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Tax Alert

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Can I carry forward my tax losses? Final guidance from Inland Revenue

By Vyshi Hariharan, Hamish Tait and Robin Kim

Inland Revenue has recently released, in final form, a new interpretation statement [Loss carry-forward – continuity of business activities] (the final statement). We have previously [commented] on an earlier draft of the statement (the draft statement). The final statement provides helpful guidance on how the main aspects of the business continuity test (BCT) apply.

Enacted nearly two years ago, the BCT relaxes New Zealand's previously strict loss carry-forward rules for companies. Under the rules, losses are no longer forfeited where there is a breach in shareholder continuity, provided there is no major change in the nature of the company's business activities; or if it is a major change, provided it is one of four "permitted changes".

In this article, we have briefly commented on the guidance included in the final statement and our observations in respect of matters not addressed by the statement - such as when Inland Revenue will seek to apply anti-avoidance rules.

What does the statement cover?

Consistent with previous drafts, the final statement includes helpful examples and expands guidance previously issued.

We have summarised the main changes and key additional guidance included in the final statement below.

- **Defining the nature of a company's business activities**

  Taxpayers relying on the BCT will need to define their business activities as a first step.

  The draft statement released in mid-2021 included detailed comments in relation to the level of granularity that taxpayers should apply to define business activities. Specifically, it stated that, rather than describing a business "very broadly" (e.g. agriculture), or "very narrowly" (e.g. merino sheep farming for fine wool), the business should be described "more narrowly" (e.g. sheep farming).

  The final statement sets out more generalised guidance on the relevant factors to be considered in determining the "nature of a company's business activities", noting that this should be described with reference to:

  - The core business processes;
  - The type of product or service produced or provided;
  - Significant assets utilised and where relevant, significant suppliers or other inputs;
  - Scale; and
  - The main markets supplied to.

- **Groups of companies**
  The BCT deems a group of NZ resident companies that are part of the same group of companies at the time of a shareholder continuity breach (e.g. the acquisition of an entire corporate group) to be a single company for the purposes of assessing the nature of any future changes to business activities.

  The final statement provides further guidance on how this should be applied in practice, including that intra-group activities/transactions are ignored for BCT purposes. For example, administrative services from a holding company to other companies within the same group are disregarded when considering whether there has been a major change, as are a holding company's shares in its subsidiaries when determining the relevant assets.

  Furthermore, the guidance notes that if a deemed single company produces/ provides multiple products/services, a significant change in the relativities of these products/services can be considered to be a major change.

- **Major changes or cessations occurring part-way through an income year**
  The final statement provides guidance in relation to the impact of a major change that occurs part-way through an income year, noting that this does not prevent a tax loss from being carried forward and set off against income that arises in the part of the year prior to the major change, provided there are adequate financial statements calculating the company's taxable income for that part of the income year. This position is consistent with the outcome where a shareholder continuity breach occurs part-way through an income year.

- **Decreases in scale, and/or discontinuation of existing products or services**
  A reduction in the scale of output or the discontinuation of existing products or services may be indicative of a major change in certain (but not all) circumstances. The statement helpfully includes examples that indicate the context in which such changes may or may not be considered a major change.

  The BCT provides that certain major changes are "permitted" major changes. This includes:

  a. Changes to increase the scale of a business; and

  b. Changes in the type of products or services, if they are produced using mainly the same assets, or are closely connected with the old products/ services.

  Where a reduction in the scale of output or the discontinuation of existing products or services is determined to be a major change in the context of the operations of a company (or group), the final statement notes that the changes would not be considered a permitted major change under (a) or (b) above.

- **Examples**
  The final statement helpfully includes new and expanded examples which cover a wide range of situations, including the application of the rules with respect to
  - Ownership continuity breaches taking place prior to the 1 April 2020 application date (but still in the 2021 income year), e.g. early balance dates;
  - Companies with intervening or a series of ownership continuity breaches and changes in the nature of business activities carried on;
  - Where a major change occurs part-way through an income year;
  - Determining the nature of business activities carried on by a deemed single company;
  - Where major changes are in respect of technological advances that are not related to the business activities of the company;
  - Start-ups and permitted major changes; and
  - A diversified group of companies disposing of one of its businesses and whether this is a major change and if so, a permitted change.

Matters not covered in the final statement

- **Trade buyers and post-merger integration**
  It is common to see one company purchasing a competitor or related business, with a view to essentially absorbing it into the purchaser's business. The purchaser may look to integrate a number of functions (e.g. back office, sales etc) from the target, either immediately or gradually over time as part of the integration process to achieve synergies.

  Inland Revenue's guidance includes a helpful example around outsourcing a manufacturing operation being a permitted major change, given it is made to increase efficiency (Example 8). Based on this example, it may be acceptable in some situations for a number of a target company's functions to be outsourced – provided fundamentally the same business continues to be carried on. However, Inland Revenue's guidance does not discuss whether or when any such changes might be a 'bridge too far', or what should be done (e.g. intercompany agreements, management fees) to support the outsourcing. Therefore, where the target has pre-completion tax losses, a purchaser will need to be wary of the extent to which any changes made could be a 'major change' and carefully consider the application of the rules before implementing post-acquisition integration measures.

- **Anti-avoidance rules**
  The BCT rules are buttressed by several specific anti-avoidance rules. The final statement does not provide any comment on what situations Inland Revenue might regard as being in breach of these rules.

- **Interaction with other tax rules**
  The statement does not comment on or provide examples that consider, whether the tax consolidated group rules or the amalgamation tax rules could impact on the application of the BCT.

How are we seeing taxpayers responding to the new rules?

- **Market practice / paying for losses**
  One of the big questions ahead of the introduction of the BCT was how purchasers in merger & acquisition (M&A) transactions would respond, including whether they would place value on targets with tax losses. Whether losses have value in specific scenarios varies depending on the purchaser and their circumstances. For example, the likely usage of losses (i.e. when will the losses start to shelter go-forward income), and the likelihood they will stay intact (depending on the purchaser's plan for the business post-completion) is impacting on this.

- **Seeking certainty through rulings**
  Officials have engaged with taxpayers and advisers throughout the design of the rules and issued helpful guidance, including a number of practical examples. Where the application of the rules is not clear or taxpayers would like to have more certainty, it is also possible to seek binding and non-binding views in relation to the application of the rules. We understand that in most cases, these views are provided in relation to a targeted aspect of the rules.

- **Documenting the positions taken**
  The application of the BCT is ultimately a fact intensive, subjective analysis. Therefore, each company (or group of companies) must evaluate the relevant factors under the rules with reference to their own circumstances. We recommend documenting an initial snapshot of the business (with reference to the relevant factors noted in the guidance and the rules) and regularly monitoring and updating the documentation to track any changes in activities. This will ensure that positions taken can be supported with appropriate documentation and analysis. Businesses should also consider their internal processes so that appropriate consideration is given to the impact of the BCT prior to making changes.

Please get in touch with your usual Deloitte advisor if you would like to discuss this further or are relying on the BCT to carry forward tax losses. We can work with you to help with undertaking the required analysis, determine whether a binding or non-binding view should be sought, and document the results in an efficient way.

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Self-employed tax deductions in the spotlight

By Kirsty Hallett and Rosie Fresen

Inland Revenue is keeping a close eye on expenses claimed against income earned by Independent Contractors. Are you claiming expenses correctly and what does a recent Inland Revenue decision mean for you?

Following in the footsteps of IS 21/06 – Income Tax and GST – Treatment of meal expenses released mid-last year which concluded that a self-employed person cannot claim a deduction for meal expenses on the basis these are inherently private in nature, Inland Revenue have now released a tax technical decision summary (TDS) which disallowed deductions claimed by a self-employed person on travel, accommodation and meals while working away from home.

This decision follows Inland Revenue's recent theme of placing increased focus on compliance of small self-employed taxpayers. They have been imposing stricter requirements to support the basis for deductions than many taxpayers will be accustomed to. This has the potential to further diverge the treatment for travel, accommodation and meal costs incurred by a self-employed person from that for employers and employees.

Going forward, it is becoming critically important that documentation is in place to support the basis for deducting business expenses incurred by a self-employed person that could be viewed as being private in nature referencing the need for the expenditure in the course of undertaking the contracting activity.

Overview of the TDS Decision

A TDS is a sanitised technical decision made by Inland Revenue on a specific set of taxpayer facts, therefore they are of less precedential value than an interpretation statement or other formal statement. Nevertheless, a TDS provides useful guidance as to how Inland Revenue will apply interpretations.

This TDS decision concerns an individual involved in more than one venture. The Taxpayer operates a farm on their property as a self-employed person and also earns schedular income from undertaking work as an independent contractor. The Taxpayer was required to undertake the contracting work in a different city to where they ordinarily resided and sought to claim deductions for expenses incurred on travel, meal and accommodation costs against their schedular income.

Travel and Accommodation Expenses
Inland Revenue denied the Taxpayer a deduction for their travel and accommodation costs on the basis that the travel took place between the taxpayer's home and a different city where they went to derive their schedular income. As the nature of the work undertaken at each location was unrelated and travelling between the two cities was not required while the Taxpayer was engaged in undertaking either activity, the deduction was denied. Rather Inland Revenue viewed the costs as having been incurred to put the Taxpayer in a position where they could undertake their activity from which their taxable income would be derived. In relation to travel, the costs were viewed as travel "to one's work" and "from one's work", as opposed to "on work" for either activity. Inland Revenue concluded that the expenses incurred by the Taxpayer did not satisfy the statutory nexus with the income-earning activity and were incurred as a result of the Taxpayers' personal preferences rather than as a result of the nature of the contracting work.

Meal Expenses
Consistent with the position in IS 21/06, deductions for meal expenses were denied on the basis that these are of a private and domestic nature and although there was an extra cost associated with the meals while away from home (as compared to the cost of meals at home), this was not as a result of a requirement of the Taxpayer's contracting work.

What does this mean for you?

While the decision itself may not be in dispute in the taxpayer's context, it does raise a series of questions for taxpayers operating as self-employed persons, particularly in an increasingly mobile world where the boundaries between home and work/private and business have become increasingly blurred. It would seem a higher burden of proof is being applied by Inland Revenue in this context to support deductions than would likely be the case for a company providing allowances or reimbursements for employees which in many cases would be able to be provided tax-free.

As many independent contractors will attest to, the nature of their work can often require them to travel and/or spend time away from home as part of undertaking their contractual activity. In these cases, many would claim the costs of travel, accommodation and meals while away from home as deductible business expenses on the basis that the costs have been incurred in the course of undertaking their taxable activity or incurred in deriving their assessable income and are not of a private or domestic nature.

We expect many situations can be differentiated from the facts of this particular case, for example, if the taxpayer usually worked from home and had to visit the client site for meetings once a week in another town. In this situation, they are travelling from their usual place of work (home) to the client site in the course of deriving income. Travel, accommodation, and meal costs are necessary expenses as a result of the business trip and our expectation is a deduction may be supported in this case.

Operate with Caution! Taxpayer Beware

Previously Inland Revenue has not focused heavily on deductions for individuals. This example, along with other recent rulings, is showing a trend towards Inland Revenue starting to look more closely into deductions claimed for individuals.

The case references documentation to support the basis for the claims and serves as a reminder to be vigilant about keeping a proper record of expenses incurred when travelling for business including the reasons they are being incurred. Where deductions are being claimed for expenses that could in essence be viewed as private in nature or putting you in a position to generate taxable income, documentation should be put in place at the time they are incurred outlining why the costs are being incurred as part of carrying out your business activity. This will help to support your positions should Inland Revenue review your position down the track.

If you have queries about what is deductible against your taxable income it is important to be speaking with your usual Deloitte advisor.

Previously Inland Revenue has not focused heavily on deductions for individuals. This example, along with other recent rulings, is showing a trend towards Inland Revenue starting to look more closely into deductions claimed for individuals.

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Accounts payable and receivable practices under the spotlight

By Robyn Walker, David Webb and David Sinkins

There is a well-known saying by Alan Miltz that *"revenue is vanity, profit is sanity and cash is king"*, and we couldn't agree more. The most successful business ideas won't work if there isn't the cash flow to support them.

A 2019 report by the Small Business Council highlighted that a key concern of business owners is the late payment of invoices. Picking up on that concern, the Government has taken the next step of introducing proposed reporting laws for large businesses, to essentially shame businesses into paying invoices on time. The Business Payment Practices Bill (the Bill) is currently being considered by the Economic Development, Science and Innovation Committee, with submissions closing on 8 January 2023.

The Minister for Small Business explained the Bill's purpose during the first reading:

"Poor payment practices persist and continue to affect many small New Zealand businesses. Small-business owners in New Zealand continue to report that delays receiving payment are hurting cash flow, increasing stress levels, and inhibiting their business growth. It is abundantly clear that this situation warrants intervention. … Small businesses face challenges enforcing their payment terms, because they have limited bargaining power and limited resources. We know that larger firms can exploit the power imbalance by setting payment terms that advantage themselves at the expense of their smaller suppliers. When this happens, small suppliers often feel unable to ask for more reasonable terms, for fear of damaging relationships. … The purpose of the Business Payment Practices Bill is to establish a disclosure regime that brings transparency to business-to-business payment terms and practices in New Zealand. This will lead to businesses having better information to inform their decision making when engaging new customers. It will also incentivise larger businesses who are increasingly conscious of their reputation to improve their business payment practices. A secondary benefit of the regime is that it will build an evidence base on business-to-business payment practices and enable the Government to assess, over time, whether any further regulatory intervention is needed."

All political parties, with the exception of ACT, supported the Bill through its first reading; albeit one opposition member noted that while they support small businesses being paid promptly and timely, the current proposal is likened to getting out a sledgehammer to whack a walnut.

Proposal

The proposal takes form in two parts. There is the Bill that sets the framework, and also draft regulations that are subject to a separate consultation process.

Who is subject to the rules

Businesses with more than $33 million annual turnover. A group of companies will need to disclose information at a group level and also for individual companies within the group that are independently large.

Given the potential penalties at stake for non-compliance, large businesses will need to undertake a process to assess how this data can be collected, extracted and reported accurately.

What is required
Disclosure (on a website) of payment terms and twice-yearly reporting of payment practices in relation to invoices received or paid, as well as invoices issued. The potential data to report is discussed below.

How will information be publicised
The Ministry of Business, Innovation and Employment (MBIE) will be establishing a Business Payments Practices Register. The register will be accessible by the public and will contain a variety of data (discussed below).

Penalties for non-compliance
If a business omits material information from disclosure or provides false or misleading information there is a $500,000 fine.

When will these rules take effect
Legislation has not yet been enacted, it will be with a select committee to consider submissions until late April. If the legislation is enacted it will take effect from the day after Royal Assent.

As noted above, the precise data which needs to be reported is not included in the Bill, instead, options are set out in a separate discussion document. The 11 potential reporting measures include:

1. Average number of days to pay invoices from suppliers
2. Percentage of the number of invoices that were paid within the agreed payment period
3. Percentage of invoices paid in full during the reporting period
4. The percentage of invoices unpaid 61 days or more after receipt of invoice
5. Average payment time
6. The proportion of total number of invoices paid within 0-20; 21-30; 31-60; 61-90; 91-120, over 120 days
7. The proportion of total value of invoices paid within 0-20; 21-30; 31-60; 61-90; 91-120, over 120 days
8. Average number of days for receipt of payment
9. Percentage of invoices received on time
10. What are your standard payment terms offered to your suppliers in calendar days?
11. What other payment practices does the entity employ?

Items 8 and 9 relate to accounts receivable and are designed to provide a broader picture of whether the large business has the cash flow to alter its payment practices.

Disclosure of the above information would need to be made on a six-monthly basis.

Consultation on the draft regulations closes on 26 February 2023.

How to comply

The discussion document notes that the Government "expect that compliance costs to produce the measures below should be modest, and that reports should be able to be automated."

Given variable approaches to invoicing by businesses, the discussion document provides some technical notes, albeit doesn't go so far as to explain how to deal with data inconsistencies such as differences between the date recorded on an invoice and the date it was actually received, when an invoice is considered to be received (for example if there are specific purchase order or invoicing procedures for suppliers to follow), or what to do in respect of reporting of contract disputes leading to withheld payments. The discussion document suggests:

- "Paid invoices" are recorded only once payment has been made in full.
- Invoices included are only those due during the disclosure period.
- Invoices included are received by the reporting entity (not issued by the reporting entity), and exclude invoices from businesses in the same commonly owned group as the reporting entity.
- Payment times are measured in calendar days, starting from the date of receipt of the invoice until the day the invoice has been paid in full.
- The agreed payment period is usually set out in the contract, but there may be instances where it depends on details in the invoice or other documents.

Given the potential penalties at stake for non-compliance, large businesses will need to undertake a process to assess how this data can be collected, extracted and reported accurately.

In our experience before determining whether an entity complies with the proposed requirements it is worth reviewing your current payment systems and whether there is an opportunity to consolidate and optimise any divergent payments processes and systems.

To start with, this would involve mapping both your accounts receivable and accounts payable processes end-to-end and identifying the key risks, controls and gaps that would enable you to meet the new requirements (and in general to see whether working as designed).

Some of the proposals in the discussion document have many variables, for example determining when the clock starts, stops or can be paused; we would hope that in due course MBIE will issue some guidance notes on how to comply. Without this clarity measuring the number of days will vary from entity to entity.

Some of the proposed requirements such as *"the proportion of total number of invoices paid within 0-20; 21-30; 31-60; 61-90; 91-120, over 120 days"* don't match with the common business practice of businesses monitoring creditor and debtor information is based on 0-30; 31-60; 61-90 days etc, and therefore systems changes may be required.

What to do in the short term:

1. Review your current accounts payable and accounts receivable systems, policies and processes against the requirements above and:

a. Understand when the clock starts. For example, when an invoice is received in an inbox (is that an ap@abc.co.nz or a named employee inbox). Are they checked daily, what happens if the person is on leave? What happens if an invoice is posted and remains uncollected or unopened?

b. Have a clear definition of "paid invoices", what are the rules for underpayments of a few cents/dollars?

2. Do your systems distinguish between customer invoices and intercompany invoices? If not, how will you address this?

3. Does your system clearly record the date payments are due? If not, how will you address this?

Whilst the legislation and regulations are still in draft, this is a good time to review your accounts payable and accounts receivable systems and process. This is sometimes an area where Boards, Audit and Risk Committees and management do not pay much attention as they often rely on their external auditor to identify issues as part of the review of financial management controls. But as Alan Miltz said, "revenue is vanity, profit is sanity and cash is king." and we would add that the two queens are your accounts payable and accounts receivable systems and processes.

Other issues to be aware of

While considering how to comply with these proposals, businesses should also be considering whether this represents an opportunity to look more closely at accounts payable and accounts receivable processes.

From 1 April 2023 changes will take effect for GST purposes, with a loosening of the prescriptive "tax invoice" requirements. Accounts payable teams need to understand the new requirements to ensure that payment is not withheld because an invoice doesn't satisfy the "old" tax invoice requirements. You can read more about those changes here.

Optimising Cash flow

Taking control of cash flow is the first step toward optimising cash flow. Cash flow can be optimised in a number of ways, aside from just getting the money in the bank from customers.

Prepare a Cash flow

Prepare a realistic cash flow, and importantly, closely monitor it. Preparing a cash flow will allow you to foresee any potentially difficult periods and plan for these. As an example, work may be seasonal resulting in lower income or balloon payments may be due on loans at certain times. Regularly monitoring and updating your cash flow will allow you to manage external stakeholders, such as

creditors, financiers and Inland Revenue. For example, accounts receivable may be declining, could this be due to an increase in disputed invoices? If so, this may be an area you need to address as to why, or maybe one customer is falling behind on payments which need to be addressed.

Accounts Receivable
Your payment terms should be commensurate with your business and payment terms with your suppliers. Whether payment terms are 7 days or the 20th of the month, this needs to be clearly stated and understood by both parties.

To encourage timely payment, consideration could be given to discount incentives for early repayment or penalties for late payments.

Send invoices promptly and have a system to monitor payments with timely follow-up. Don't wait for outstanding invoices to accrue before following up. Ideally, pick up the phone!

Know your customers and their payment patterns. Any digression in a payment pattern may be an early indicator of difficulties on their behalf. Again pick up the phone!

Don't be afraid to stop credit and move to cash-only terms. Bad business is not good business.

Accounts payable
Negotiate payment terms with suppliers that align with your business.

Unless early payment discount incentives are offered maintain your agreed payment terms.

Review Inventory
Regularly review inventory on hand, and forward stock orders, to ensure excessive amounts are not held which may subsequently become obsolete and worthless.

Review customer patterns to identify any change in demand.

Capital Expenditure
Consider the viability of leasing vs buying. Leasing may eliminate an initial capital outlay, (although requiring monthly expenditure), and in some cases, depending on the terms of the lease, remove the cost of repairs and maintenance.

Invoice Factoring
Invoice factoring is a means of improving cash flow by selling invoices to a factoring company at a discount. The factoring company will immediately make payment of a certain amount, (which may be around 80%) and once full payment is received from the customer by the factoring company the balance will be paid less all agreed fees.

The advantage is the access to immediate working capital, and the ability to focus on other areas of the business, with the disadvantage being a reduction in profit margin.

For further advice on the issues raised above, please contact one of the authors or your usual Deloitte advisor.

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Automatic transfer of business income details on the way

By Robyn Walker

The Inland Revenue's new computer system has the capacity and functionality to receive and process vast amounts of data and from April 2023, more data will be collected about businesses.

In November 2022, the Government finalised an Order In Council (OIC) which sets out the details of data that 'payment service providers' (PSP) will need to collect and provide to Inland Revenue on a six-monthly basis. The approach in the OIC will replace the ad hoc requests for data that Inland Revenue currently make with routine reporting.

Those who satisfy the definition to be a PSP are likely to be contacted shortly by Inland Revenue to provide further practical details about the data required and how it should be provided. To be subject to reporting under the rules, a business must meet the following payment service provider definition in the OIC:

a. means a business that participates in a payment system by facilitating payments; and

b. includes an acquirer (this is an entity (for example, a bank) that provides access by a merchant to a payments system that enables the clearing and settling of funds used to conduct a transaction, irrespective of whether the entity also provides other services (for example, lending); and

c. includes an entity that provides any of the following services:

   i. switch services:
   ii. settlement services:
   iii. online payment gateways:
   iv. alternative payment methods; but

d. does not include the following, except to the extent that the business also provides a service referred to in paragraph (b) or (c):

   i. an issuer (for example, the customer's bank that issues a payment card):
   ii. a business that provides payment service hardware.

It may be possible for a PSP to be exempted from the rules on application if it is clear to the Commissioner of Inland Revenue that another PSP holds the same or more information. The approach of providing exemptions will help eliminate double-ups of data being supplied about businesses.

The data to be supplied is set out in the OIC, so businesses should be on notice that Inland Revenue will have baseline data about the minimum levels of income they might expect to see included in tax returns.

Ultimately the purpose of these rules is to help ensure that taxpayers are complying with their tax obligations. While the vast majority of taxpayers

These rules will help Inland Revenue focus its resources on those taxpayers who need help complying with their tax obligations.

fully comply with tax laws, there will always be a segment of society that tries to operate outside of the law or who understate income levels. The size of the black economy, by its nature, is difficult to estimate, but it is likely to be billions of dollars of uncollected tax on an annual basis. Hopefully, the ongoing reduction in cash transactions will not reverse as a consequence of these new rules.

These rules will help Inland Revenue focus its resources on those taxpayers who need help complying with their tax obligations. For compliant taxpayers, time will tell if the collection of this information will lead to questions from time to time; for example, if there is a mismatch between incoming payments which have been reported by PSPs and income reported because of a sale of a capital asset or sales being exempted from GST.

For more information about these rules, please contact your usual Deloitte advisor.

Type of information to be collected

The information that may be collected from a PSP is information of all or any of the following types about a business (referred to as a 'merchant') on behalf of whom the payment service provider processes payments:

a. the name of the merchant, including legal and trading names:

b. contact information for the merchant, including physical and postal addresses and telephone numbers:

c. the name of any individual who acts as a contact person for the merchant in relation to the payment service provider:

d. contact information for an individual referred to in paragraph (c)

e. the unique identifier for the merchant in the payment service provider's system:

f. other identity information about the merchant, including—

   i. the merchant's date of birth (if the merchant is an individual); and
   ii. if held by the payment systems provider, the merchant's IRD number, GST number, New Zealand Business Number, and Companies Office company registration number:

g. bank account numbers used by the merchant:

h. information about payments processed on behalf of the merchant:

   i. any other information that is incidental to the information specified in paragraphs (a) to (h).

The payment information in (h), must break down on a month-by-month basis:

a. the total value of all payments processed; and

b. the total value of all payments processed in each transaction category, including the following categories: debits, credits, cash-outs, reversals, refunds.

c. the total number of all payments processed; and

d. the total number of all payments processed in each transaction category.

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The Christmas Tax Conundrum

By Amy Sexton and Robyn Walker

With Christmas just around the corner, not only is it time to unleash Mariah Carey and Michael Bublé on the masses, but it's also time for the annual work Christmas party and token of appreciation. After the last few years, we are sure that everyone is looking forward to relaxing with colleagues with a few fruit mince pies and cold beverages before heading off on holiday.

Regardless of what your business is planning to do for Christmas, it's important to remember that different tax rules will apply to different festive choices. These tax implications are often overlooked when providing benefits to employees and clients and so to save any uh-oh moments next year, let's review the differences between the entertainment, FBT and PAYE regimes.

Tax Regime	Benefit characteristics	Tax Implications
Entertainment	• Benefits that have both a private and a business benefit • Includes recreational events away from business premises, including corporate boxes, exclusive areas, pleasure craft and holiday accommodation • May include food and drink • Benefits are not received in the course of, or as a necessary consequence of employment duties	• Expenditures are restricted to 50% of the cost for certain expenditure that provides both a private and a business benefit • Rules differ depending whether the entertain is on or off the business premises • A supply is deemed to take place for GST purposes on the non-deductible proportion
FBT	• Non-cash benefits provided to employees that can be enjoyed at the employee's discretion and is unrelated to their employment duties • Employer legally incurs the cost	• Expenditures are 100% deductible • Pay FBT at the chosen rate and make a GST adjustment • A de minimis threshold may apply for unclassified benefits
PAYE	• Costs incurred by employees that are reimbursed by their employers or funded by an allowance	• Expenditures are 100% deductible • PAYE may or may not apply

As a general rule of thumb, when it comes to food and drink the entertainment regime overrides the FBT regime and typically applies, unless:

- The employee can choose when to enjoy the benefit, or the benefit is enjoyed outside New Zealand; and
- The benefit is not received or used in the course of, or as a necessary consequence of, the employee's employment duties.

As another rule of thumb, PAYE trumps FBT when it comes to determining the tax treatment of any accommodation provided to employees for any extended Christmas parties.

Examples

Let's consider some practical examples that your business may come across.

Costs associated with organising a Christmas party event off premises
Expenditure on venue hire, food and drink will be subject to the entertainment regime. Expenditure also includes incidental costs such as hiring crockery, glassware or utensils, wait staff and music. Employers can only deduct 50% of the expenditure incurred.

Providing employees with food and drink
Food and drink provided on premises at a party, reception, or celebratory meal, as well as taking employees out for food and drink off premises at restaurants, would all be subject to the entertainment regime. However, if an employer was to give employees vouchers for a restaurant meal as a gift, and the employee can choose when to use the voucher, the cost of the voucher will be subject to FBT.

Providing employees with Christmas gifts
Most gifts, such as drink bottles and keep cups, would be subject to FBT in the first instance, as these benefits can be enjoyed at the employee's discretion. Similarly, gift baskets containing food and drink, which typically fall within the entertainment regime, would also be subject to FBT for the same reason.

Note that any benefit subject to FBT may qualify for an FBT exemption, such as the de minimis exemption. The de minimis exemption excludes all unclassified benefits from FBT provided that:

- The total value of all unclassified benefits provide to all employees is less than $22,500 in the previous 12 months (this amount includes all benefits provided to all employees of associated employers); and
- No employee has received more than $300 of benefits in an individual FBT quarter (or $1,200 for annual filers).

Providing customers with Christmas gifts
An odd quirk of the entertainment regime is that Inland Revenue considers that it applies to the provision of any food and drink, not just to food and drink consumed at a function. Inland Revenue made this position clear with an operational position specifying that if a business provided a customer with a gift basket containing wine, cheese, tea towels and soap the tax outcome would be that the tea towel and soap were fully deductible but the wine and cheese was only 50% deductible.

Cash bonuses to employees
Cash bonuses paid by an employer to an employee are taxable under the PAYE regime, this is a payment made in connection with the employee's employment and not a payment that is regularly included in the employee's salary and wages. A cash bonus should be taxed at the 'extra pay' rate.

Using a company vehicle for personal travel
Given there is likely to be a desire to travel around the country this summer, some employees may be using their company vehicles as their means of transport during the holidays. Employers need to remember that FBT will arise whenever a company vehicle is available for an employee to use privately. If an employee pays for their own petrol, provided evidence is provided to the employer, these costs may be deducted from the taxable value of the fringe benefit and reduce the amount of FBT payable.

Hopefully, this clarifies some of the Christmas expenses fishhooks before you are snagged with an expensive mistake, but if you have any further queries please contact your usual Deloitte advisor.

Regardless of what your business is planning to do for Christmas, it's important to remember that different tax rules will apply to different festive choices.

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Snapshot of recent developments

Tax Legislation and Policy Announcements

Increase in Family tax credit and Best Start tax credit

On 17 November 2022, the Income Tax (Tax Credit) Order 2022 (SL 2022/296) was notified in the New Zealand Gazette and comes into force on 1 April 2023.

Under the Income Tax Act 2007, an inflation-indexed increase to the Family Tax credit and Best Start tax credit is required once the cumulative value of quarterly increases in the New Zealand Consumers Price Index is 5% or more. The Order:

- Adjusts the family tax credit (eldest child rate from $6,642 to $7,121, subsequent child rate from $5,412 to $5,802);
- Increases the Best Start tax credit from $3,388 to $3,632; and
- Increases the minimum Family Tax credit threshold from $32,864 to $34,216.

Inland Revenue statements and guidance

Inland Revenue Public Guidance Work Programme 2022-23

On 2 November 2022, Inland Revenue updated its Public Guidance Work Programme 2022-23. The work programme summarises all of Inland Revenue's Public Guidance projects based on their current progress status, with a link to further information on each item.

Inland Revenue Update: Defaulting property developers

Inland Revenue has advised that it has identified defaulting property developers as a risk group. Inland Revenue will be intervening to help this group improve their overall compliance. Inland Revenue will carry out early and timely education and enforcement action to ensure they comply with their tax obligations.

Determination: Variation to section 68CB(2) of the Tax Administration Act 1994

On 3 November 2022, Inland Revenue published COV22/20 – *Variation to section 68CB(2) of the Tax Administration Act 1994.*

The variation provides extra time for a person with a September balance date who is seeking the Commissioner of Inland Revenue's approval of their research and development activities. This can be done by filing a general approval application for the 2021-2022 income year under section 86CB of the Tax Administration Act 1994. The variation recognises that, in some cases, COVID-19 has prevented applicants from promptly receiving the information needed for their general approval applications.

Inland Revenue Update: Filing requirements for Research & Development loss tax credit statements

Inland Revenue is reminding taxpayers that section 70C of the Tax Administration Act 1994 requires the R&D loss tax credit statements to be filed by the earlier of:

- The date on which the taxpayer files the tax return; or
- The final tax return due date (usually 31 March of the following year for customers with agent's extension of time).

Taxpayers that choose to file their income tax return before the final due date for filing must also file their R&D loss tax credit statement by this earlier date. Note that Inland Revenue does not have the discretion to accept a late R&D loss tax credit statement under section 70C of the Tax Administration Act 1994.

Technical Decision Summary: GST Taxable Activity "Preparatory Work"

On 17 November 2022, Inland Revenue published TDS 22/20. The Tax Counsel Office (TCO) determined that a taxpayer who had returned expenses in respect of a new video production business claimed input tax deductions, but did not return any income or output tax (resulting in a refund position)

was not yet carrying on a taxable activity. The TCO determined that the taxpayer had not yet moved beyond preparatory work and did not involve the supply of goods and services to another person for consideration.

Technical Decision Summary: Profit-making undertaking or scheme and a taxable activity

On 17 November 2022, Inland Revenue published TDS 22/21. In this case, the taxpayer resided in a property, which they have subsequently subdivided. One of the lots (House B) was then sold. TCO decided that the taxpayer:

- Did not enter into the undertaking or scheme at the property for the dominant purpose of making a profit. This meant that the sale proceeds were not income for the taxpayer under section CB 3 of the Income Tax Act 2007 (ITA 2007);
- Acquired the property for the sole purpose and intention of creating a home for themself and their extended family. This meant that the proceeds of the sale of House B were not income for the taxpayer under section CB 6 of the ITA 2007;
- Occupied the property mainly as residential land before the subdivision. Therefore, the exclusion in section CB 17(2) of the Income Tax Act 2007 applied to the taxpayer and the sale proceeds were not income for the taxpayer under section CB 12 of the ITA 2007; and
- Did not carry on a "taxable activity", as defined in section 6 of the Goods and Services Tax Act 1985 (GST Act), in carrying out the development, construction and subdivision project at the Property. Therefore section 8(1) of the GST Act did not require the taxpayer to charge GST on the supply of House B.

Trusts reporting variation

On 23 November 2022, Inland Revenue published TRU 22/01 – Variation to s 59BA(2) of the Tax Administration Act 1994 for trustees of certain trusts that derive a small amount of income. This variation limits the information that a trustee of an Eligible Trust is required to disclose to comply with section 59BA(2) of the Tax Administration Act 1994 (TAA). It also means that a trustee of an Eligible Trust does not need to provide all the information set out in section 59BA(2)(a)-(e) of the TAA.

An Eligible Trust is a complying trust under section HC 10. It must also satisfy one of the following criteria:

- Criteria A
  - Derived no income other than reportable income (section 22D of the TAA) that does not exceed $1,000
  - No deductions
  - Assets of the trust have not given rise to income in a person's hands or given rise to fringe benefits to an employee
- Criteria B
  - A testamentary trust
  - Distributions do not exceed $100,000, reportable income does not exceed $5,000 and non-reportable income does not exceed $1,000 and deductions against that income are at least $800.

This variation is effective for the 2021-22 income year. For a trustee of a trust that is wound up during the 2022-23 income year, it is also effective for the 2022-23 income year.

Draft Public Ruling: GST – Supplies of properties used for transitional housing

On 23 November 2022, Inland Revenue published PUB00428 – Supplies of properties used for transitional housing for public consultation. These draft Rulings (BR Pub XX/XX, YY/YY and ZZ/ZZ consider the Goods and Services Tax treatment of supplies of properties by landlords to organisations for use in the Ministry of Housing and Urban Development's Transitional Housing Programme. The draft ruling outlines when GST needs to be charged by the landlord.

The conclusions in these items do not affect the rent paid by transitional housing tenants.

Deadline for comment is on **31 January 2023.**

FBT rate for low-interest loans increased

On 24 November 2022, the Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2022 (SL 2022/306) Order in Council was notified and comes into force on **1 January 2023**. The regulations amend the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1995 by increasing the interest rate that applies for FBT to employment-related loans from 4.78% to **6.71%**. The new rate applies for the quarter beginning 1 January 2023 and subsequent quarters.

But wait there's more…

UOMI rate increased

On 1 December 2022, the Taxation (Use of Money Interest Rates) Amendment Regulations (No 3) 2022 (SL 2022/315) Order in Council was notified and apply on and after **17 January 2023**. The regulations amend the Taxation (Use of Money Interest Rates) Regulations 1998 by increasing the taxpayer's paying rate of interest on unpaid tax from 7.96% to **9.21%**. The Commissioner's paying rate of interest on overpaid tax increases from 1.22% to **2.31%.**

As a result of the rapid increases in market interest rates, the FBT and UOMI prescribed rates are likely to change again, with a new FBT rate likely to apply from 1 April 2023.

OECD Updates

Pricing Greenhouse Gas Emissions: Turning Climate Targets into Climate Action

To cut greenhouse gas emissions, countries have increased their use of carbon pricing through taxes or emissions trading systems. A new OECD report finds that this coverage is increasing across countries and sectors in 2021. The report, *Pricing Greenhouse Gas Emissions: Turning climate targets into climate action,* determined that carbon prices covered more than 40% of greenhouse gas emissions in 2021. This is an increase of 32% from 2018. The report also determined that average carbon prices are higher in 47 of the 71 countries studied.

New countries and jurisdictions sign international agreements to exchange information

On 9 November 2022, 28 countries and jurisdictions, including New Zealand, signed international tax agreements to exchange information concerning income earned on digital platforms and offshore financial assets. This included the multilateral competent authority agreement for the automatic exchange of information under the OECD Model Rules for Reporting by Digital Platforms.

The agreement will allow jurisdictions to automatically exchange information collected by digital platform operators on transactions and income realised by platform sellers in the sharing and gig economy and from the sale

of goods through such platforms.

Raising the Bar on Tax Transparency

The Global Forum on Transparency and Exchange of Information for Tax Purposes has published its annual report on tax transparency. This report includes the latest information on the exchange of information on request, the automatic exchange of information and its capacity-building activities. In 2022, countries automatically exchanged information on 111 million financial accounts worldwide, covering total assets of EUR 11 trillion. Over EUR 114 billion in additional tax revenues have been identified through voluntary disclosure programmes, offshore tax investigations and related measures since 2009. You can also access the Forum's statement of outcomes here.

Peer Review of the Automatic Exchange of Financial Information 2022

On 9 November 2022, the Global Forum on Transparency and Exchange of Information for Tax Purposes released the Peer Review of the Automatic Exchange of Financial Account Information 2022. This report presents the latest conclusions of the peer reviews of the legal frameworks put in place by each jurisdiction to implement the Automatic Exchange of Information (AEOI) standard. The results relate to the more than 100 jurisdictions that committed to commence AEOI by 2020. It also contains, for the first time, the results of the Global Forum's initial peer reviews about the effectiveness in practice of implementing the standard.

The overall ratings on the effectiveness of AEOI in practice for the 99 jurisdictions reviewed are as follows:

- 65 jurisdictions are rated as on track;
- 15 jurisdictions are rated as partially compliant; and
- 19 jurisdictions are rated as non-compliant.

Peer Reviews on the Exchange of Information on Request

The Global Forum monitors and peer review the implementation of the international standard of exchange of information on request (EOIR) and automatic exchange of information. The EOIR provides for international exchange on request of foreseeably relevant information for the administration or enforcement of the domestic tax laws of a requesting party.

The Global Forum has published ten new peer review reports on the EOIR. Seven of the ten reports cover the practical implementation of the EOIR standard and provide an overall rating for the jurisdictions. The overall ratings are as follows:

- Largely compliant: Barbados, Iceland, Morocco, Slovenia, South Africa, and Turkey; and
- Partially compliant: British Virgin Islands.

Corporate Tax Statistics

On 17 November 2022, new data was released which highlighted continuing base erosion and profit-shifting risks. The latest edition of Corporate Tax Statistics covers over 160 countries and jurisdictions. It includes new aggregated Country-by-Country Report data on the activities of almost 7,000 multinational enterprises, representing a significant boost in tax transparency efforts. This database also provides information on corporate tax revenues, statutory corporate income tax rates, action 13 implementation, anonymised and aggregated Country-by-Country report statistics, forward-looking effective tax rates, tax incentives on research & development and intellectual property, controlled foreign company rules, interest limitation rules, and standard withholding tax rates.

New mutual agreement procedure statistics and country awards on the resolution of international tax disputes

The latest mutual agreement procedure (MAP) statistics cover 127 jurisdictions and practically all MAP cases worldwide. The 2021 MAP statistics illustrate the following:

- Significantly more MAP cases were closed in 2021 due to the greater use of virtual meetings, the prioritisation of simpler cases, greater collaboration to solve common issues collectively that could be applied across multiple MAP cases and increases in staff numbers.
- Fewer new MAP cases in 2021 due to a significant decrease in new transfer pricing cases being opened.
- Outcomes remain generally positive. Around 75% of the MAPs concluded in 2021 fully resolved the issue both for transfer pricing and other cases (similar to 76% for transfer pricing cases and 74% for other cases in 2020). Approximately 2% of MAP cases were closed with no agreement compared to 3% in 2020.
- Cases still experience significant delays, especially for more complex cases. The

COVID-19 crisis affected the quality of their communication with some treaty partners.

- Competent authorities have continued to adapt illustrated by an increase in MAP engagement with treaty partners. This is exemplified by a hybrid approach (face-to-face and virtual meetings) which expedites MAP resolutions and improves the efficiency and effectiveness of their MAP programmes.

Simultaneously, country awards on the resolution of international tax disputes were given in recognition of efforts made by competent authorities. You can access the press release here.

OECD Tax Certainty Day 2022

On 22 November 2022, tax policymakers, tax administrations, business representatives and other stakeholders attended the OECD Tax Certainty Day 2022. You can now watch the replay of the event here.

Season's Greetings

And finally, this is the last Tax Alert issue for 2022 and we hope that you have found our articles helpful, insightful and thought-provoking.

Whatever your festive season celebration and holiday plans are, Deloitte wishes you and your families a Merry Christmas and Happy New Year, along with a few days with your feet up enjoying the (hopefully) warm and sunny weather. Tax Alert will be back in February 2023.

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

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