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Tax Alert

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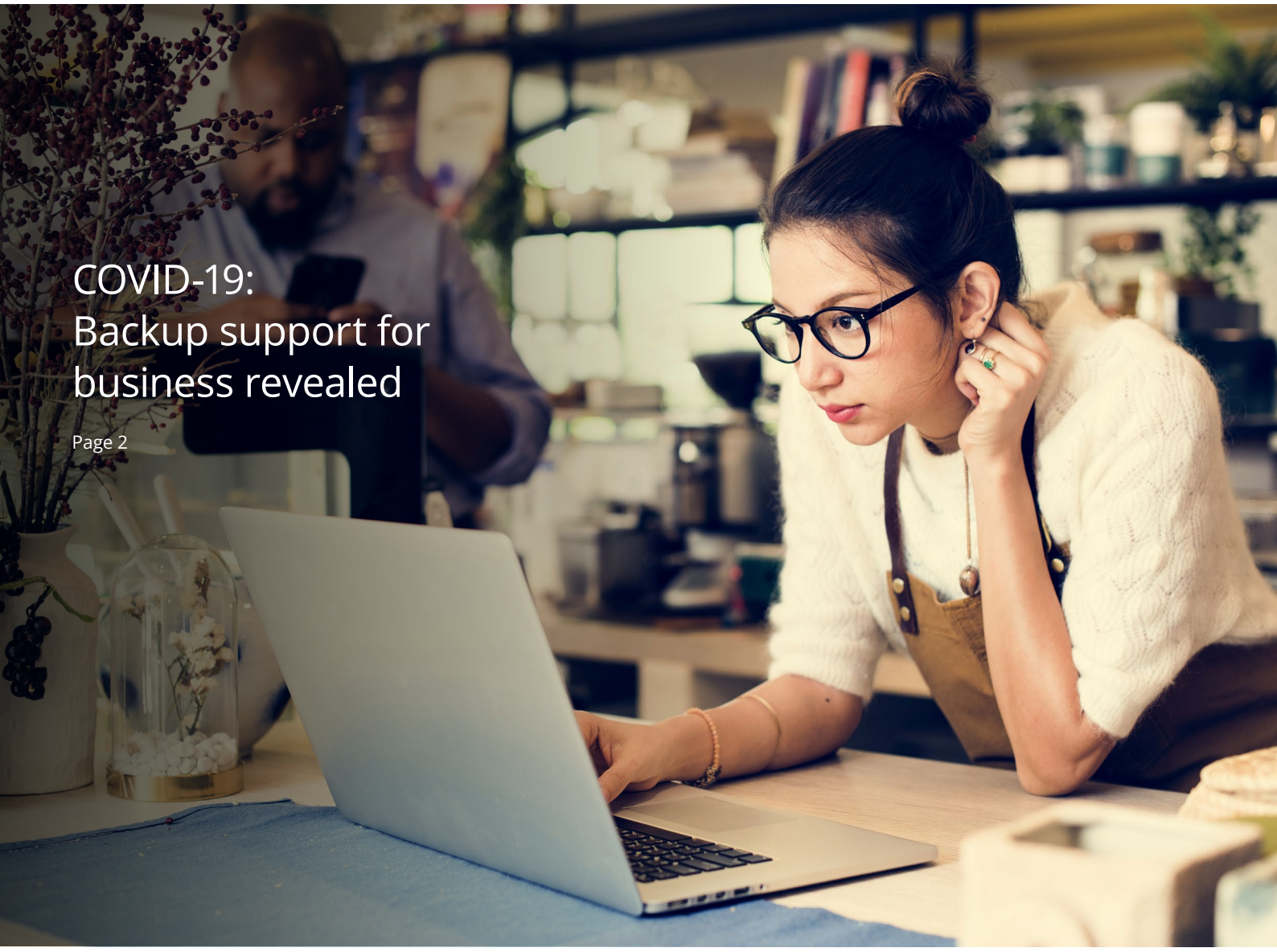

COVID-19: Backup support for business revealed

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Government announces assistance for businesses if COVID-19 Alert levels heightened

By Robyn Walker

While everyone was happy to put 2020 behind us, it is clear that COVID-19 is still going to be part of our lives in 2021. In light of the fact that an outbreak could happen at any time, the Government has outlined what assistance will be made available to businesses in the event COVID-19 Alert Levels need to be heightened – reminding businesses to be prepared should there be a resurgence of COVID-19 in the community.

In this article we explain what assistance will be available.

What is currently available at Alert Level 1

Currently businesses are able to utilise the Leave Support Scheme when employees who cannot work from home are required to self-isolate due to potential exposure to COVID-19, or they are considered "higher risk" if they contract COVID-19 when there is active community transmission. The Leave Support Scheme provides a fortnightly payment of $1,171.60 or $700 respectively for a full-time or part-time employee who is isolating.

Businesses with 50 or fewer employees can be eligible to apply for a Small Business Cashflow Loan. This scheme, administered by Inland Revenue, allows certain businesses to apply for a loan of up to $100,000. The maximum value of the loan available is $10,000 plus $1,800 per full time equivalent employee. Loans are interest free for a period of up to two years (if fully repaid in that time).

The Business Finance Guarantee is also available to provide greater confidence in business lending.

What will be available if there is a move to Alert Level 2

A new "Resurgence Support Payment" will be available should New Zealand, or any region/s within the country, move to Alert Level 2. This payment will be available to businesses which see a 30% or greater reduction in revenue as a consequence of the change in Alert Level. To determine whether this criterion is met, businesses will need to show a 30% reduction over a 14-day period following the change in Alert Level, as compared with revenue earned in the weeks immediately before the change in levels. The Resurgence Support Payment will be available to all businesses (including sole traders) that have been operating for six months or more, and the value of the payment will depend on the size of the organisation. Businesses will receive a payment of $1,500, plus an additional $400 per employee, up to a total of 50 FTEs. This means the maximum payment available will be $21,500.

In response to some issues identified through the wage subsidy scheme, it's expected that some restrictions may be applied to the payment to ensure it is targeted. For example, applicants will need to be aged 18 years or older. We also expect more detailed guidance on measuring revenue – in particular a requirement to look at how business activity has been restricted rather than purely looking at invoices raised (which can be subject to manipulation).

The Resurgence Support Payment will provide an immediate cashflow boost to impacted businesses (after they have demonstrated that a revenue loss has occurred). The Resurgence Support Payment will be administered by Inland Revenue. It technically requires new legislation, and this is expected to occur in late-February 2021.

What will be available if there is a move to Alert Level 3 or 4

In the event Alert Levels escalate to Level 3 or higher there will be a new wage subsidy scheme put in place. Many of the terms and conditions are likely to be similar to those applied under the former schemes implemented in 2020, but there will be a difference to the length of the scheme and the frequency of payments. In particular:

- A wage subsidy will be put in place if the Alert Level is raised to 3 or 4 for 7 days or more, in any part of New Zealand.
- Support will be provided in two-weekly payments, for the duration of the Alert Level escalation, rounded to the nearest fortnight (e.g. if Level 3 were in place for 22 days, there would be a payment for 2 fortnights). This contrasts to the lump sum approach taken with the original Wage Subsidy (12 weeks) and the Wage Subsidy Extension (8 weeks).
- The payment rate will remain $585.80 and $350 per week per full-time and part-time employee respectively.
- Businesses will need to see a 40% reduction in revenue as compared to the typical fortnightly revenue during the six-week period immediately preceding the change in Alert Level.
- Businesses will be required to provide evidence of the decline in revenue being due to the change in Alert Level (e.g. it was not an expected normal decline in revenue as a result of seasonally higher sales during the Christmas period).
- Other requirements are expected to remain the same, in particular there will be a requirement to retain staff and pass on the subsidy amounts.

Other benefits to assist employees

In mid-February 2021 the Leave Support Scheme will be supplemented by a new Short-Term Absence Payment. This payment of $350 per eligible employee will be available to support employees who are required to stay at home while they await the results of a COVID-19 test but are unable to work from home. The payment will also apply to parents or caregivers who have dependents awaiting a test result, as well as self-employed workers.

This additional payment will be of most assistance for those employees who have used their sick leave entitlements. Employers will be able to apply for the Short-Term Absence Payment once in any thirty-day period per eligible worker (unless a health official or medical practitioner advises or requires the worker to re-test during that period). If the employee subsequently tests positive, they will be eligible for the Leave Support Scheme.

If you have any questions in relation to the issues discussed above, please consult your usual Deloitte advisor.

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Revised Inland Revenue guidance on tax avoidance – Happy New Year

By Campbell Rose and Virag Singh

On 17 December 2020, Inland Revenue issued a draft interpretation statement – Tax Avoidance and the interpretation of the general anti-avoidance provisions section BG 1 and GA 1 of the Income Tax Act 2007 (**Draft IS**). In addition three QWBAs were withdrawn (QB 14/11, QB 15/01 and QB 15/11), with aspects of the QWBA's being reconsulted on through PUB00305 QB 1 and PUB00305 QB 2.

When finalised, and from its publication date, the Draft IS will replace Inland Revenue's current equivalent statement (IS 13/01), which was published in June 2013 (**Current IS**).

Much of the Draft IS comprises a comprehensive and unobjectionable summary of general anti-avoidance principles established by the courts over the years, including particularly in *Ben Nevis* and *Penny & Hooper*, and drawing from more recent decisions such as *Alesco* and *Frucor*.

The Draft IS has changed the emphasis in the analysis in a number of areas. There is an increased emphasis on the "ultimate question" that needs to be addressed under the Parliamentary contemplation test, an increased emphasis on the consideration of artificiality and contrivance, and a reduced emphasis on confirming the facts, features and attributes that Parliament would contemplate being present (or absent) when permissible tax advantages arise under relevant specific provisions (although this is still accepted as being useful).

In this article we have briefly commented on these changes in emphasis and other areas of the Draft IS that we consider would benefit from further reflection by Inland Revenue. We have also highlighted certain parts of the Draft IS that serve as useful reminders of key principles, and some additional elements that could be usefully included (although at 137 pages, the Draft IS is already a weighty tome!).

The rise of artificiality and contrivance

The Draft IS starts its analysis by noting – uncontroversially – that the focus when applying the general anti-avoidance provision is on answering the "ultimate question" posed by the Supreme Court in Ben Nevis when it established the Parliamentary contemplation test: *whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose.*

In examining the factors that the courts have taken into account in applying this test, the Draft IS then characterises as "particularly significant" whether the taxpayer has gained the benefit of the specific provision in an artificial or contrived manner, or by pretence. This seems to be driven by the Supreme Court in *Ben Nevis* describing artificiality and contrivance as a "classic indicator" of a use of a specific provision that is outside Parliamentary contemplation. While artificiality and contrivance was discussed at length in the Current IS, it has a heightened level of emphasis in the Draft IS and features prominently in the Commissioner's revised approach to the application of section BG 1 (including the associated flowchart).

The significance of the commercial and economic effects

In discussing the commercial and economic effects of documents and transactions, the Draft IS lists at paragraph 1.87 factors that are seemingly 'bad'. This includes:

- a tax advantage obtained from a deduction for expenditure, when the commercial reality is that the expenditure is of a capital or private nature; and

- a benefit of a non-assessable receipt when the commercial reality is that they have received income.

The inclusion of these two factors is interesting in that they do not have any clear origin in decided cases (relevant case law is summarised in Appendix 2). These capital/revenue-related dimensions of what is effectively an economic substance approach were not specifically addressed in the Current IS. They reflect the increased emphasis on answering the "ultimate question" based on the arrangement viewed in a commercially and economically realistic way, however, as clearly stated in the Draft IS (and as noted below), it is important to note that this does not involve a comparison of the arrangement entered into with a hypothetical alternative which is economically equivalent.

The fall of facts, features and attributes

The Current IS has a significant focus on the facts, features and attributes that Parliament would have expected to be present to give effect to its purpose for the relevant provisions. The Draft IS has significantly reduced the emphasis on this aspect of the analysis focusing more on the "ultimate question" itself along with the commercial and private purposes (non-tax purposes) of the arrangement. The Draft IS notes that in answering the "ultimate question", "in some cases", it can be "useful" to consider whether there are any facts, features or attributes that Parliament would contemplate being present (or absent) when permissible tax advantages arise under the specific provisions.

In our view identifying the facts, features and attributes that Parliament would have expected as described above is an important part of the analysis and this change in emphasis should be revisited. This enquiry sets the scene for any general anti-avoidance analysis by assisting to establish what is Parliament's purpose for the relevant provisions in the context of the ultimate question. Of course, in a particular case artificiality or contrivance may have distorted the application (or non-application) of specific provisions. In such a case, it is necessary to establish whether this artificiality or contrivance directly affects the presence or absence of the relevant facts, features and attributes.

Answering the "ultimate question"

Under the Current IS, the consideration of non-tax purposes is confined predominantly to determining whether a tax avoidance purpose or effect is merely incidental. In the Draft IS, these purposes are also focused upon in determining the "ultimate question", as part of the core tax avoidance analysis. The purpose or effect of an arrangement is required to be determined objectively and the subjective motive, intentions or purposes of the parties is irrelevant. However, contemporaneous evidence and consistency of factual narrative are critical for taxpayer credibility in this respect.

The Draft IS confirms that the core tax avoidance test does not involve postulating a counterfactual and asserting that, because the taxpayer's arrangement was different from the counterfactual, its tax outcomes cannot have been contemplated by Parliament. In practice we are often seeing Inland Revenue staff adopting counterfactuals as a dominant element of their avoidance analysis, so it is helpful that the Draft IS itself states that an analysis free of "impermissible" counterfactuals is "the approach the Commissioner will take". Equally, a taxpayer cannot postulate a counterfactual arrangement that they would otherwise have entered into that would have resulted in the same or a similar tax effect. The avoidance analysis is undertaken in relation to the particular arrangement entered into by the parties.

In a similar vein, the Draft IS also valuably notes that the inference or conclusion that the general anti-avoidance provision applies must be reasonable i.e. the inference must be one that is:

- open on the evidence and the acts established from the evidence;
- logical and cogent;
- not mere speculation; and
- not an intuitive subjective impression of the morality of what taxation advisers have established.

The Draft IS helpfully reconfirms that the general anti-avoidance provision cannot be used to fill a legislative gap, the analytical approach is firmly grounded in the words of the relevant statutory provisions, and that in appropriate circumstances, using legislated options (with no additional problematic features) solely for tax purposes is acceptable.

Missing in action

The Draft IS (and the related QWBAs) suffer from little to no new practical examples of the application of the general anti-avoidance provision. These are critical to ensuring voluntary compliance. Inland Revenue should have plenty of material to include from the field and its Disputes Review Unit, so that scenarios towards the middle and not extreme ends of the spectrum (i.e. ironically, more closely aligned to commercial and economic reality) should be part of the finalised statement.

At the same time as issuing the Draft IS, Inland Revenue has also withdrawn three *Questions We've Been Asked* (including QB 15/01 regarding debt capitalisation), and is reconsulting on two revised QWBAs with examples of how the analysis is to be applied. In our view the debt capitalisation scenario in QB 15/01 should also be revised as although there are specific rules dealing with debt forgiveness, they do not apply to debt capitalisation nor do they apply where forgiveness is not pro rata to ownership interests. Debt capitalisation is still taking place in practice and so continued guidance on this is important.

There is no discussion of *White v CIR*, the only avoidance case in recent history where the court ultimately found for the taxpayer and the decision was not appealed. Nor does the Draft IS address the Court of Appeal's comments in *Roberts v CIR* regarding the appropriateness of referencing extrinsic material (Policy Officials' discussion documents etc) when it discusses the relevance of these materials to understanding the background to a specific provision.

As noted above, the Draft IS applies from the date of publication but in our view the revised analysis should at least be considered alongside the Current IS in respect of audits, disputes, ruling applications etc. already in progress notwithstanding the fact that it may not materially impact the conclusions reached by Inland Revenue.

Finally, depending on timing of when the Draft IS is finalised and when the Supreme Court's judgment in *Frucor* is available (once that hearing has taken place), the statement may need to be updated to reflect any appropriate revisions as a result.

Submissions on the draft statement close on 31 March 2021. If you would like to make a submission or to understand the impact of the draft statement in more detail, please get in touch with your usual Deloitte advisor.

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R&D Tax Incentive Regime: Planning for the year ahead

By Simon Taylor and Brendan Ng

As we get into the business end of tax return filing season, many taxpayers will find themselves preparing their Research and Development ("R&D") Tax Incentive claims for the first time. While there may be some awareness of the process, there are a number of considerations that taxpayers should be taking into account.

We discuss below how taxpayers can organise themselves to ensure they are able to meet the required R&D tax credit regime deadlines for the 2019-20, 2020-21 and future income tax years, as well as a quick general update on the regime. Some of the key deadlines are summarised in the table below. The key is to ensure you are adequately prepared.

How do I ensure I am prepared?

Below are some key points to consider when preparing the 2019-20 and/or 2020-21 income tax year claims:

- Enrol in the R&D Tax Incentive regime via myIR. It is only once a taxpayer is enrolled in the R&D regime that the supplementary return (and the general approval form and significant performer application) can be accessed.
- Factor in the supplementary return in your income tax return timelines. As the amount of the R&D credit will impact a taxpayer's tax position, the R&D credit should be considered in conjunction with the preparation of the income tax return. It is likely to require involvement of technical staff outside of the finance function. It is also worth noting that a taxpayer's R&D supplementary return can currently only be filed online.
- For the 2020-21 income year, consider what R&D projects you are undertaking and prepare your general approval application by the 7th day of the 2nd month after the end of your income year. For some taxpayers this may even be required before your 2019-20 supplementary return has been prepared / submitted. The general approval process is discussed in more detail below. An extension has been made to the filing deadline for the 2020-21 income year due to COVID-19, as explained further below.
- Identify whether more than $2 million of eligible R&D expenditure is expected to be incurred in the income year (in which case an organisation may elect to be a significant performer). Note that Inland Revenue must be notified of this by the 7th day of the 2nd month after the end of your income year (i.e. 7 May for a 31 March balance date). The significant performer regime is discussed in more detail below, including a proposed deadline change.
- All draft approval applications in myIR are kept for 60 days. This should encourage taxpayers to start preparing their applications as early as possible as it provides most taxpayers with enough time to develop their answers before submitting their applications.

What dates should I be aware of?

The key dates to be aware of for selected example balance dates are below:

Balance date	General Approval and Significant Performer applications due	General Approval application due *(COVID-19 extension – where applicable)*	Income Tax Return due (with extension of time)	R&D Supplementary Return due (with extension of time)
2019/20 income year				
All 2019/20 income years	N/A	N/A	31 March 2021	30 April 2021
2020/21 income year				
31 December 2020	7 February 2021	7 May 2021	31 March 2022	30 April 2022
31 March 2021	7 May 2021	7 August 2021	31 March 2022	30 April 2022
30 June 2021	7 August 2021	7 November 2021	31 March 2022	30 April 2022

With a short timeframe between year-end and general approval / significant performer applications, in addition to financial reporting and audit commitments, the timing for completion of applications should be planned carefully and considered well in advance. Early applications are consistent with Inland Revenue's expectations around contemporaneous supporting documentation.

What is general approval?

For the 2020-21 income year onwards, taxpayers will need to get their core and supporting R&D activities approved by the Commissioner (unless filing under the significant performer regime) in order to be eligible to claim the R&D tax credit (known as general approval). This general approval application is essentially the same as the activity parts of the R&D Supplementary Return, asking the same questions in relation to R&D project / activity eligibility, but excluding detailed questions in relation to expenditure. Once submitted, Inland Revenue will then analyse information, raise questions as necessary, and if accepted, taxpayers will have assurance that their R&D activities are eligible for a claim at the end of the year. This general approval will be binding so long as there are no material changes, law changes etc, and the approval can last up to 3 years. Variations can be made to approvals before the due date and new projects can be added as required. Taxpayers should note that this last point is critical – a variation or addition can only be made if it is notified by the general approval due date, not the supplementary return filing date. It is therefore critical that R&D projects are identified on a real time basis and the R&D processes don't only start after balance date.

A COVID-19 determination allows a filing extension to the 7th day of the 5th month after the end of the 2020-21 income year. This applies where the planning or conduct of eligible research and development, or the ability to appropriately obtain necessary information, seek advice and formulate a general approval application on time has been materially delayed or disrupted by the COVID-19 outbreak and its effects. This is done on a self-assessment basis and it is recommended that affected taxpayers keep supporting records of why they meet these criteria.

What if I elect to be in the significant performer regime?

If an organisation expects to spend more than $2 million of eligible R&D expenditure, they may elect to claim under the significant performer regime, rather than the above project-by-project general approval regime. The following points should be considered:

- When making a significant performer notification, an organisation needs to apply for approval of their criteria and methodologies ("CAM") for determining whether R&D activities and expenditure are eligible. Approval involves a very detailed presentation of the procedures used to identify and track R&D and sufficient time should be allocated to this process to ensure the information required by Inland Revenue is provided.
- Significant performer applicants are also required to obtain certification from an Inland Revenue approved certifier that they have complied with their approved CAM R&D identification systems, and have incurred more than $2m of eligible R&D expenditure.
- Applicants under the significant performer regime may still choose to seek general approval for selected projects – for example, for those where upfront certainty of their eligibility status is desired. This can be beneficial given that even after CAM approval, the Commissioner may still review the eligibility of specific R&D projects should she desire.
- It is also important to note that there is no fall-back ability to apply for general approval if a CAM application is denied after the deadline for applying for general approval has expired. Significant performer applicants should accordingly carefully consider their choice of the pre-approval mechanism. If the significant performer approval is chosen, applicants should submit their CAM applications as early as possible to allow for a general approval claim to still be made if their CAM is not ultimately successfully accepted by the Commissioner. To address the no-fall back ability, it is proposed in the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill to bring the CAM application deadline forward from the 2021-22 income tax year onwards, to six months before the end of the applicant's income year.

Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill

A number of R&D specific proposals are included in this Bill – please see our previous Tax Alert article. Oral submissions have been heard on the Bill, with the Finance and Expenditure Committee report back on submissions due on 4 March 2021. After the report is published there will be greater clarity about the proposed changes.

If you would like to discuss how the R&D tax credit regime could benefit your business, please do not hesitate to contact our specialist R&D team or your usual Deloitte advisor.

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What's new in the world of GST?

By Sarah Kennedy and Nathan Lardner

COVID-19.... Elections.... Housing.... How about GST? While these events unfolding around the world capture the majority of media attention, Inland Revenue continues to address the issues and complexities of our GST system. This article summarises the core developments that have been made over the past six months in the world of GST.

What is land?

Land transactions are, and will likely always be, an area of focus for Inland Revenue. The rules are complicated and it's a common misconception that the compulsory zero-rating rules made things easier. You might think that determining whether a transaction falls within the definition of "land" is straightforward, however, there are a number of situations where it is not as clear-cut.

In December 2020, Inland Revenue finalised and released the question we've been asked (QWBA): 'Do certain supplies wholly or partly consist of land for the compulsory zero-rating (CZR) rules?' In summary, the QWBA concluded:

1. Transferable development rights (TDRs) are not land

A TDR is a mechanism in a district plan which allows development restrictions to be altered to allow for the land to be developed and receive subdivision consent. However, the sale of a TDR itself is not the sale of an interest in land or a right to an interest in land as there is insufficient connection between the TDR and the land itself. Having a TDR merely enables the purchaser to subdivide land in circumstances where they would otherwise not be able to.

2. An interest in a sale and purchase agreement for land will usually be land

The sale of a purchaser's interest in a sale and purchase agreement for land will be a land transaction for the purposes of the CZR rules provided the agreement gives rise to an equitable interest in land. An equitable interest arises when the purchaser has enforceable rights under the contract for which they are able to obtain relief. Inland Revenue's view is that unconditional sale contracts will meet this criteria as will the majority of conditional contracts. If the contract is conditional, you will need to be very sure that it is legally binding before you treat the interest as a sale of land.

3. An easement is land

As an easement is an equitable interest in land, the grant of an easement wholly or partly consists of land and is therefore subject to the CZR rules.

GST and unconditional gifts

As an early Christmas gift, on 23 December 2020, Inland Revenue released Interpretation Statement: GST – unconditional gifts. This statement gives non-profit bodies further guidance as to when a receipt will be an 'unconditional gift' with no obligation to return GST.

This is an area where you can't rely on the ordinary meaning of a term. A payment does not need to be condition free to be an unconditional gift. In fact, a payment made for specific purposes with a number of conditions can still qualify as an unconditional gift. The key is whether the payment was conditional on a benefit being received in return, as opposed to whether it was made subject to being used in a specific way.

A payment will qualify as an 'unconditional gift' where a voluntary payment is made to a non-profit body (in order for them to undertake their activities) where no 'identifiable direct valuable benefit' is provided to the payer (or an associate). Broadly speaking an 'identifiable direct valuable benefit' arises where an advantage or gain is provided to the payer in the form of a supply of goods or services. This is why GST needs to be returned on donations and sponsorship, where the donor chooses a sponsorship level that provides them with free event tickets or advertising, for example.

It is important however to note that there are scenarios where a payer may receive a benefit (goods or services) but the payment still retains its unconditional nature. For example the provision of an unsolicited thank you gift or a benefit of a nominal amount should not change the nature of the original unconditional gift. This is because there is not a sufficient connection between the benefit received and the original payment.

Other developments

- GST and Agency: In the last week of January 2021 Inland Revenue released a finalised interpretation statement on GST and agency relationships. The length of the statement (56 pages) is a testament to the difficulties of the concepts involved. Keep an eye out for next month's Tax Alert, where we'll summarise the final statement.
- The Commissioner's statement on payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package concluded that they are subject to GST as they are in the nature of a grant or subsidy from the Crown.
- COVID Response: Inland Revenue have released a determination that applies from 4 November 2020 to 31 March 2021 which allows a taxpayer to switch to a one month filing basis (from a six monthly filing) earlier so that businesses can obtain GST refunds faster.

Upcoming deadlines – 31 March 2021

- Non-profit body opt-out elections close on 31 March 2021. If you haven't made an election to remove any assets from your taxable activity before this date, all assets where input tax has been claimed (no matter how small) will be brought into the GST net (and subject to GST on disposal unless they can be zero-rated).
- If there have been any changes to the way you have used an asset held in your business over the past year (such as from taxable to non-taxable use) a change in use adjustment should be put through your GST return for the period ending 31 March 2021. This is particularly relevant in the short-stay property market if your taxable activity changed or permanently ceased. If you think this may be relevant to you check out the Deloitte Private Blog article issued last year and let us know if you would like any assistance.

As always, if you have any questions about this article or GST generally, get in touch with your usual Deloitte advisor.

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Inland Revenue and OECD provide further guidance on COVID-19 related transfer pricing issues

By Bart de Gouw, Julian Bryant & Celia Brownlee

On 18 December 2020, the OECD released Guidance on the transfer pricing implications of the COVID-19 pandemic. As a result, New Zealand's Inland Revenue (IR) has updated its guidance on COVID-19 transfer pricing issues. IR's initial guidance was outlined in our article in the September 2020 edition of Tax Alert. The new guidance is consistent with that initial guidance, but now references the OECD guidance and elaborates on matters such as limited risk arrangements, losses and treatment of the Wage Subsidy. For completeness we note that the OECD has also published updated guidance on tax treaties and the impact of the COVID-19 pandemic on 21 January 2021, which is covered in this article from this month's Tax Alert.

While the overriding theme is that transactions must continue to be conducted in accordance with the arm's length principle, there is recognition that there are a number of practical difficulties in applying the arm's length principle. The OECD guidance on the transfer pricing implications of the COVID-19 pandemic focuses on four priority issues:

1. Comparability analysis;
2. Losses and the allocation of COVID-19 specific costs;
3. Government assistance programmes; and
4. Advance pricing agreements (APAs)

The following provides a summary of each of those issues with specific reference to IR guidance. Deloitte's summary of the OECD guidance can be found here.

Comparability analysis

Identifying reliable comparable data to support the arm's length nature of financial outcomes may be difficult in exceptional economic circumstances arising from COVID-19, particularly in the short term. Comparability analysis relating to contemporaneous transactions between independent parties in markets facing similar conditions (e.g. in the same jurisdiction) would be the most reliable, but may not be available, particularly when applying the transactional net margin method ('TNMM'), because financial year 2020 information will typically not be available until much later. Care should be taken when selecting sets of comparable data as economic and market conditions in some markets could materially differ from New Zealand in a COVID-19 environment (for example Europe or the UK), and this might require using new comparable sets rather than updating the financials of existing sets in some circumstances. It also may not be appropriate to mechanically apply ordinary transfer pricing approaches that have been applied in prior years. The OECD also discusses the potential to agree a price adjustment mechanism in controlled transactions to allow more time to make adjustments in a subsequent income year.

Both IR and the OECD have identified a number of practical approaches that may assist in the absence of comparable data. IR suggests reference to pre-COVID-19 expectations and analysis of variances that have arisen due to COVID-19 impacts, both positive and negative. In doing so, IR require detailed consideration of the financial impacts on the local entity and compilation of supporting evidence, including documenting:

- why local sales are lower than expected;
- why local expenses are higher than expected;
- any unusual financial items;
- any government assistance received;
- the impact of any amended intra-group transactions; and
- any adjustments made.

Losses and the allocation of COVID-19 specific costs

The OECD's guidance notes that any labels such as "limited risk distributor" do not preclude an entity from bearing losses where those losses in fact relate to risks assumed. Any losses or allocation of COVID-19 specific costs will need to be consistent with the allocation of risks between parties with respect to the tested transaction, and carefully documented. The guidance anticipates that a limited-risk distributor that assumes some marketplace risk may, at arm's length, earn a loss, for example where decline in demand means that the value of sales does not cover the fixed local costs. However, a distributor that does not take on inventory risk should not bear any losses associated with inventory obsolescence.

IR have stated that any changes to the risks assumed by parties to a tested transaction compared to periods before or during the COVID-19 pandemic will come under scrutiny, and if it is purported that an entity has always assumed a risk that has materialised during the COVID-19 pandemic, IR would expect the entity to have been compensated for assuming that risk in prior periods.

Government assistance programmes

IR has stated a clear position on the treatment of the Wage Subsidy, including the Wage Subsidy Extension and the Resurgence Wage Subsidy. IR's expectation is that where the Wage Subsidy was received by a multinational operating in New Zealand, the benefit of that subsidy should generally be retained by that entity. IR has explained its rationale for this with regard to the OECD guidance on the transfer pricing implications of the COVID-19 pandemic, and provided examples in both the context of a distributor and service provider operating in New Zealand. IR cautions against mechanistic approaches to the application of transfer pricing methodologies without proper analysis, as this could result in non-arm's length pricing. This includes circumstances where subsidies received have been offset against wages and salary costs in accounting records.

The OECD provides guidance on the allocation of COVID-19 specific costs, for example expenditure on personal protective equipment, reconfiguration of workspaces, and IT infrastructure for tracing or remote working. The accurate delineation of the transaction should be the first consideration to inform which party should bear exceptional costs. We consider the analysis of the treatment of exceptional items and government subsidies might be able to be considered together in some circumstances to provide an outcome that is arm's length and commercially reasonable.

Advanced Pricing Agreements (APAs)

IR has not provided specific advice on APAs in the context of COVID-19. The OECD acknowledges that COVID-19 has led to material changes in economic conditions that were not anticipated when many existing APAs were agreed to. Tax authorities and businesses should not automatically disregard terms of an APA, or unilaterally alter them. Instead businesses are encouraged to notify tax authorities as soon as possible when it appears the changes in economic conditions might lead to a breach of a critical assumption in the APA and seek collaborative solutions.

Comments

The recent guidance from the OECD and IR provide some additional clarity in respect of approaching transfer pricing issues arising in the context of the COVID-19 pandemic, while highlighting the risks of mechanical application of existing transfer pricing policies without further analysis. The guidance emphasises the importance of preparing supporting documentation detailing operational and financial impacts of the COVID-19 pandemic on New Zealand businesses (both positive and negative), and transfer pricing approaches taken. It is important that multinational groups with operations in New Zealand turn their mind to the specific position of the New Zealand business, which may have been impacted differently to other group members in other jurisdictions.

If you have any questions about your transfer pricing policies, and preparation of appropriate supporting documentation, please contact your usual Deloitte tax advisor.

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How do continued COVID-19 border restrictions impact tax?

By Robyn Walker and Mila Robertson

The OECD, as part of their overall compilation of COVID-19 policy responses, have released "updated guidance on tax treaties and the impact of the COVID-19 pandemic" (the previous version released in April 2020 is available here). The guidance provides an overview of some of the tax implications arising from COVID-19 and provides useful summaries of the varying responses that different jurisdictions have taken, both under domestic law and with reference to the application of their tax treaties. In particular, the guidance provides an overview of the tax treaty articles relating to the creation of permanent establishments ("PE"), tax residence of companies and individuals, and the right to tax income from employment.

While many New Zealand businesses are back operating 'normally' to a large degree, many businesses with international connections will be impacted due to the continued COVID-19 restrictions in other jurisdictions and the continued lack of mobility of employees and directors. It will be important for businesses to continue to assess restrictions (and relaxation of restrictions) and how business operations adapt in order to avoid any adverse tax impacts arising. For example, an ordinarily New Zealand based employee who is working remotely in a foreign jurisdiction, deciding to voluntarily continue doing so because the arrangement worked well and is more convenient for the parties, may result in the need to reassess company and individual tax issues.

Inland Revenue's guidance on how these issues are interpreted in New Zealand is available here. This guidance is based on the April 2020 OECD positions; our expectation is that Inland Revenue would continue to follow the approaches endorsed by the OECD.

Permanent establishments

The nature of COVID-19 means that employees may be stranded in locations where they would usually not perform their employment related duties. The guidance is clear that temporary dislocation of employees due to COVID-19 should not create a PE for employers. This is regardless of whether the risk of PE stems from the conclusion of contracts in a jurisdiction, or a home office appearing to give rise to a permanent place of business.

With reference to home offices, the guidance refers to article 5 of the OECD's Model Tax Convention and the relevant commentary. Determining whether a fixed place of business PE exists is a question of fact. Almost all jurisdictions referenced in the guidance acknowledge that an employee's temporary home office (which exists as a result of having to work from home due to public health measures/travel restrictions) does not constitute a fixed place of business (a PE) for an employer. Many jurisdiction's tax authorities have made public announcements to the same effect, although the reasons underlying this common position vary. However, the guidance notes that if employees continue to work from home after they become able to return to their normal work patterns, there may be a certain degree of permanence attributed to the home office.

Consideration of the facts is still required to determine whether this is sufficient to create a PE.

The guidance provides that a similar approach should be taken in considering whether a PE exists due to contracts being concluded in countries where they are not normally concluded. Under Article 5(5) of the OECD's Model Tax Convention, the activities of a dependent agent will create a PE where that employee "habitually" concludes contacts on behalf of their employer. The guidance concludes that an employee's activity concluding contracts in a foreign jurisdiction would not likely be habitual in nature if they are working from home due to public health measures/travel restrictions. However, if agents continue to conclude contracts in a jurisdiction after COVID-19 related travel restrictions end, a PE may be created. The guidance is unclear whether this PE will be backdated to the first date agents began concluding contracts in the relevant jurisdiction.

PEs can also be created through construction projects. The guidance provides that temporary COVID-19 related disruptions to work will not cause this type of PE to cease to exist. However, it does note that jurisdictions can choose to 'stop the clock' (on the timing provisions that dictate when a PE arises from a construction project) where work has been halted due to COVID-19 related public health measures.

The guidance is clear that the all of the above concessions and application of treaties cannot be relied upon to create instances of double non-taxation.

Company residence

The OECD does not expect a company's residence under the 'place of effective management' test to be impacted due to the temporary inability of directors / board members to travel. This is the general approach that the jurisdictions referenced in the guidance have adopted. Inland Revenue's guidance continues to be that "[e]ach case turns on its own facts and circumstances, but in terms of the director control test, what is relevant is where control is ordinarily exercised. … Where directorial control is ordinarily exercised can be viewed over a broader timeframe. Where there are some directors exercising control from New Zealand and others from another country, consideration can be given to where the majority ordinarily exercise control (if the powers of the directors are the same). Similarly, in terms of the centre of management test, a broader consideration of the usual overall management of the company is appropriate. It is also necessary to look at the various levels of management of the company, not just management at the director level."

Individual residence and income from employment

The guidance notes that it is unlikely that COVID-19 travel restrictions will impact an individual's treaty residence position in most cases (depending on their personal circumstances). Although individuals may not become resident while 'stranded' in a country as a result of COVID-19 travel restrictions (due to various domestic COVID-19 concessions or treaty interpretations consistent with the OECD guidance), employees and their employers may encounter tax obligations where the employee is non-resident of a jurisdiction, but has become subject to tax on income from employment due to exercising employment duties in that country. Inland Revenue has released their own guidance on this topic, however, it should be noted that IR's concession to the 92 day rule has a strict interpretation of when an employee is reasonably able to depart New Zealand. Employers should be wary of this both in New Zealand and abroad, due to the withholding obligations that could fall on an employer.

For more information on this topic, please contact your usual Deloitte advisor.

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More guidance on cryptoassets – hard forks and airdrops explained

By Ian Fay and Alex Chang

Following on from our previous article about investing in cryptocurrency, Inland Revenue (IR) has issued further guidance in the form of an issues paper "Income tax – Tax Treatment of cryptoassets received from blockchain forks and airdrops". The issues paper sets out initial views on how tax laws may apply to these more novel situations. However, it also provides more technical detail on the tax treatment of cryptoassets and once finalised, it will add to a growing library of tax analysis related to cryptocurrencies.

What are blockchain forks and airdrops?

The world of cryptoassets has many terminologies, for the purposes of the latest guidance the following terms are explained:

a) **Blockchain:** A blockchain is a type of distributed ledger technology, providing a digital record of transactions that is shared and maintained by users across the network.

b) **Hard fork:** A hard fork (sometimes also referred to as a "chain split") changes the protocol code to create a new version of the blockchain alongside the old version, thus creating a new token which operates under the rules of the amended protocol while the original token continues to operate under the existing protocol.

c) **Soft fork:** A soft fork also updates the protocol, however, it is intended to be adopted by all users on the network and thus no new coin is expected to be created (the tax treatment of soft forks is not expanded on in the issues paper).

d) **Airdrops**: An airdrop is the distribution of tokens without compensation (i.e. for free), generally undertaken with a view to increasing awareness of a new token, particularly amongst "influencers", and to increase liquidity in the early stages of a new token project.

Taxability of cryptoassets from blockchain forks and airdrops

1. Receipt of cryptoassets from a hard fork and/or airdrops

As a general point, the receipt of new cryptoassets from a hard fork and/or airdrop will not be income to the recipient in many cases. However, there will be a number instances where the receipt of new cryptoassets may be income, including where the recipient has a cryptoasset business (such as a dealing or mining business) or is involved in a profit-making undertaking or scheme involving acquisitions of airdropped or forked cryptoassets.

2. Disposals of cryptoassets

Generally, disposals of cryptoassets are taxable if you acquire the cryptoassets for the purpose of disposing of them. However, the taxability of disposing of these cryptoassets depends on the person's circumstances. Disposal includes selling them for fiat (traditional) currencies, exchanging to another type of cryptoassets or using the cryptoassets to acquire goods. A question that exists around hard forks and airdrops is whether the recipient has done anything to acquire the cryptoasset (so as to assess intention) or whether they are received passively.

Disposals of cryptoassets received from a hard fork

IR is of the opinion that the purpose of acquiring new cryptoassets from a hard fork should remain the same as the purpose of acquiring the original cryptoassets i.e. similar to the tax treatment of a share subdivision and the treatment of shares under some demergers. For example, if the original purpose of acquiring the cryptoassets was to dispose of them, any additional cryptoassets acquired from a hard fork will also be treated as being acquired with the same purpose.

Dealers or mining businesses will be subject to trading stock rules and taxable that way.

Disposals of cryptoassets received from airdrop

Cryptoassets that are received from airdrop by a cryptoasset business (i.e. a cryptoasset dealing or mining business) are likely to be trading stock of the business and subject to the trading stock rules. Likewise, the disposal of cryptoassets received from airdrop which is part of a profit-making undertaking or scheme are taxable.

In cases where the person had done something to become entitled to receive or take possession of the airdropped cryptoassets (i.e. signed up online to receive an airdrop), disposals of these cryptoassets are likely to be taxable if the person acquired them for the purpose of disposal. Conversely, if the person is acquiring for the purpose of holding for the long term to generate income other than from disposal, any subsequent disposal will arguably be non-taxable.

Interestingly, the disposal of cryptoassets from airdrop is treated differently in some other jurisdictions.

Cost of acquisition of cryptoassets received from a hard fork or airdrop

If the disposal of a hard fork or airdrop cryptoasset is taxable, it is worth noting that the full disposal value will be taxable as there was no cost incurred in acquiring the cryptoasset (other than transaction fees, if any). However, in cases where a person is taxed on the receipt of cryptoassets and again on disposal, a cost should be attributed to the cryptoassets at the time of their disposal to ensure there is no double taxation.

Deloitte's Comment: More complexity on your taxes when you invest in cryptoassets

While IR has released guidance to enlighten taxpayers on the tax treatment of cryptoassets, there is still complexity relating to the taxability around buying and selling cryptoassets from blockchain forks and airdrops.

As mentioned in our previous article, IR has been gathering data on anyone who transacts in cryptoassets. If you have significant transactions relating to cryptoassets and you are of the view that the transactions are not taxable, then be prepared to support this position if IR ask questions.

If you have any queries on the taxability of cryptoassets or you are unsure of your tax obligations, please seek advice from your usual Deloitte tax advisors.

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Snapshot of recent developments

Tax legislation and policy announcements

Taxation (Income Tax Rate and Other Amendments) Act 2020

The Taxation (Income Tax Rate and Other Amendments) Act 2020 ("the Act") was introduced on 1 December 2020 and received Royal Assent on 7 December 2020. Deloitte has also published an article on the Act.

The Act includes the following tax amendments, mostly with effect from 1 April 2021 income year, unless otherwise stated below:

- A new personal income tax rate of 39 per cent on annual income over $180,000;
- All fringe benefit tax rates are increased consequentially;
- A new employee superannuation contribution tax (ESCT) rate of 39 per cent, with the ESCT threshold being $216,001 upwards;
- A new 39 per cent resident withholding tax rate on interest with effect from 1 October 2021;
- Additional disclosure requirements on trustees (compulsory from 2021-22 income year; the Commissioner may also require trustees to provide information back to 2013-14 income year);
- A new information gathering power (section 17GB) for the Commissioner to gather information she considers relevant for tax policy reasons, with effect from the enactment date. The Commissioner must not use the information collected under this section as evidence in proceedings against a person, but this does not apply to any information the Commissioner subsequently obtains under another section of the Tax Administration Act 1994; and
- An increase in the minimum family tax credit threshold for the 2020-21 and later tax years.

June tax bill report back date pushed out

The Finance and Expenditure Committee report back date to the House on the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill (June Tax Bill) has been deferred by 4 months to 4 March 2021. The due date was previously set for early December 2020.

Small Business Cashflow Loan eligibility criteria expanded

On 18 December 2020, the Government announced that Cabinet will amend the Small Business Cashflow Loan scheme by introducing revised eligibility criteria with effect from 28 January 2021 (originally February 2021). The Small Business Cashflow Loan scheme is administered by Inland Revenue. Deloitte has published an article regarding this.

Public consultation on the Pillar One and Pillar Two Blueprints

On 16 December 2020, the OECD published the public comments they received on Pillar One and Pillar Two Blueprints. On 14 and 15 January 2021, the OECD held a public consultation meeting focused on the key questions identified in the consultation document and raised in the written submissions received.

Protocol to NZ – Switzerland Treaty comes into force

On 10 December 2020, the amending protocol, signed on 8 August 2019, to the New Zealand – Switzerland Income Tax Treaty (1980), came into force.

Inland Revenue statements and guidance

Guidance on setting up a business asset sale

Inland Revenue has already started to publish guidance on sale price allocation rules for both the buyer and seller. It states

both parties need to agree on how the sale price is allocated between taxable and non-taxable assets and allocate the sale price for all assets in line with market value. Inland Revenue will investigate the sale and correct the sale price allocation if they find that the buyer and seller did not allocate the sale price reasonably in the same way in their income tax returns or did not allocate it in line with market values. This supports legislation introduced in 2020 to govern purchase price allocations in asset sales, which we wrote about in July 2020.

Finalised kilometre rates

Inland Revenue has set the rates for the 2019/20 income year. Compared to the prior year, the Tier One rates are slightly higher to reflect the small increase in the cost of owning a vehicle. However, Tier Two rates are slightly lower to reflect the decrease in the overall costs of operating a vehicle. If the 2020 tax return has been flied using the 2018/19 rates, Inland Revenue can reassess the return upon being notified of this.

Vehicle Type	Tier One Rate per km	Tier Two Rate per km
Pertol or Diesel	82 cents	28 cents
Petrol Hyprid	82 cents	17 cents
Electric	82 cents	9 cents

Salary, wages and bonuses paid in cryptoassets

On 11 January, Inland Revenue issued two revised rulings: BR Pub 21/01 Income tax – salary and wages paid in crypto-assets and BR Pub 21/02 Income tax – bonuses paid in crypto-assets. While these rulings replace BR Pub 19/01 and BR Pub 19/02 respectively, the tax treatment in the rulings remain the same. The rulings have been replaced as some aspects of the arrangement originally ruled on and the commentary may be inconsistent with the Wages Protection Act 1983. BR 19/01 and BR 19/02 will be withdrawn on 28 February 2021 but the Commissioner will continue to be bound by those rulings for arrangements entered into on or before 28 February 2021 until 1 September 2022.

First step legally necessary to achieve liquidation when a liquidator is appointed

On 11 December 2020, Inland Revenue issued Questions We've Been Asked QB 20/03 – First step legally necessary to achieve liquidation when a liquidator is appointed. The statement concludes that the first step legally necessary to achieve a short-form liquidation is a resolution by the shareholders or board of directors or, where applicable, another overt decision-making act provided for in a company's constitution to adopt a course of action that will end in removal from the register. In comparison, the first step legally necessary to achieve a long-form liquidation is a shareholders' resolution appointing a named liquidator as required by the Companies Act 1993.

Prohibiting Fair Dividend Rate method for Foreign Investment Funds income from specific investments

On 7 December 2020, Inland Revenue issued five determinations (FDR 2020/02, FDR 2020/03, FDR 2020/04, FDR 2020/05 and FDR 2020/06) which prohibit the use of the Fair Dividend Rate method to calculate foreign investment fund income from interest in certain investments.

Special financial arrangement determinations for public-private partnerships

Inland Revenue has published three special financial arrangement determinations which were issued on 17 December 2020:

- Special Determination 27B – Convertible Notes in Respect of a Limited Partnership Interest. This determination replaces Special Determination 27A to take into account amendments to the convertible notes under the 2020 amendments.
- Special Determination 28B – Arrangements Rules to the Design and Construction Phase in a Public-Private Partnership. This determination replaces Special Determination 28A to take into account 2020 amendments to the project.
- Special Determination 29B – Application of the Financial Arrangements Rules to a Public-Private Partnership. This determination replaces Special Determination 29A and take into account 2020 amendments to the arrangement.

Consultation documents

The following documents are out for public consultation

- IRRUIP15 – Income tax: trusts and the Australian/New Zealand Double Tax Agreement (DTA). The focus of this paper is the access to the Australia/ New Zealand Double Tax Agreement for trusts. It examines if a trust can access the benefits under the DTA and how residency is determined for a trust. It then explores the DTA's accommodation of trusts as fiscally transparent entities to understand exactly what that means in the Tran-Tasman context for both trustees and beneficiaries. Finally, there is an analysis of the credit allowance provisions that provide relief for tax paid in the other jurisdiction. Submissions close on 1 March 2021.
- PUB00359a – Charities business exemption – when it must be used and PUB00359b – Charities business exemption – business carried on in partnership. These two draft Question We've Been Asked documents consider the situations in which a charitable entity needs to use the business income exemption in s CW 42 (which contains additional territorial and control restrictions) rather than in s CW 41 of the Income Tax Act 2007, and whether income derived by a charitable entity from a business will be exempt under s CW 42 if the business is carried on by a charitable entity in partnership with a non-charitable entity. Deadlines for submissions on both consultation documents are 1 February 2021.

- ED0225 – Administration of the imported mismatch rule – section FH 11. This draft operational 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. Submissions close on 5 February 2021.
- ED0224 – Deduction notices. This draft standard practice statement sets out Inland Revenue's power to issue a deduction notice to recover outstanding amounts of tax from a third party and provides guidance on how the Commissioner will use such notices. The statement updates and replaces SPS 11/04 – Compulsory deductions from bank accounts. Submissions close on 5 February 2021.
- ED0226 – Retention of business records in electronic formats, application to store records offshore and keeping records in languages other than English or te reo Māori. This draft standard practice statement provides guidelines on the retention of business records in electronic format and sets out the Commissioner's practice when considering an application to store business records offshore and when considering an application to keep records in a language other than English or te reo Māori. Submissions close on 5 February 2021.

Other

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

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