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Tax Alert

November 2023

Tax cuts may be around the corner (...but say goodbye to the EV rebates!)

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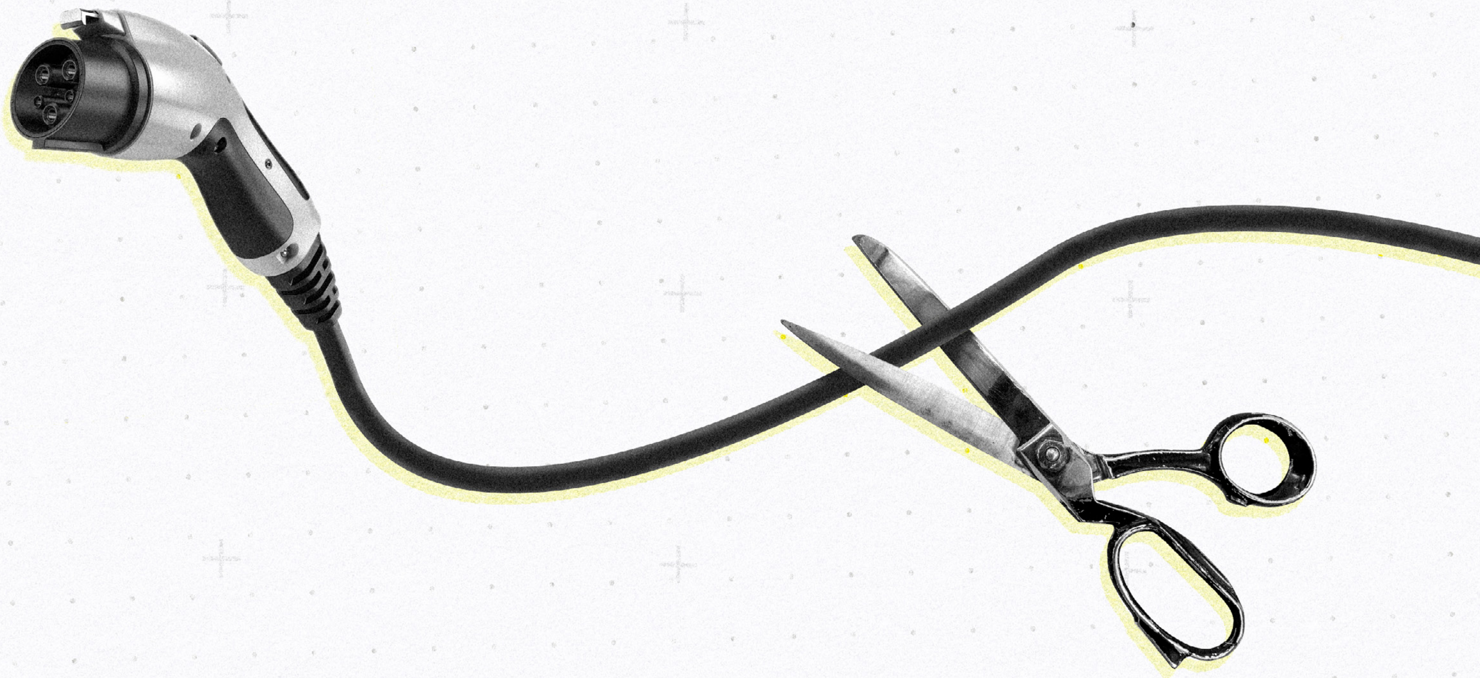

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Tax cuts may be around the corner (...but say goodbye to the EV rebates!)

By Viola Trnski and Robyn Walker

While the end of a whirlwind campaign brings welcome respite to some, the “winners” of the General Election will now be around the negotiating table ironing out the details of a coalition agreement to form the 54th New Zealand Government.

We canvassed the election policies of key players in an earlier edition and now take a closer look at the current state of tax affairs and the various promises and statements made by National, ACT and New Zealand First. To get more depth than just campaign promises we dig into comments in Hansard, Finance and Expenditure Committee hearings, and questions from reporters also shed some light on what we might see happen next.

These projections must be taken with a grain of salt. While there are some clear areas of consensus between National, ACT, and New Zealand First, areas of ambiguity remain and will need to be ironed out.

We’ve also summarised key legislation to keep an eye on, and when you can expect any changes to take place.

Where are we at?

The General Election was held on 14 October. The results showed a turn to the right with National and ACT, who gained a significant number of seats, as well as New Zealand First who made it back into Parliament. National and ACT’s majority currently sits on a knife’s edge, with preliminary results affording the two parties 61 seats combined (out of 120 – subject to confirming the extent of the Parliamentary overhang caused by parties winning more electorate seats than party votes). In any case, the National Party may wish to garner support from both ACT and New Zealand First in some form for stability, because one rogue MP can cause such a slim majority to fall apart.

The half-a-million special votes will determine the final makeup of our next Government and whether New Zealand First will need to be a part of it. These results, which have traditionally favoured the left, will be announced on **3 November 2023**. A number of Māori electorates are finely balanced, and if more tip to Te Pāti Māori in comparison to the size of the party vote for that party, the size of Parliament will increase (known as an overhang).

A further element in the mix is the Port Waikato byelection which increases the number of seats in parliament to (at least) 121 and therefore increases the number of seats needed to form a majority. National are set to gain this seat – it has never gone to any other party, and neither Labour nor ACT are standing a candidate. Voting in the by-election closes on 25 November.

What can we expect?

Tax policies

CHANGE	NAT.	ACT	NZF	VERDICT	LIKELY ENACTMENT TIMEFRAME
Changes to income tax brackets/ rates	✓	✓	✓	All parties support tax cuts but in different shapes. NZ First and National want to index rates to inflation, while ACT wants to work towards a three-rate system with a tax offset for low-income earners. NZ First also want a tax-free bracket by April 2027.	New tax brackets will most likely be introduced as a priority for the National Party given the emphasis on tax cuts during the election campaign. Tax cuts could be quickly legislated and could take effect from 1 April 2024 (the start of the new tax year) or 1 July 2024 (the date stated in the National Party tax policy).
Increase trust tax rate to 39%	✓	?	?	National's tax plan uses costings based on the 39% trust tax rate being built in. ACT and NZ First have been silent on this issue.	The new Government will need to reinstate the tax bill containing this change (Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill) and complete its remaining legislative steps. This change is currently proposed to come into effect from 1 April 2024.
Remove building depreciation deductions	✓	×	?	National's tax costings include removing commercial building depreciation deductions. ACT wants these deductions to remain.	The outcome is uncertain, however, National's costings disallow deductions from the 2024/25 income year.
Repeal platform economy rules	✓	✓	?	Both National and ACT support repealing the platform economy rules, which were set to levy GST on digital platforms from 1 April 2024. Separate rules requiring platforms to report information about sellers from 2024 will remain in place.	Likely repealed before the rules take effect on 1 April 2024. Digital platforms will need certainty on the change as soon as possible to avoid having to build software system to implement these rules.
Reinstate interest deductibility for rentals	✓	✓	✓	Looks certain, with National, ACT and NZ First all committing to repeal the interest deductibility limitation rules.	National adopts a 3-year phase-out, ACT wants immediate deductibility, and NZ First does not provide a timeframe.
Bright-line test	✓	✓	?	National's policy to revert the test back to two years seems likely. ACT wants to repeal it completely.	National has budgeted for the bright-line adjustment in their costings from 2024/25.
Repeal Tax Principles Reporting Act	✓	✓	?	Both National and ACT supported repealing during the debate under urgency. May not be a priority as the focus is on reporting.	Expect repeal during first term; but unlikely to be repealed before December 2023 (when the first report is due).
Repeal Business Payments Practices Act	✓	✓	?	National and ACT want to repeal but have not provided a timeframe, nor does it seem to be a priority.	Expect repeal during the Government's first term, but possibly not before the first reporting period (July 2024).
Remove Auckland Regional Fuel Tax	✓	✓	?	Very likely to be removed, with both National and ACT supporting its removal.	Can expect both policies to be repealed within the first 100 days of the new Government being formed (prioritised by National in their "100 Day Action Plan")
Scrap Clean Car Discount	✓	✓	?	Will likely be removed, with both National and ACT supporting the removal. Emissions Trading Scheme funds may be redirected to fund tax cuts.	
International tax reform	✓	×	✓?	Pillar Two reform will likely continue, has general support.	Likely from 1 January 2025 but depends on other countries. These rules are contained in the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill which lapsed due to election and will need to be reinstated by the new Government.
R&D, gaming tax offsets	✓	×	✓	ACT has budgeted to scrap R&D, gaming, and film tax incentives. NZ First and National retain these.	Timeframe and changes are uncertain. Labour introduced a gaming rebate in 2023 Budget.
Digital Services Tax	?	?	?	Area of uncertainty as most parties have been silent on this. Bill introduced in August 2023 and the first reading will be heard by the new Government.	Not before 1 January 2025 if passed, and OECD progress continues to stall. The Digital Services Tax Bill lapsed due to the election and the new Government would need to decide whether to reinstate the Bill.
Capital gains & wealth tax	×	×	×	All parties have opposed introducing capital gains and wealth taxes.	No introduction of a wealth or capital gains tax is expected.

Recent Tax Legislation
The status of key recent tax legislation will affect whether statutes will need to be repealed, or if they can be amended (or drafted afresh). All legislation sitting with the House prior to the Election, including the omnibus tax bill introduced in the May 2023 budget, has lapsed. The incoming Government will need to decide what to continue with, and where changes are made.

A summary of key statutes, what tax changes they contain, and their current status, is provided here.

There are many areas of uncertainty following the Election, and time will tell what tax changes will take place.

For now, watch this space and the outcome of special votes once counted. Inland Revenue will also release a briefing to the incoming Minister of Revenue, which will outline their summary of the current tax system and suggestions for priorities going forward. A mini-budget may or may not be announced before Christmas, but in any case, there is likely to be plenty of tax changes on the table to keep the tax community busy.

If you have any queries or would like to know more about how these changes will affect you or your business, please contact your usual Deloitte advisor.

STATUTE OR BILL	TAX CHANGES PROPOSED OR INTRODUCED	CURRENT STATUS AND WHAT TO EXPECT NEXT
Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 – Enacted	Act contains (non-exhaustive): • Platform economy rules • OECD information reporting rules • Changes to NRCT and dual resident companies • FBT exemption for public transport and e-Bikes (via SOP)	This omnibus act set the 2022-23 income tax rates among other changes. Some sections (e.g. platform economy rules) are likely to be repealed. OECD reporting rules and remedial changes for NRCT and dual resident companies may remain.
Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill	Bill contains (non-exhaustive): • Pillar Two rules • Increase trust tax rate to 39% • Flooding rollover relief • ACC lump sum payments • Kiwisaver for paid parental leave	This Bill lapsed as it was being passed through the House and will need to be picked up by the new Government. First reading was completed, and written submissions were received. Oral submissions have been delayed for the new Finance and Expenditure Committee to hear. There will likely be changes by the new Government before the Bill is passed.
Taxation Principles Reporting Act 2023 – Enacted	Introduced seven Tax Principles and outlined a framework for Inland Revenue to report on.	The Act was assented to in Parliament's last sitting week and the first report is due December 2023. National and ACT opposed the legislation.
Digital Services Tax Bill	Proposes introducing a 3% Digital Services Tax on large multinational tech companies.	Introduced to Parliament, no first reading yet. If the Bill is picked up, submissions likely in early 2024. Doesn't seem to be a priority either way, with no comment from parties.

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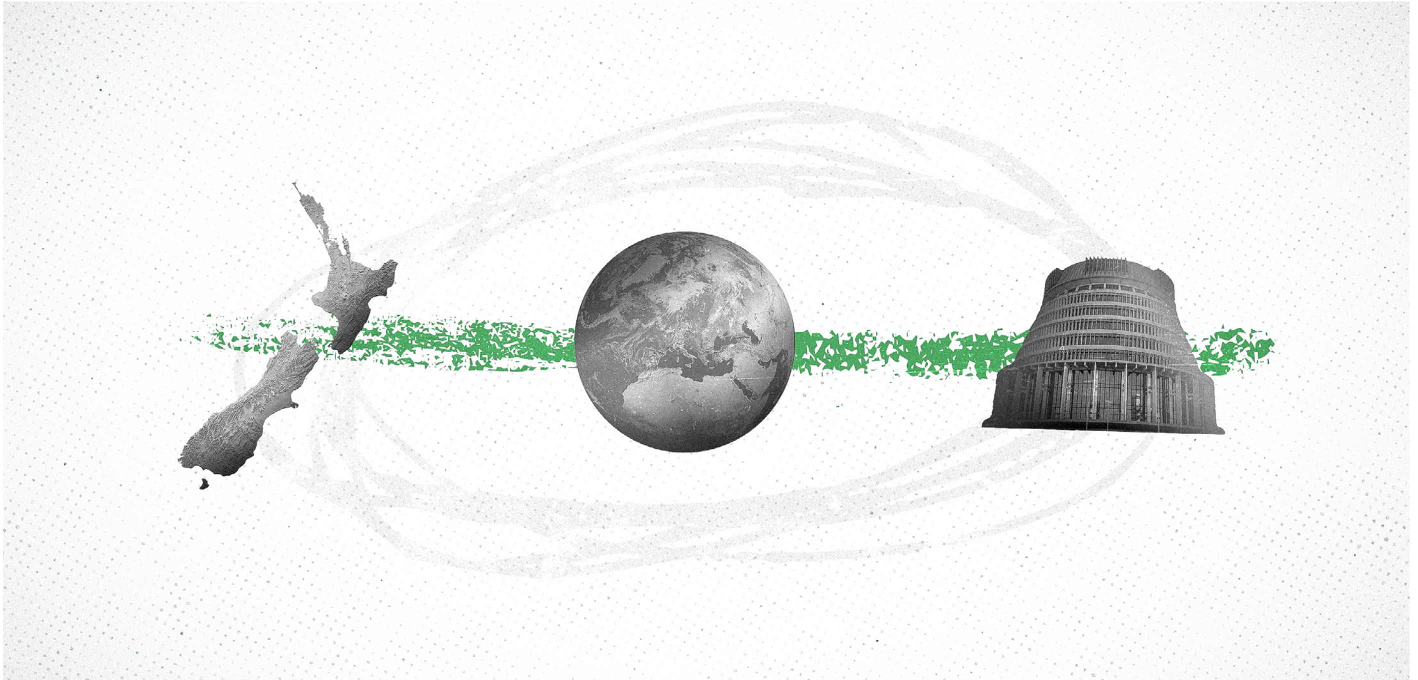
Inland Revenue takes on FIF feedback in revised consultation document

By Amy Sexton and Robyn Walker



In late 2022 Inland Revenue issued a somewhat controversial draft QWBA for consultation on the default calculation methodology a taxpayer must use if they have failed to declare Foreign Investment Fund (FIF) income in a tax return. Our February 2023 Tax Alert article outlined our disagreement with Inland Revenue's proposed position in the consultation document. This disagreement must have been a common thread in the consultation submissions to the Inland Revenue as on 26 October 2023 the Inland Revenue reissued the draft QWBA for further consultation, reversing their previous position.

What does the proposed QWBA now say?

The QWBA now states that a person (a natural person or eligible trustees) has a choice of one of the five FIF calculation methods (subject to certain restrictions), even if they initially fail to declare the FIF income in a tax return and later file a voluntary disclosure or fail to file a tax return by the due date and later file a return which includes the FIF income. The QWBA also explains that if a person does not file a return and the Commissioner of Inland Revenue issues a default assessment, the default assessment will normally be based on the default calculation method. To challenge the default assessment a person will need to file a tax return to challenge the assessment and the person can choose from the available methods to calculate the amount of FIF income to return.

The change in the Inland Revenue position between the two versions of the draft QWBA shows the value of the consultation process and how the Inland Revenue is open to considering the points made in submissions during this process.

The Inland Revenue has also recently issued a Binding Ruling in relation to changing FIF calculation methods, with the ruling made public via a Technical Decision Summary (TDS) under Inland Revenue's drive to improve transparency over its decision-making. But before we delve further into the technical FIF calculation methodology issues, what exactly are FIFs?

FIF's

The FIF rules were introduced to combat New Zealand tax residents investing in offshore tax havens with the aim of capturing the foreign-sourced income earned by New Zealand tax residents.

Without specific FIF rules, New Zealand could only tax the income earned in these offshore funds when the dividends/distributions were physically paid out to the New Zealand tax residents. The FIF rules and calculation methods attempt to capture tax on accumulated income or the change in value of the investments and so the rules are a de facto "capital gains tax", even if those gains are unrealised.

The FIF rules target New Zealand tax residents who have an ownership interest, but not a controlling interest, in certain offshore entities. The methods for calculating FIF income (or loss) are prescriptive, and in most cases, the choice of methods is limited. Currently, there are five FIF income calculation methods; the fair dividend rate method, the comparative

value method, the cost method, the deemed rate of return method and the attributable FIF income method. A taxpayer should elect the method they are using by filing their tax return by the due date.

Technical Decision Summary – Changing FIF calculation methods

The Arrangement subject to the binding ruling application involved a Trust and a Company (the Applicants) who had been returning their FIF income under the attributable FIF method. The Applicants were seeking to change their FIF calculation method. The general FIF rule is that once a taxpayer uses a particular calculation method for FIF income they must continue to use the same method for the FIF interest in subsequent periods unless they are allowed a change of method under the provisions of the FIF rules in the Income Tax Act 2007. The first issue the Applicants sought the ruling on was to confirm that they met the relevant permissions in the FIF rules to change the calculation method. The Inland Revenue determined that the Applicant met the requirements as:

- The binding ruling application constituted a notice to the Commissioner of the Inland Revenue of the reason for the change and was given before the first income year/accounting period that the calculation change would be effective; and
- The Applicants had only returned FIF income using the attributable FIF method, and this was the first time they would change the calculation method.

The second ruling point the Applicants sought was that they were able to use the Fair Dividend Rate (FDR) method. The Inland Revenue ruled that as the FIF interests were shares in foreign companies that were not non-ordinary shares the Applicants were able to choose to use the FDR method.

Finally, the Applicants sought a ruling point on whether the Trust was able to use the Comparative Value (CV) method. The Inland Revenue determined that the Trust was able to use the CV method as the requirements under the FIF rules were met, including that:

- The Trust was (and had always been) a New Zealand complying trust;
- The gifting settlors were all natural (or deceased) persons;
- The Trust had always been for the benefit of natural persons for which the gifting settlors have natural love and affection; and
- The Trust was not a superannuation scheme.

While the Trust was able to use the CV method, the FIF rules place a number of restrictions on using the CV method, the ruling was issued with a number of provisions place on the Applicants.

So, what can we take away from this TDS?

The background facts of the TDS read as fairly uncontroversial and straightforward, so readers may be wondering why the Applicants sought a binding ruling?

> The fact is that the FIF rules are not straightforward to apply, are overly complex, and the devil is in the detail.

Getting these rules wrong can have significant and costly consequences for the taxpayer. Therefore, if you have any overseas investments, we recommend you talk to your usual Deloitte adviser to first determine if the FIF rules apply to you, and if they do, to ensure you are using the correct calculation methods. This is especially important as the Inland Revenue regularly takes part in the OECD's Automatic Exchange of Information (AEOI) framework, in which participating jurisdictions collect and exchange financial account information concerning residents who invest or maintain assets in a country other than the one in which they are tax resident.

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Reductions in shortfall penalties, the downward trend continues…. but for how long?

By Amy Sexton and Robyn Walker

Every year the Commissioner of Inland Revenue is required to report to the Minster of Finance under section 141L of the Tax Administration Act 1994 on the shortfall penalties that have been applied in that financial year. Earlier this year the Commissioner issued his report for the year ending 30 June 2022. The report showed that for the 2022 income year, the Inland Revenue imposed $22,122,067 (1,887 individual penalties) of shortfall penalties, compared with $13,922,752 (3,431 individual penalties) in 2021.

Shortfall penalties are imposed to encourage taxpayers to voluntarily comply with their tax obligations. The penalties have a progressive level of severity, depending on the nature of the breach and are imposed as a fixed percentage of a tax shortfall identified in a voluntary disclosure from a taxpayer or an Inland Revenue investigation/audit.

The shortfall penalty regime

When a taxpayer takes a tax position that the Inland Revenue later determines to be incorrect, the taxpayer may be charged a penalty on the tax shortfall. This table summarises the shortfall penalty framework:

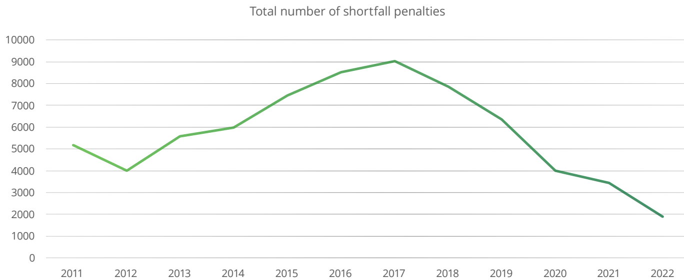
PENALTY TYPE	PERCENTAGE OF TAX SHORTFALL	APPLIES WHEN:
Not taking reasonable care	20%	Taxpayer does not take "reasonable care" in taking a tax position and that tax position results in a tax shortfall.
Unacceptable tax position	20%	Viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct*. *To apply, the tax shortfall must exceed $50k and 1% of the total tax for the relevant return period.
Gross carelessness	40%	Doing or not doing something in a way that in all the circumstances suggests or implies a complete or a high level of disregard for the consequences.
Abusive tax position	100%	Is an "unacceptable tax position" and when viewed objectively, a taxpayer enters into or acts in respect of arrangements or interprets or applies tax laws with a dominant purpose of taking, or supporting the taking of, tax positions that reduce or remove tax liabilities or give tax benefits.
Evasion or similar act	150%	Evades the assessment or payment of tax by the taxpayer or another person under a tax law or a similar act, or knowingly uses a tax deduction for a purpose other than the payment of tax.
Promoter penalty	The sum of the tax shortfalls arising as if the promoter had been the party to the arrangement.	Applies to a 'promoter' who has sold, offered, issued or promoted an arrangement to 10 or more persons, where a shortfall penalty for an abusive tax position is imposed on a party to the arrangement as a result.

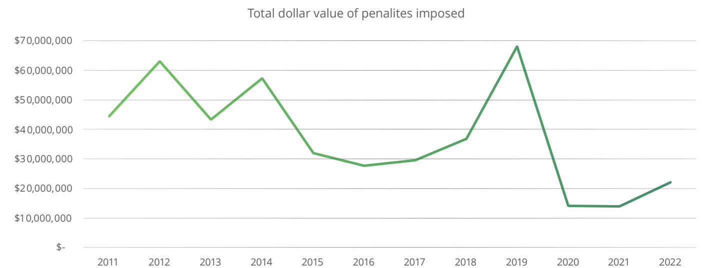
The framework aims to assess the taxpayer's level of culpability for the tax shortfall and ensure the penalty is proportionate to the seriousness of the breach. In some circumstances the amount of shortfall penalty may be reduced, including:

- 100% reduction (in cases of not taking reasonable care or unacceptable tax position) when a full unprompted voluntary disclosure is made
- 75% reduction (in the case of other penalties) when a full unprompted voluntary disclosure is made
- 75% reduction if there is a "temporary shortfall" when a taxpayer has reversed or corrected a shortfall permanently
- 40% reduction when a voluntary disclosure is made post notification of an investigation/audit but before the investigation/audit starts
- 50% reduction for taxpayers with "prior good behaviour"

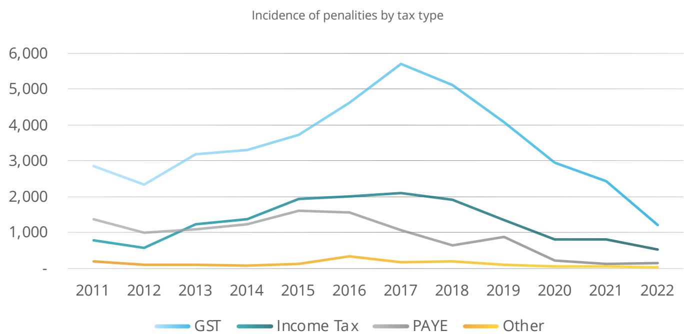
Trends in shortfall penalties imposed

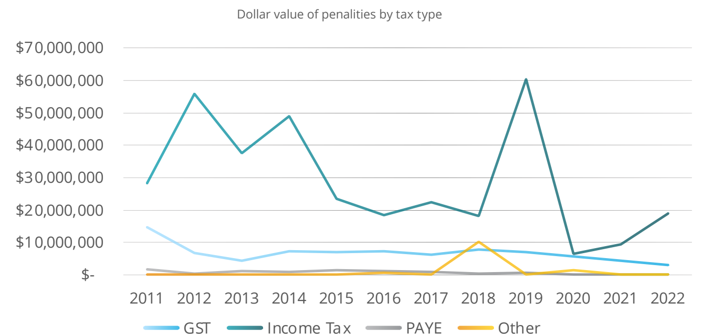
Since a peak in 2017, there has been a steady drop in the total number of shortfall penalties imposed, which coincides with the Inland Revenue's Business Transformation project and from 2020, their COVID-19 pandemic response work. The total dollar value of the penalties imposed has however fluctuated over time, with the Inland Revenue advising the increase in 2022 being influenced by penalties imposed on one taxpayer involved in an avoidance arrangement.



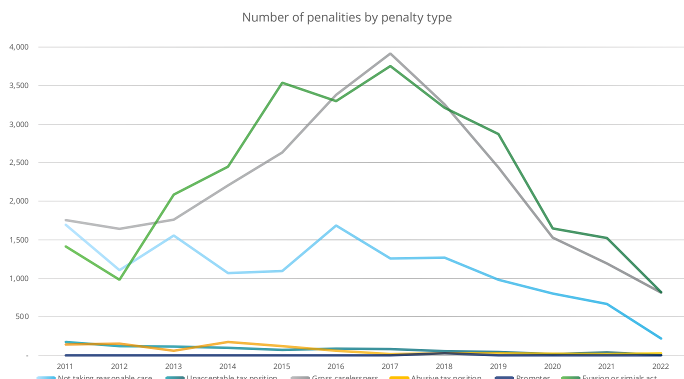


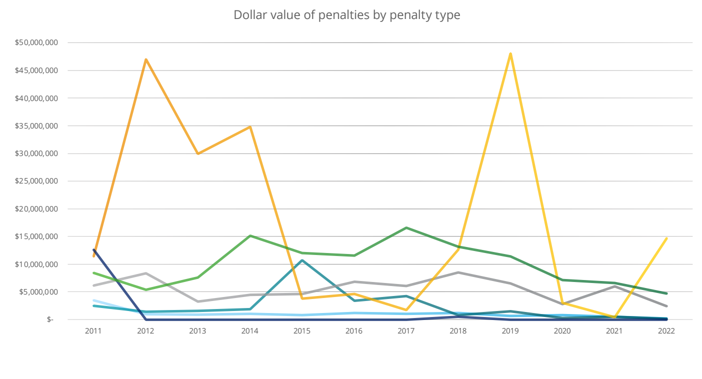
GST remains the tax type with the highest number of shortfall penalties imposed and the decline in GST penalties from 2017 is dramatic when compared to the other main tax types. This drop in GST penalties again corresponds with the Inland Revenue's focus on Business Transformation and the pandemic. Income tax remains the tax type with the highest "dollar value" of shortfall penalties imposed.

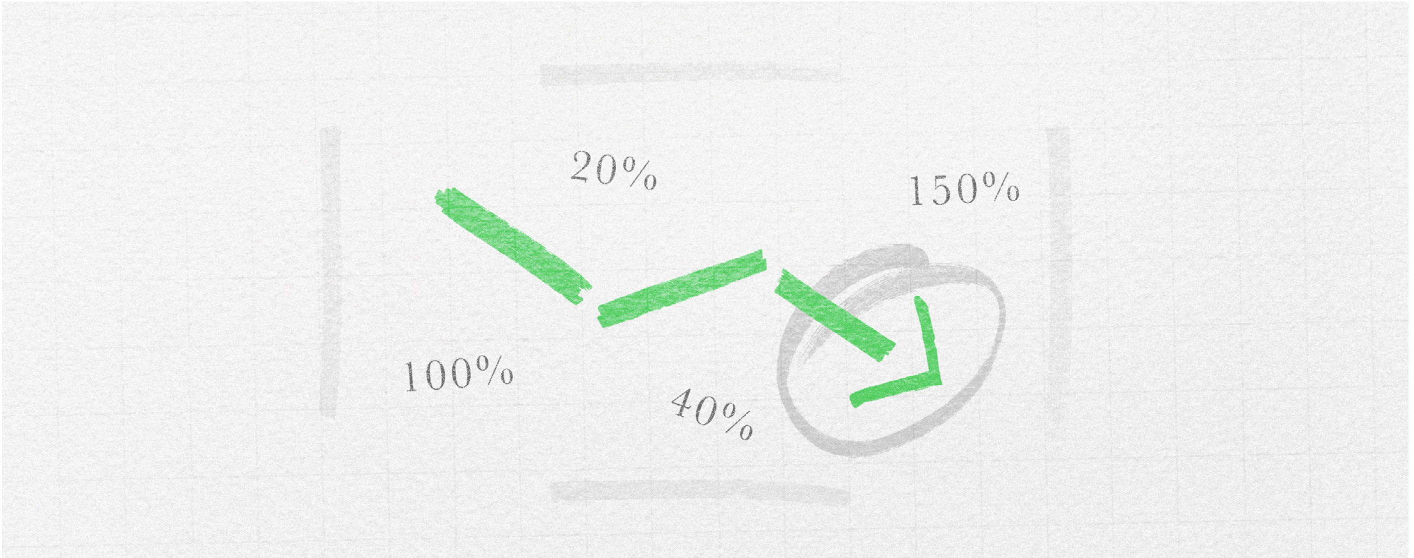




When looking at the type of shortfall penalties imposed the numbers show that if a penalty is imposed it is most likely to be for evasion (150%), gross carelessness (40%) or not taking reasonable care (20%). However, when looking at the actual dollar value, these types of penalties are dwarfed by the abusive tax position (100%) penalty. This is due to the fact that tax avoidance cases, while not common, usually deal with very large tax shortfalls, for example, the Trinity forestry schemes, and the use of mandatory convertible notes and optional convertible notes, in which tax shortfalls were in the millions.







Overall, the trend shown in these charts is that the has been an ongoing reduction in the shortfall penalties imposed.

There are likely to be a number of factors that have influenced this trend, including the reduction in Inland Revenue staff numbers, the reallocation of resources at Inland Revenue arising from both Business Transformation and the response to the pandemic, as well as an increased focus on taxpayer education and processes to help taxpayers get their tax positions "right from the start".

Increasing investigation/audit activity

Now that both the Business Transformation programme and pandemic work have finished, Inland Revenue is now shifting its focus back to investigations. This has been demonstrated by the increase in GST return reviews we have seen being initiated by the Inland Revenue recently. Time will tell whether this shift back to "business as usual" for the Inland Revenue will result in an upward trend in shortfall penalties when we review the next few shortfall penalty reports.

If you have any concerns about tax positions you have taken or increased Inland Revenue audit activity, seek advice from your usual Deloitte advisor as prompt action can help mitigate future penalties.

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Five years living with the Restricted Transfer Pricing Rules

By Bart de Gouw, John Leightley and Young Jin Kim

New Zealand has now been living with the Restricted Transfer Pricing ("RTP") rules for five years - a milestone that has its own relevance due to the construction of the rules themselves. During this time taxpayers have largely adapted to these unique rules, while Inland Revenue has brought itself up to speed and developed resources to monitor and manage the implementation.

As the RTP rules require loans to be priced as if they were five-year loans, many arrangements are coming to the end of their first pricing period. Given the highly dynamic interest rate environment and prevailing economic conditions, taxpayers need to carefully reconsider loan pricing and reassess compliance with the rules.

Recapping the RTP Rules

The RTP rules broadly require taxpayers with over NZD10 million of cross-border related party borrowings with high leverage or counterparties in low-tax jurisdictions to follow prescriptive conditions when setting terms on financing arrangements. Importantly, the RTP rules are not consistent with the OECD Transfer Pricing Guidelines and specific commentary in respect of financing arrangements.

Taxpayers who are considered "insuring or lending persons" have their own specific RTP rules, and taxpayers who are below the NZD10 million threshold can continue to price lending based on OECD transfer pricing principles or using Inland Revenue's administrative guidance, if applicable.

For more details about the operation of the rules themselves, our earlier articles provide a great starting point to better understand the operation of the rules - see Restricted Transfer Pricing and the impact on interest deductibility in New Zealand and Restricted Transfer Pricing – evolving complexities.

If you have total cross-border related party loans over NZD10 million it's time to revisit them...

The RTP rules were brought in for income years commencing on or after 1 July 2018 – and after five years it's time for taxpayers to revisit the analyses (five years was the longest term permitted by the rules). In particular, taxpayers who have structured their cross-border related party borrowing in compliance with the regime from the get-go may have loan contracts with five-year terms that have matured or are approaching maturity.

If loans have matured or will shortly, it is important to remember that where the related party borrowing is renewed, extended, or renegotiated, a 're-pricing event' occurs such that the loan must be reassessed under the rules of the RTP regime. This re-pricing event is important given the current interest rate environment and current economic conditions.

Since the RTP rules were brought in interest rates have fluctuated significantly – falling very low during the pandemic and now at high levels due to persistent inflation. Rates that were agreed upon five years ago are unlikely to be appropriate in the current environment, and repricing provides an opportunity to reflect on the broader terms and conditions of the lending into New Zealand. Whether

this results in reconsideration of capital structure or a change to the term structure of lending, new interest rate analyses will need to support the loan documentation.

Inland Revenue really is paying attention

We continue to see a growing focus from Inland Revenue on the calculation of interest rates under the RTP regime. Although other financing transactions are similarly being looked at, the RTP rules have driven significant Inland Revenue activity.

Inland Revenue has high expectations of taxpayers' supporting documentation for tax positions taken in relation to the deductibility of interest expenditure and has been reviewing loans covered by RTP – particularly for taxpayers with significant cross-border related party debt (greater than NZD100 million).

The level of tax authority activity and the prescriptive pricing provisions mean that taxpayers need to ensure they have contemporaneous documentation in place for all loans.

Monitoring loans is a part of good taxpayer governance

Tax governance is a focus area for Inland Revenue, which is running an ongoing campaign to put it on taxpayers' priority lists.

Part of the tax governance agenda needs to include monitoring cross-border related party borrowing arrangements throughout their term – and not just at the start and end. Ensuring an appropriate connection between treasury, business, and tax stakeholders regarding the level and consequences of debt funding can help manage the direct risks under the RTP rules, as well as some of the other risks highlighted at the end of this article.

Furthermore, for taxpayers not already in the RTP rules, as the rules apply to cross-border related party borrowing that exceed NZD10 million in aggregate at any point during a year, with loans close to this level need to monitor the level of debt on an ongoing basis – as exceeding the balance at any time will trigger the RTP rules. Unintended and unplanned breaches of the NZD10 million can occur simply through the capitalisation of interest or through changes in the exchange rate of a foreign currency denominated loan.

What else is impacted by the RTP rules?

Although most of the attention goes on the limitation on interest deductibility, there are several other issues for stakeholders to be aware of. Some of these points are still subject to ongoing global and local developments, but taxpayers should still take account of the following:

- **Divergence from OECD position:** the OECD has issued detailed guidance on the pricing of financing transactions – the RTP rules take a different approach. This divergence creates a double tax risk for taxpayers, especially where the RTP requirements mandate a change from group transfer pricing policy.
- **Deemed dividends:** to the extent there is a denial of a deduction through the RTP rules the recently amended dividend rules require the non-deductible amount to be treated as a dividend. The Inland Revenue is yet to provide guidance on the amended dividend rules and many uncertainties remain around these rules.
- **Limitation on applying for Mutual Agreement Procedures (MAP):** Despite the commonly used reference to a RTP regime, Inland Revenue considers RTP to be an interest limitation rule. This limits the ability of taxpayers to use MAPs under double tax agreements to prevent double taxation in respect of the amount of interest denied.
- **BEPS Disclosures:** Taxpayers and loans covered by the RTP rules need to ensure they complete their BEPS disclosures, as part of annual tax return packages.
- **Pillar Two:** For taxpayers that may be covered by the Pillar Two rules, an RTP unilateral adjustment may not comply with the arm's length principle and could trigger adjustments to the GloBE income calculation for New Zealand entities.

Contact us

The RTP regime is unique to New Zealand, and compliance needs to be carefully managed to reduce the risk of interest deductions on significant lending. As we move into the next five years, it is important to leverage the experience of dealing with the rules and what opportunities may still exist within these prescriptive rules. By contacting your usual Deloitte advisor, we can share some of our recent experience in managing the process, as well as raising any opportunities to better manage financing transactions within your wider tax management framework.

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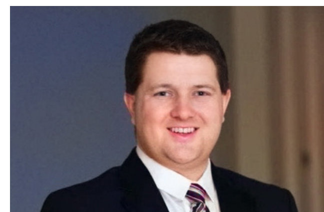

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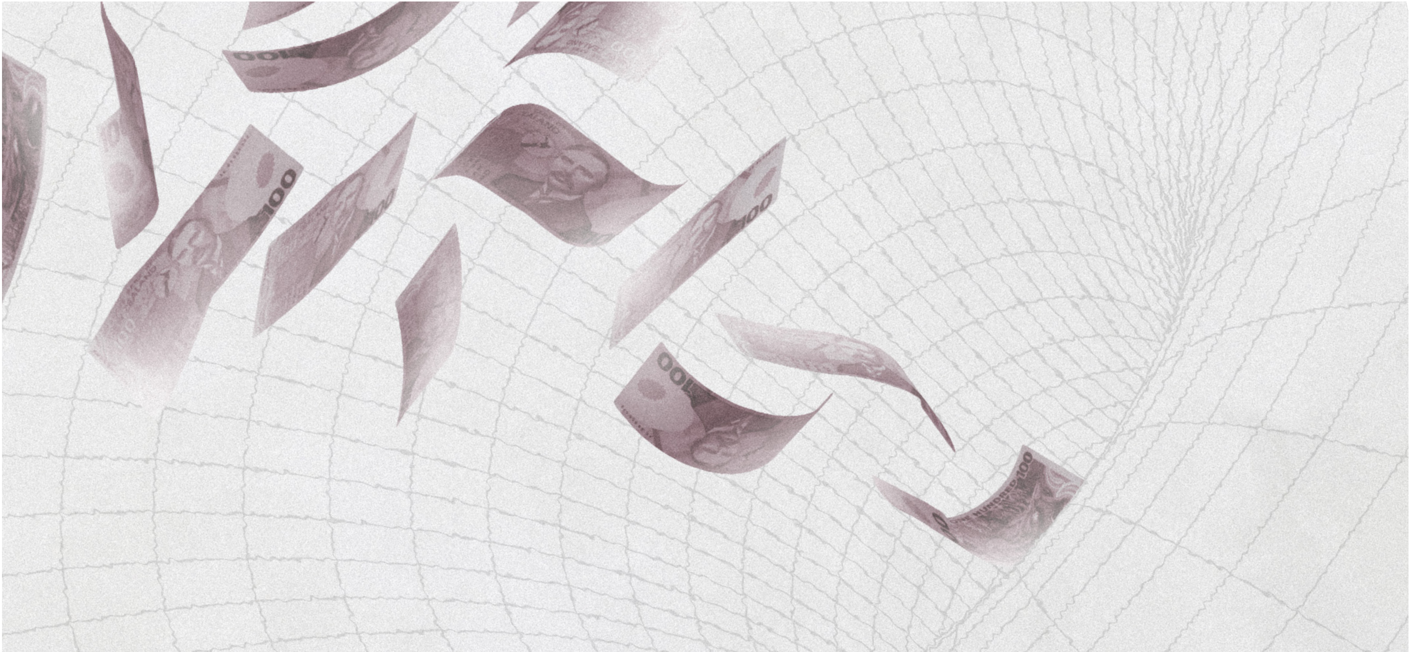
Finalised Inland Revenue guidance on deductibility of SaaS-related costs

By Alex Kingston and Troy Andrews



In the April 2023 Tax Alert, we discussed the ins and outs of Inland Revenue's proposed guidance on the deductibility of software-as-a-service (SaaS) configuration and customisation (C&C) costs. The guidance has now been finalised as Interpretation Guideline IG 23/01, largely in line with what was expected and with only some minor tweaks and helpful clarifications.

Big picture, there is not a material shift from Inland Revenue's draft position. There is a clear path to taking a deduction for C&C costs (and avoiding "blackhole" expenditure), with the main consideration being over what term a deduction may arise – either immediately or spread over a period of up to four years under the depreciation rules.

A recap on the tax treatment

As discussed in our earlier article, Inland Revenue accepts it is highly likely SaaS C&C costs will have the necessary nexus with income to be deductible, but that in most cases expenditure will be capital in nature. Despite being capital in nature, an immediate deduction may be allowed for expenditure incurred on R&D (as defined) that is expensed for accounting purposes, when applying particular parts of NZ IAS 38 (a "DB 34 deduction"). Failing that, the depreciation rules should kick in to provide a deduction over time.

The Guidance now includes a simple flowchart outlining this approach.

Key changes from the draft Guidance

Some of the relevant changes/clarifications made by Inland Revenue from the draft Guidance include:

- A broadening of the guidance on determining the capital/revenue nature of certain costs. For example, Inland Revenue acknowledges that SaaS C&C expenditure may be revenue in nature in some circumstances (but does not give specific examples of when this may be the case). Further, the Guidance acknowledges that wider costs incurred as part of a SaaS integration project (such as data migration, testing and support) will need to be assessed for their capital/revenue nature based on the activity that the costs are incurred on. Again, this is less prescriptive than the draft Guidance which suggested that any activities related to the SaaS project should always be viewed as a single project from a capital/revenue perspective.
- Similarly, there has been a broadening in the wording of how to determine whether costs are incurred on an "internally generated" intangible item, which in Inland Revenue's view is required to claim a DB 34 deduction. The Guidance does not dismiss the ability for costs incurred on work undertaken by the SaaS provider (in addition to third-party consultants) to potentially qualify for a DB 34 deduction (but again, there is no discussion or specific example of when this may be the case).
- Inland Revenue has clarified its position that a SaaS contract length (or legal life) of less than four years will be fixed life intangible property (FLIP); whereas a contract length of greater than four years

will not be FLIP, so the usual software depreciation rates (of 40% straight line or 50% diminishing value) should apply. This effectively creates a four-year "brightline" in terms of tax treatment. The Guidance also lists some relevant factors to consider when assessing the legal life, e.g., fixed or minimum terms, and rights of renewal, and also acknowledges that a contract may have an indefinite legal life (e.g., where it runs indefinitely, subject to the cancellation by the parties with appropriate notice).

What isn't covered?

The Guidance explicitly doesn't cover SaaS C&C costs incurred by a non-resident party that charges a portion to a New Zealand entity. Withholding tax needs to be considered where there are payments being made to non-residents (e.g., non-resident contractors' tax) and, in a related party context, it can be complex to work through how transfer pricing rules should apply.

The Guidance is also relatively quiet on how to treat the costs of abandoned SaaS projects, or costs incurred that may ultimately not contribute to the final SaaS arrangement entered into, e.g., where a decision has been made mid-project to change SaaS product or implementation partner or abandon certain modules.

While there are tax rules that provide some relief from blackhole expenditure arising in these circumstances, it is not clear that these rules would always apply to abandoned SaaS projects, particularly where the SaaS contract would not have met the definition of FLIP (i.e., contracts of more than four years' length). This is an area that may warrant some legislative amendments, as we expect the intention would be for tax relief to be allowed in these situations.

Final comment

The Guidance is true to its title – it is very much a guide. While some of the changes to the Guidance from its earlier draft should be seen as taxpayer-friendly, the downside is that they do leave more points open to interpretation, so the devil will be in the detail of the underlying SaaS arrangements and the nature of the activities/costs being analysed. We expect that where DB 34 deduction positions are taken there could be additional scrutiny from Inland Revenue, so it will be very important to maintain robust documentation on all positions taken when it comes to SaaS-related costs. If you have any questions about cost deductibility, contact your usual Deloitte advisor.

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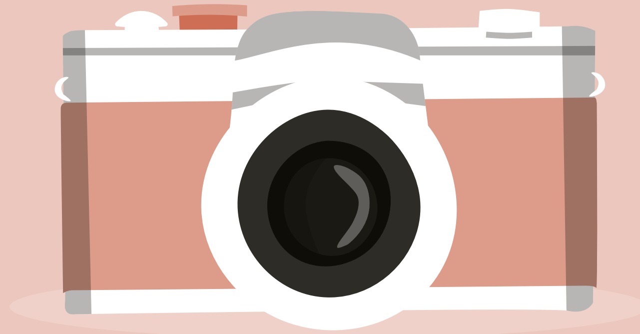
Snapshot of recent developments



Tax legislation and policy announcements

Changes to charity regulations affecting all charities in New Zealand

The main provisions of the Charities Amendment Act 2023 came into force on 5 October 2023, and will affect all New Zealand charities. The Charities Amendment Act 2023: What Charities Need To Know booklet and website Charities reform — Seed The Change | He Kākano Hāpai provide information on the changes.

Information release: Deductibility of co-operative company dividends

On 17 October 2023, Inland Revenue published an information release in relation to the deductibility of co-operative company dividends (relating to Fonterra). The release includes the cabinet paper and minute seeking agreement on the Supplementary Order Paper that introduced the amendment.

Inland Revenue statements and guidance

Tax Information Bulletin Vol 35 No 9 October 2023

On 2 October 2023, Inland Revenue published the Tax Information Bulletin for October 2023.

Global tax news

New Zealand and Slovakia sign tax treaty

On 26 September 2023, officials from Slovakia and New Zealand signed an income tax treaty which broadens the base of bilateral agreements, respects current international requirements in the fight against tax evasion and profit shifting, and increases transparency.

Austrian National Council approves Protocol to Tax Treaty with New Zealand

On 18 October 2023, the Austrian National Council approved the amending protocol, signed on 12 September 2023, to the Austria - New Zealand Income and Capital Tax Treaty (2006). The protocol is aimed at, among other things, avoiding abuse of agreements in the case of dual-domiciled companies.

Netherlands and New Zealand sign Memorandum of Arrangement on Implementing MLI Arbitration Process under Tax Treaty

On 15 August 2023 and 18 September 2023, respectively, the Netherlands and New Zealand signed a Memorandum of Arrangement to establish the mode of application of the arbitration process provided for in Part VI (Arbitration) of the OECD MLI. The Competent Authorities may modify or supplement this memorandum by an exchange of letters.

OECD updates

Progress continues in strengthening Country-by-Country reporting

On 25 September 2023, the OECD released the outcomes of the implementation of BEPS Action 13 on the transparency of global operations of large multinational enterprises.

BEPS Convention updates

On 27 September, the OECD announced that Eswatini signed the BEPS Convention, and Serbia deposited a notification to extend the application of the Convention on its existing treaties. Armenia and Côte d'Ivoire have deposited their instruments of ratification for the Convention, which will enter into force on 1 January 2024 for both countries.

Report: Tax Administration 2023

On 29 September 2023, the OECD released Tax Administration 2023. The report surveyed 58 economies with net revenue of EUR 13.4 trillion and more than 900 million taxpayers, highlighting the scale,

complexity, and digital transformation journeys of tax administrations worldwide.

Multilateral Convention to Facilitate Implementation of Pillar Two Subject to Tax Rule

On 3 October 2023, the OECD announced that the Inclusive Framework on BEPS has concluded negotiations on a multilateral instrument (MLI) to implement the Subject to Tax Rule (Rule).

The Rule will enable developing countries to tax certain intra-group payments, in instances where these payments are subject to a nominal corporate income tax rate below 9%. The MLI will allow countries to implement the STTR in existing bilateral tax treaties.

Multilateral Convention to address globalisation and digitalisation

On 11 October 2023, the OECD announced that the Inclusive Framework on BEPS has released the text of the new Multilateral Convention to Implement Amount A of Pillar One which updates the international tax framework to co-ordinate a reallocation of taxing rights to market jurisdictions, improve tax certainty, and remove digital service taxes.

Report: Methodological Guidelines for Environmentally Related Tax Revenue Accounts

On 12 October 2023, the OECD released a report presenting the methodological guidelines for compiling Environmentally Related Tax Revenue accounts, in line with the System of Environmental Economic Accounting.

OECD webinar recordings

On 16 October, the OECD hosted its latest Tax Talks webinar, which presented an update on the OECD's work. The recording and presentation are available here.

On 27 October, the OECD hosted a webinar on the key features of the MLC, including applying Amount A rules, the tax certainty framework for Amount A, and the removal and standstill of digital services taxes and relevant similar measures. The recording is available here.

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

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