways to address them.

• On 29 July 2021, the OECD released Corporate Tax Statistics: Third Edition. The data shows that statutory corporate income tax rates (CIT) have been decreasing in almost all countries over the last two decades. Across 111 jurisdictions, 94 had lower CIT rates in 2021 compared with 2000, while 13 jurisdictions had the same tax rate, and only 4 had higher tax rates. These declining rates highlight the importance of OECDs proposed "Pillar Two", which will put a multilaterally agreed limit on corporate tax competition. The new statistics also suggest continuing misalignment between the location where profits are reported and the location where economic activities occur. This can be seen through differences in profitability, related-party revenues, and business activities of Multinational Entities (MNEs) in investment hubs and zero-tax jurisdictions compared to MNEs in other jurisdictions. It is noted that evidence of continuing BEPS behaviours as well as the persistent downward trend in statutory corporate tax rates reinforce the need to finalise agreement and begin implementation of the two-pillar approach to international tax reform.

• On 29 July 2021, the OECD published Corporate Effective Tax Rates For Research and Development (R&D). This paper contributes a methodology to construct forward-looking effective tax rates for an R&D investment that reflect the value of expenditure-based R&D tax incentives. The new OECD estimates cover 48 countries (including New Zealand) and consider the case of large profitable firms, accounting for the bulk of R&D in most economies. The results provide new insights into the generosity of R&D tax incentives from the perspective of firms that decide on whether or where to invest in R&D and the level of R&D investment. The paper also highlights differences in countries' strategies to support R&D through the tax system.

Deloitte Global News Focus

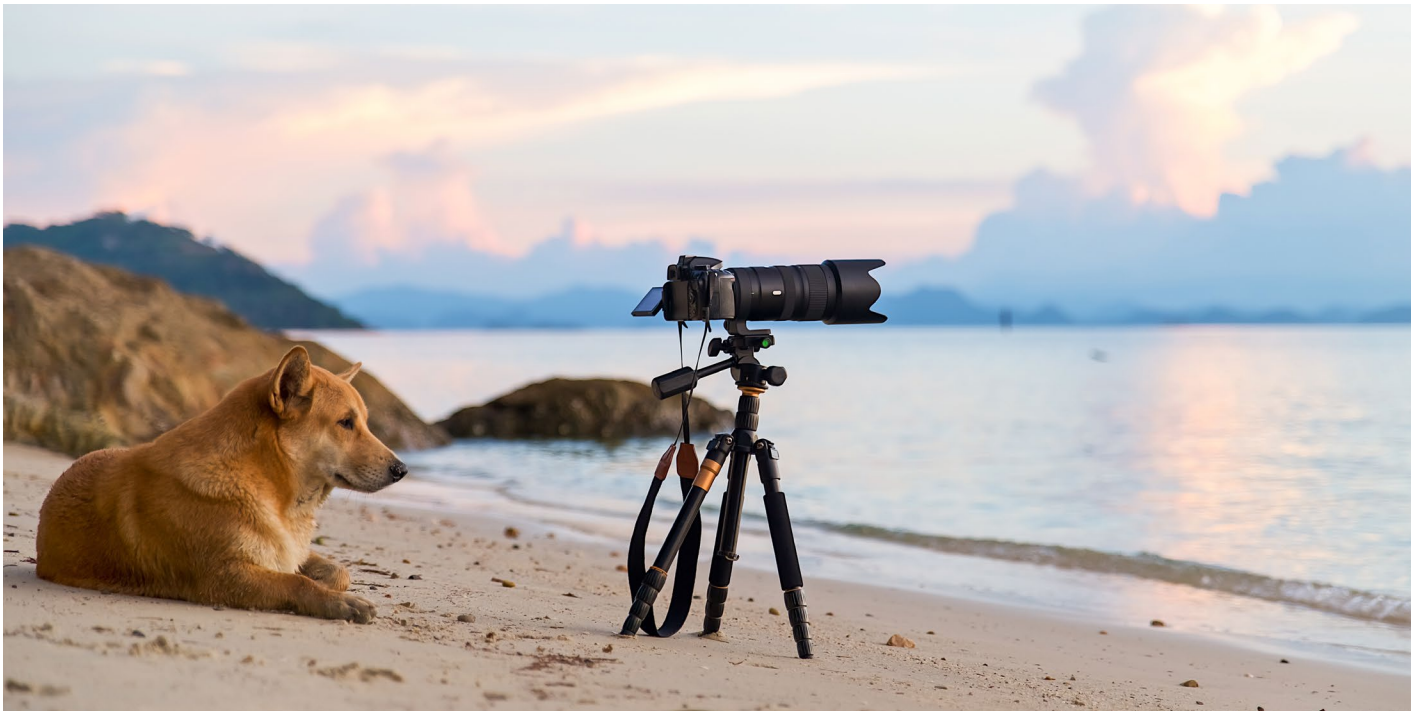
ATO offers help to new investors

Deloitte Australia has written a helpful article explaining New Investment Engagement Service (NIES) launched by the Australian Taxation Office (ATO). The NIES forms part of the Federal Budget 2021-22 initiatives to encourage global businesses to invest in and relocate to Australia.

Status of the Multilateral Convention

The impact of implementation of the anti-tax treaty abuse measures under the Organization for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS) project have had far-reaching consequences. The implications of certain BEPS Actions are still being worked through, particularly in relation to the multilateral instrument (MLI or Convention). The MLI constitutes a major change to international taxation and will enable international tax authorities around the world to challenge transactions and structures on a new basis. While New Zealand was quick off the mark to have the MLI in force from 1 October 2018, other countries are going through the process of ratifying the MLI. Deloitte maintains a list of all status of the MLI across the globe, you can access the latest copy here.

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



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