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Tax Alert

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COVID-19 Omicron Business Support

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COVID-19 Omicron Business Support

By Robyn Walker

With the move into the red traffic light setting at 11:59pm on 23 January 2022 and the concern that soon many employees will be unable to work because they're self-isolating from the omicron variant of COVID-19, businesses should be looking at whether they could be claiming either the [Leave Support Scheme](#) (LSS) or [Short-Term Absence Payment](#) (STAP) to help deal with the financial burden of paying staff who are unable to work.

Many employers may not have looked at these schemes as they couldn't be claimed at the same time as a wage subsidy was claimed. In summary, the LSS provides a payment when a person (or a dependent) is required to self-isolate due to COVID-19, potential exposure to COVID-19, or they are considered "higher risk" if they contract COVID-19 when there is active community transmission; the STAP is designed to provide employees who are self-isolating while they (or a dependent) await the result of a COVID-19 test. In both cases, the employee needs to be unable to work from home in order to be eligible. Neither test looks at the financial position of the employer. Both payments are administered by the Ministry of Social Development (MSD).

What are the payments?

The LSS is paid at the rate of:

- $600 a week for full-time workers (those working 20 hours or more a week).
- $359 a week for part-time workers (those working less than 20 hours a week).

To be eligible for a one-week payment of Leave Support Scheme an employee needs to have been advised to self-isolate for at least four consecutive calendar days. If an employee needs to isolate for an additional 7 days, a second payment can be claimed. Claims can be made to cover each subsequent 7-day self-isolation period. This table summarises the claims that can be made:

LSS applications can be made retrospectively without time limits, however at present a retrospective claim can only be made in 1-week increments even if an extended self-isolation period has concluded.

The STAP is a one-off payment, paid at the rate of $359 for each employee who meets the eligibility criteria. Generally, a business can only apply once in a 30-day period for each eligible employee unless the employee has been formally advised by a doctor or other health official of the need to seek an additional test. STAP applications can be made retrospectively up to 8 weeks after the relevant test was taken.

Actual number of consecutive days in self-isolation (inclusive)	Number of consecutive days in self-isolation rounded to the nearest 7 days	Number of weekly payments
0 - 3	0	none
4 -10	7	1
11-17 days	14	2
18 - 24 days	21	3
25 - 31 days	28	4
32 - 38 days	35	5

Like Wage Subsidies, LSS and STAP payments are not subject to income tax (unless received by a self-employed person) and tax deductions are not available. GST is not required to be returned on the receipt of either payment.

What are the eligibility criteria?

For businesses who have claimed COVID-19 wage subsidies over the previous two years, many of the criteria will be familiar; for example, the employer must be registered and operating in New Zealand, employment laws must be followed, best endeavours must be made to continue to pay employees at least 80% of ordinary salary and wages, the application must be discussed with the employee and their consent must be received to make the application etc. As with the wage subsidy, the schemes are also open to self-employed individuals.

For the LSS, the key additional criteria taken from the MSD website are:

- The employee must have been advised to self-isolate for a period of at least four consecutive days for any one of the following reasons (and be unable to work from home for that period):
  - they have COVID-19; or
  - they are a close contact of a person who has COVID-19; or
  - they are the parent or caregiver of a dependant who has been advised to self-isolate; or
  - they are in the category of people most at risk of severe illness from COVID-19; or
  - they have household members in the category of people who are most at risk of severe illness from COVID-19.
- The employee, or their dependant, must have been advised to self-isolate by any one of the following:
  - a medical officer of health (as defined in the Health Act 1956) or their delegate e.g. the Ministry of Health or a public health unit; or
  - a medical practitioner (as defined in the Health Act 1956); or
  - the National Investigation and Tracing Centre.
- Employees, or their dependants, who have been named as someone who must stay at home or in a managed isolation facility under the relevant legislative order or direction outlined in the declaration are also eligible, as long as they are not self-isolating because they have returned from overseas.

It is important to note that household members and secondary contacts of close contacts and casual contacts of someone with COVID-19 do not meet the LSS eligibility criteria. Employers and employees will need to ensure they understand the Ministry of Health contact classifications.

To be eligible for the STAP, an employee needs to be seeking a test and self-isolating in accordance with public health guidance (e.g., someone who has not been assessed by Healthline or a doctor as needing a test will not be eligible). Employees subject to routine workplace testing or surveillance testing, aircrew, anyone outside of New Zealand or in managed isolation facilities will not be eligible for the STAP.

The LSS and STAP require that the relevant employee be unable to work from home for the relevant period. While the scheme was naturally designed to apply to businesses where employees are physically required to go to the workplace (e.g., cafes, supermarkets etc), it can also apply to workers who are ordinarily able to work from home but physically are unable to work because they are unwell with COVID-19.

An employer cannot be receiving the STAP and the LSS for the same employee at the same time.

What's been the uptake so far?

The LSS has been around in various iterations since March 2020; as at mid-January 2022, 60,303 applications have been made, with 32,913 applications approved and $151.7million paid out under the scheme. The STAP was introduced in February 2021, with 36,597 applications made to date, 30,918 application approved and $19.2million paid out. For comparison, the most recent 8-round August 2021 Wage Subsidy had 1.26 million approved applications and paid out $4.783billion in wage subsidies. The total amount of business support payments across all the wage subsidies and leave schemes has been $18.977billion since March 2020.

Other Business Support

Under the previous Alert Level system, additional business support was available in the form of Wage Subsidies and Resurgence Support Payments. These are no longer available, but there are still some forms of business support which business can consider accessing.

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).

Businesses are also able to take advantage of concessions around the timing of tax payments, so any businesses with cash flow concerns should also consider talking to their accountant about these options.

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

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Red Alert: What this means

By Robyn Walker, Veronica Harley and Amy Sexton

With all of New Zealand holding its collective breath over the last few weeks as the cloud of Omicron hovered at our borders, our fears were finally met with the whole of New Zealand going into the RED COVID-19 protection framework setting at 11:59 pm on Sunday 23 January 2022. In this article, we recap what COVID-19 tax relief and support are currently available for businesses.

Tax Relief

Keep filing returns on time

If Omicron takes hold as expected, staff absences may present a new challenge in meeting filing deadlines and so having a plan to keep on top of filing employment and PAYE information, GST, FBT and other tax returns will be imperative even if payment cannot be made. Inland Revenue is unlikely to consider requests for relief if it doesn't have this information as a starting point. Also bear in mind that this information will be required as evidence of ongoing business activity when applying for the small business cashflow loan scheme. For businesses that may struggle to physically file returns, Inland Revenue is likely to be flexible in this regard and remit late filing fees, on request, provided contact is made as early as possible and sufficient reasons are provided with the remission application as to why the return was filed late. These remission requests can be made via myIR.

Set up an instalment arrangement

If a business will struggle to make tax payments on time because it has been significantly impacted by COVID-19, a business can apply for an instalment arrangement. Again, it is best to get on to this as soon as practicable and not leave it until after the payments are due. Deloitte can assist you with setting this up. Essentially you will need to agree on an instalment amount, a payment start and end date. Inland Revenue may ask for some financial information to support the application that tax payments can't be made. It can be set up for any tax type, but the overriding condition is that you will need to agree to pay the tax as quickly as possible. In other words, this is not a holiday or deferral from paying tax. A 1% penalty (instead of potentially 5%) will still be applied upfront, but Inland Revenue has discretion to remit this down the track if the business complies with the arrangement and the core tax is paid in full.

Apply for UOMI relief

Use of money interest, or UOMI, will still be charged for missing a payment at the current rate of 7%. However, under the currently enacted rules, Inland Revenue has discretion to waive UOMI charges until **25 March 2022** if the taxpayer's ability to make payment on time has been significantly adversely affected by COVID-19 and certain criteria are met. This relief only applies to tax payments due on or after 14 February 2020 and is only available once the core tax has been paid in full. Provision has been made in a current bill before Parliament to extend to this deadline through an order in council, but we are unlikely to see this enacted until late March 2022.

It should be noted that this rule does not apply to interest charged for not getting provisional tax instalments correct.

Penalty relief

One good reason for struggling businesses to apply for instalment arrangements, particularly for PAYE and FBT payments, is to minimise the penalties that might be charged in the first place. Generally, a 1% initial late payment penalty is applied on the day after the due date, with a further 4% applied at the end of the 6th day if still not paid. However, for PAYE and FBT liabilities, an incremental monthly late payment penalty of 1% might also be imposed. The incremental monthly penalty can cause outstanding tax to balloon out of control very quickly if left unmanaged. But as noted above, this can be capped to 1% under an instalment arrangement if the terms are maintained.

Review upcoming provisional tax payments

We can't stress enough the need to talk with your Deloitte advisor about options for managing provisional tax payments if you cannot make planned provisional tax instalments. The rules have become a lot more complicated in recent years as several technical changes have been made, particularly concerning how UOMI is imposed on provisional tax. If you now expect the tax liability for 2022 to be lower than 2021, there are options, but it is necessary to ensure UOMI is minimised in this regard. While it is possible to estimate 2022 provisional tax lower (as opposed to paying based on prior years Residual Income Tax), there are UOMI consequences to be aware of, particularly if a company is in a group of companies.

As a result of the first lockdown in 2020, the government did introduce a targeted temporary UOMI relief rule for those small to medium provisional taxpayers significantly affected by COVID-19. This might still be relevant for businesses that are yet to file their 2021 returns if they expect UOMI to be imposed. But this relief only applied to UOMI imposed on underpaid 2021 provisional tax. The Inland Revenue advised that, as of December 2021, sections 6H and 6I of the Tax Administration Act 1994 does not allow the extension of this relief to the 2022 tax year but we would not be surprised to see this concession extended in some form.

Investigate tax pooling options

Tax pooling intermediaries offer many options when it comes to managing provisional tax payments and UOMI. Tax pooling is particularly useful when there are decreasing profits or missed payments. It can also allow taxpayers to postpone tax payments (at a competitive interest rate) to free up working capital. We suggest you talk to your Deloitte advisor to find out more about tax pooling and whether it is right for your business.

COVID-19 variations to ease administrative issues

During the 2020 lockdown, the Government passed legislation that enabled the Commissioner of Inland Revenue to quickly issue temporary variations for administrative issues arising as a result of COVID-19. These were mainly around extending due dates, deadlines, time periods or varying a procedural or administrative requirement. While most of these have now expired, we can still raise new issues on taxpayers' behalf with Inland Revenue via a dedicated unit.

Small Business Cashflow Loan

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 Minister of Finance recently indicated that the Small Business Cashflow Loan is being reviewed and may be enhanced to provide further support to businesses.

Other Government Support

The Ministry of Social Development still provides businesses to apply for the Leave Support Scheme or Short-Term Absence Payment when staff are required to isolate and cannot work from home. You can find out more about these payments in our separate article.

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

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Mind your taxes, when thinking about vaxes

By Susan Wynne

Just as "two shots for summer" was an effective incentive to get Kiwi's vaccinated before the Christmas break, businesses across New Zealand have been offering employees incentives to get their vaccinations, most commonly in the form of one-off cash payments or gift vouchers. It's a win-win, as employees receive the incentive and can return to work in a safe environment with their peers while businesses can continue to engage with customers and the wider community with lower risk and higher confidence.

Although the "carrot" approach has proven one way of getting vaccination rates up, it is important not to overlook the tax implications these types of incentives can have.

Cash bonuses and PAYE

A cash bonus paid to an employee for getting vaccinated is linked to their employment and as such is taxable employment income. Employers should deduct PAYE from bonuses paid to employees on the basis that the lump sum payment is an extra pay. An extra pay is a payment made in connection with employment that is not regularly included in salary or wages and is not overtime pay.

Cash incentive payments may also be subject to other withholding such as KiwiSaver deductions or student loan repayments.

Employers should manage communications with staff so they understand that the net cash they receive will be a reduced by tax deductions unless an employer chooses to gross up a cash bonus for tax. Employees might not appreciate getting on board with a vaccination program only to feel short-changed later due to tax deductions.

If you have a situation where you have paid cash incentives to employees and not withheld PAYE, the best thing to do is to make a voluntary disclosure to Inland Revenue. Contact your usual Deloitte adviser for assistance.

Non-cash incentives and FBT

Where a non-cash benefit such as a supermarket voucher or Prezzy card is provided as an incentive to employees for getting vaccinated these may be subject to fringe benefit tax (FBT). Gift vouchers are not subject to FBT if they fall under

With the move to Red under the Covid-19 Protection Framework, it is also timely to note that amounts paid to reimburse staff for costs incurred while working from home (WFH) are considered income of the employee.

the de-minimis exemption that applies to unclassified fringe benefits, where:

- the value of unclassified benefits each employee receives does not exceed $300 per quarter for a quarterly FBT filer or $1,200 per annum for an annual FBT filer; and
- the total taxable value of all unclassified benefits provided by the employer, or an associated person, to all employees does not exceed $22,500 per annum or in the last four quarters.

If either of these thresholds are exceeded, all unclassified benefits, including any vouchers provided for vaccinations are subject to FBT.

The FBT exemption for benefits provided in respect of an employee's health or safety will not apply to vouchers awarded as a vaccination incentive.

For more information on FBT see our March 2021 Tax Alert article here which has further detail on current FBT rates and examples of how the recent FBT changes could impact you.

WFH allowances

With the move to Red under the Covid-19 Protection Framework, it is also timely to note that amounts paid to reimburse staff for costs incurred while working from home (WFH) are considered income of the employee. However, in some situations part of the allowance could be exempt from tax based on Inland Revenue's Determination EE003: *Payments provided to employees that work from home; Employee use of telecommunications tools and usage plans in their employment.*

For more detail refer to our September 2021 Tax Alert article here.

Don't be discouraged

Using incentives is a great way to keep staff motivated and healthy in the fast-changing environment we all currently find ourselves in. If you have been offering or are considering offering cash or non-cash incentives to employees but are unsure about your specific tax obligations or have any questions, contact your usual Deloitte adviser.

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Are you remote working in New Zealand for a foreign employer?

By Andrea Scatchard and Mihiri Nakauchi

In between catching up with friends and family, indulging in too many calories and hopefully spending some time in their favourite restful places, many readers will have reflected over the holiday break and maybe looking for a change. For some, this will involve remote working in New Zealand for a foreign employer.

Back in August 2020, we wrote an article in relation to Inland Revenue's draft operational statement relating to PAYE, FBT and ESCT obligations in cross border employment situations

Nearly 18 months later, on 1 December 2021, Inland Revenue published the finalised Operational Statement "OS 21/04 Non-resident employers' obligation to deduct PAYE, FBT and ESCT in cross-border employment situations". Not much has changed from the draft version, although a few points have been clarified.

As mentioned in our earlier article, employment income that an employee earns from services provided in New Zealand is New Zealand sourced income. This means it is taxable here, subject to some limited exemptions, and it makes no difference whether this is paid by a NZ employer or a foreign employer. Generally, employment income is taxed in New Zealand through the PAYE regime, where the onus is on the employer to withhold PAYE on employee's earnings, report the employment information and pay the tax to Inland Revenue.

But in some circumstances our tax laws do not apply when the employer is offshore. The operational statement clarifies that a non-resident employer is only required to withhold PAYE from employment income paid to an employee in New Zealand if:

- the non-resident employer has made themselves subject to New Zealand tax law by having a sufficient presence in New Zealand; **and**
- the services performed by the employee are properly attributable to the employer's presence in New Zealand.

A sufficient presence includes where a non-resident employer has a permanent establishment, a branch, permanent office, or site in New Zealand where trading operations are performed. It also includes a non-resident employer that has an individual employee working in New Zealand performing contracts on behalf of the employer.

Where an employee works in New Zealand due to their personal preference, and not because of a requirement of their employer, then provided the employment activities have no connection to New Zealand and the employee is not representing the non-resident employer in New Zealand, it is unlikely that this will be a sufficient presence for the employer to become subject to tax laws in New Zealand.

So, what happens if the non-resident employer does not have to deduct PAYE?

The draft version of OS 21/04 caused some confusion for both New Zealand based employees and some front-line Inland Revenue staff, as it did not clearly state how the PAYE rules work if the non-resident employer does not have a sufficient presence and therefore no obligation to deduct PAYE.

OS 21/04 clarifies this by explaining that the employee in New Zealand is required to calculate, return and file their own PAYE. This is called being an IR56 taxpayer. We note that Inland Revenue's webpage on IR56 taxpayers still needs to be updated to better reflect this. It currently refers to the process applying to "a New Zealand based representative of an overseas company", but the most common situation would be where the employee simply chooses to work in New Zealand and is not actually representing the employer in New Zealand at all.

Inland Revenue has the following example in OS 21/04:

> Boston Architects (BA) is an architect firm bases in the USA. BA employs George who lives in Wellington. George participates in virtual meetings and completes all of his work in Wellington but as BA does not have any New Zealand clients, all the work is sent back to the US electronically.
>
> Would BA have an obligation to deduct PAYE?
>
> No. There would be no obligation to deduct PAYE as George's employment activities have no necessary connection to New Zealand, and the only connection to New Zealand is that George lives there. George would have to account for his own tax through the New Zealand tax system.

What if a New Zealand employer has a worker based overseas?

OS 21/04 also clarifies that a New Zealand resident employer does not have any requirements to withhold PAYE from payments that are "non-residents' foreign sourced income" for the employee. This is where the employee is not a tax resident of New Zealand (including a person that has left New Zealand and ceased being tax resident here) and the employment is exercised outside New Zealand. These employees can remain on the New Zealand payroll but would not be subject to PAYE – although there may be PAYE type obligations on the country where they are working! OS 21/04 has added an example which explains this as follows:

> Sarah is a UK resident and lives in London. She has never been to New Zealand. She is employed by a New Zealand Company that resides in New Zealand and does all her work remotely in the UK for this company.
>
> The income she receives as an employee is considered to be "non-resident foreign sourced income" and is therefore not assessable income in New Zealand.
>
> Sarah is not required to file a tax return in New Zealand. As this income is not assessable to Sarah in New Zealand, the New Zealand Company does not have an obligation to deduct PAYE or any employment related taxes.
>
> The New Zealand Company would need to account for Sarah's income as an expense in their accounts and will not be required to add Sarah to their Employment Information Schedule.

Other employment related taxes

As mentioned in our previous article, where a non-resident employer has a sufficient presence in New Zealand and is required to account for PAYE, there may also be ESCT and FBT liabilities arising in relation to the employment income. But if the employee is required to account for PAYE through the IR56 process, no FBT or ESCT is payable as there is currently no mechanism for FBT and ESCT to be imposed on the individual.

Final comments

OS 21/04 applies from the date it was released, 1 December 2021, and the Commissioner states that resources will not be applied to "examine positions taken by taxpayers prior to that date". For non-resident employers this means that if they do have a sufficient presence in New Zealand and are subject to our tax rules, they will need to comply from 1 December 2021 but can expect not to be audited for earlier periods. For individuals that have an IR56 taxpayer responsibility, again Inland Revenue may not enforce that obligation to amounts received prior to 1 December 2021. But this does not mean the amounts are not taxable – those individuals will still need to return the amount pre 1 December 2021 in their income tax returns and pay tax on assessment of the return.

And finally, this may all change! OS 21/04 is based on the current legislation. Inland Revenue has also been consulting on possible law changes relating to non-resident employers and when they will be subject to PAYE, FBT and ESCT in New Zealand, so watch this space as we may see further developments in 2022.

Please contact your local Deloitte advisor if you have any queries.

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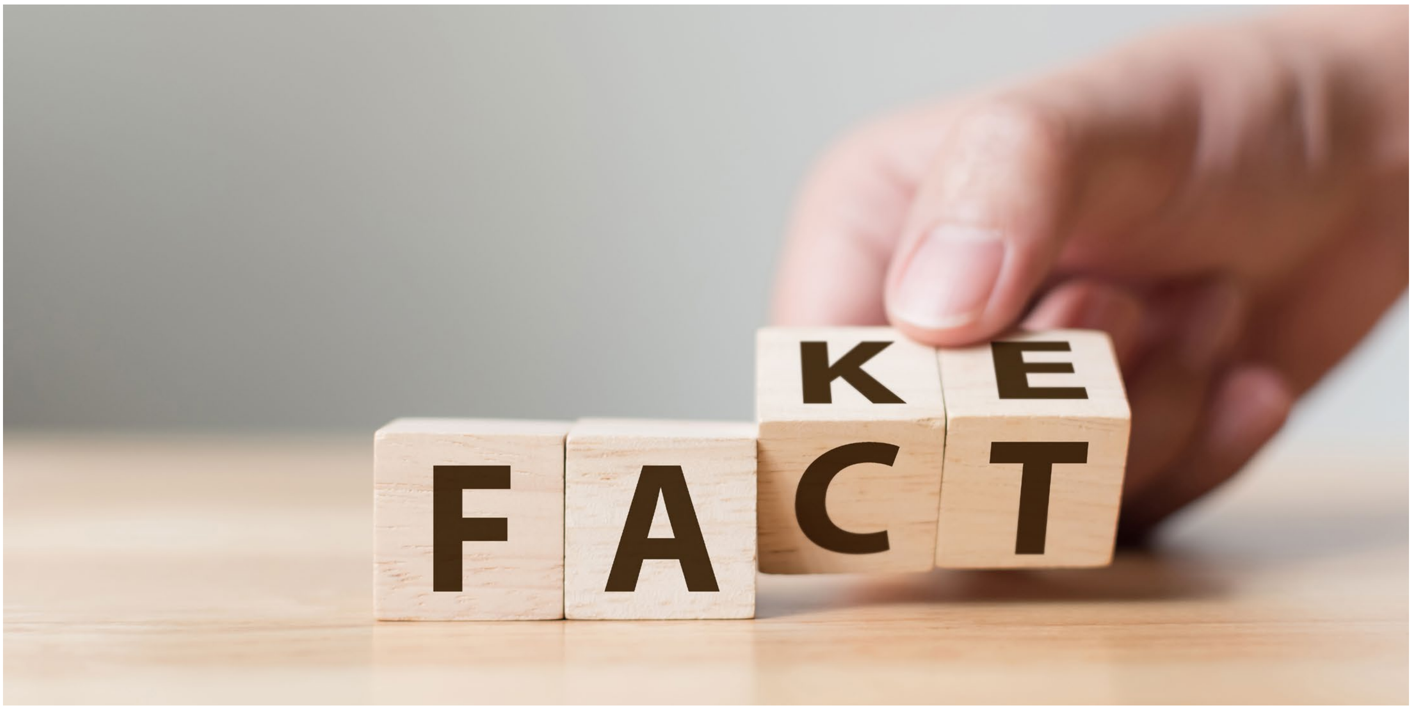
Tax fact or fiction?

By Robyn Walker



Tax is a topic that everyone seems to have an opinion on, and when the subject comes up in a social setting it can lead to some lively discussions, but also some not quite accurate sharing of "facts" about tax rules. Below are some of the commonly shared tax misconceptions.

Utes are not subject to Fringe Benefit Tax (FBT)

There is no exemption from FBT for utes, instead, there is an exemption for "work-related vehicles". To qualify as a work-related vehicle, a vehicle must not be predominantly for carrying passengers (a ute could qualify, or a vehicle which has had its rear seats removed or bolted down), the vehicle must have prominent signwriting with the business name or logo (magnetic signs are not sufficient) and the only private use of the vehicle can be home to work travel with only incidental stops on the way (all other private use must be prohibited). A ute parked up at the sports field or the boat ramp means it is not a work-related vehicle and FBT should be paid.

If an employee pays some fuel costs, there is no FBT on a vehicle

Having an employee contribute to the costs of running a work vehicle can reduce the taxable value of the vehicle fringe benefit, but it is unlikely to eliminate it. Generally, the taxable value of a vehicle that is fully available to an employee for private use is calculated quarterly as the GST inclusive cost price of the vehicle multiplied by 5%. Any employee contributions are subtracted from this amount before the result is multiplied by the relevant FBT rate (which could be 49.25% or 63.93%)

Employees can be paid in gift vouchers without tax

When employees receive payment in cash then PAYE is to be deducted by the employer. When an employee is paid "in-kind", then FBT is generally the relevant tax to be considering. Paying an employee in gift vouchers in any substantial way will result in the employer needing to pay FBT (which will likely equate to around the same amount of tax, or more, than what would be owing if the employee was paid in cash). There are two exceptions to this rule. The first is the "de minimis rule" which provides that no FBT is payable if an employer has provided no more than $22,500 of unclassified fringe benefits to all employees in the last 12 months, and no employee is receiving more than $300 of benefits in a quarter. The second is the exemption from FBT for charities; however, this exemption does not apply to "short-term charge facilities" (which could include the use of a credit card or vouchers) where the annual value is more than $1,200 or 5% of the employee's salary and wages.

If land is owned for 10 years, there won't be any tax when it is sold

Whether or not the sale of land will be subject to tax can vary based on a wide set of circumstances, and it is not true that any tax obligations automatically disappear once land has been owned for 10 years. The Income Tax Act 2007 contains a wide range of circumstances where land can be taxed, some are time-bound and expire 10 years after the acquisition, some have variable tax timelines dependent on when actions occur, and some don't expire at all.

The bright-line test does not apply to the family holiday home

The bright-line test has the potential to apply to any residential land which is sold within the relevant bright-line period (which could be either 5 years or 10 years) if the land isn't going to be taxed under any

With its new computer system and information sharing arrangements there is very little which can escape the attention of Inland Revenue… Inland Revenue also routinely collects data to detect potential non-compliance with tax laws, this includes collecting data from building supply businesses to detect "cash jobs" being completed by tradies; requesting customer data from cryptocurrency businesses; and requesting sales data from various digital intermediary platforms.

other land tax rule. The only exception to the bright-line test is if the property has been the "main home" of the owner (with a slightly different rule for property owned by a trust). A person can only have one main home, and this is the residence with which the person has the greatest connection (factoring in, for example, where immediate family live, where the person's employment is based, business or economic ties, social connections); in this case, a holiday home is unlikely to qualify for the main home exemption.

Only income from New Zealand shares is subject to tax in New Zealand

This is false, any New Zealand tax resident is subject to tax in New Zealand on income earned anywhere in the world. While there are various ways to calculate tax on income from foreign shares, any investment income is taxable.

On a related note, it is also a common misconception that foreign exchange gains are not subject to tax. Any New Zealand tax resident with a foreign currency bank account is potentially subject to tax on exchange rate movements (realised or unrealised).

Inland Revenue will never find out…

With its new computer system and information sharing arrangements there is very little which can escape the attention of Inland Revenue. Inland Revenue automatically receives details of property sales so will know how long a property was owned and if it was sold within the bright-line period. Inland Revenue receives all investment income data, so know what investments taxpayers have in New Zealand. Inland Revenue routinely exchanges data with almost 100 other countries and therefore has a lot of data about foreign income sources, including bank accounts and investments. Inland Revenue also routinely collects data to detect potential non-compliance with tax laws, this includes collecting data from building supply businesses to detect "cash jobs" being completed by tradies; requesting customer data from cryptocurrency businesses; and requesting sales data from various digital intermediary platforms.

Please contact your local Deloitte advisor if you have any queries.

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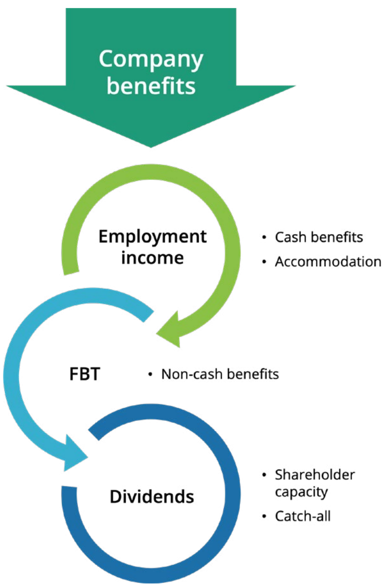
Navigating the world of non-cash dividends

By Virag Singh and Liam Sutherland

In March of 1984 Inland Revenue released "Deemed dividends", *Public Information Bulletin* 125. Now after 37 years of waiting, "fans" of non-cash dividends all over New Zealand can rejoice as Inland Revenue has released a new Interpretation Statement [IS 21/05](IS 21/05) – *Non-cash dividends*, to replace the Public Information Bulletin. Across 25 pages the interpretation statement explains the general rules of non-cash dividends with a strong focus on the types of non-cash transactions that are often entered into between small and medium-sized companies and their shareholders, potentially unaware the transaction is a dividend.

The aim of the statement is to raise awareness of when simple non-cash transactions will give rise to dividends. This is significant because the payment of cash or non-cash dividends gives rise to several administrative obligations. As such being able to spot where a simple non-cash transfer to a shareholder creates a dividend is crucial for all enterprises but particularly small and medium sized businesses where these transfers are more common.

It is important to note that a non-cash transfer will not always give rise to a dividend. For example, a non-cash transfer may occur because of an employment relationship and will be subject to either the employment income rules or fringe benefit rules. The process of determining which tax rules apply to a transfer of value is illustrated by the following graphic:



Overview of non-cash dividends

As provided by CD 4 of the Income Tax Act 2007 (the Act) a dividend is a transfer of value from a company to a person because that person has a shareholding in the company.

CD 5(1) of the Act states that a transfer of value to a person occurs when:

- A company provides money or money's worth to the person; and
- Where the person provides money or money's worth in exchange for money or money's worth from the company and the market value of what the company has provided is more than what the person provided.

It is well established in case law (see Dawson v CIR) that money or money's worth requires that the transfer be of a benefit that can be redeemed directly or indirectly for money. Given this, non-cash dividends arise where the transfer of value is not cash but is transferable either directly or indirectly into cash and the reason for the transfer was the persons shareholding in the company.

Caused by a shareholding

If there has been a transfer of value, the next step is to assess whether the transfer occurred because of a person's shareholding in the company. Inland Revenue notes that a good indication of when a transfer is caused by a shareholding is if the terms of the arrangement that results in the transfer are different from the terms on which the company would enter a similar arrangement if no shareholding was involved.

Significantly for small and medium sized enterprises where shareholder-employees are common, if the transfer of value is caused by an employment relationship and not a shareholding in the company, then it will not be a dividend. Instead, the benefit will be subject to the employment income or fringe benefit tax rules. Inland Revenue, notes that where a person is both an employee and a shareholder an indication that the transfer of value was not a dividend is that the employee was the only shareholder to receive the transfer of value or in other words no other shareholder received the non-cash transfer.

Further, shareholders in a look-through company are treated as receiving all income and incurring all deductions personally. Given this, distributions from the company to shareholder in a look-through company are ignored for tax purposes.

The interpretation statement explicitly provides examples of certain transactions that are and are not dividends. These are outlined below.

Specific transactions treated as dividends

- Making a bonus in lieu (s CD 7);
- Issuing a share under a profit distribution plan (s CD 7B);
- Making a taxable bonus issue (s CD 8);
- Dividends arising under specific avoidance provisions (s CD 11); and
  - Shares are disposed of in substitution of a dividend (that is dividend stripping arrangements) (s GB 1);
  - Where the company employs a relative of a director or shareholder to provide services, and the income payable to the relative is excessive (s GB 23); and
  - Where a close company provides remuneration for services to a shareholder, director, or relative of a shareholder or director who is not an adult employed substantially full-time in the business who participates in the management or administration of the company, and the Commissioner considers the remuneration is excessive (s GB 25).
- Providing non-cash dividends to shareholders (s CD 20).

Specific transactions that are not dividends

Inland Revenue points of some key exclusions that are likely to apply in the context of small and medium sized enterprises. Namely, the exclusion for a transfer of value that is treated as a fringe benefit (s CD 32), non-taxable bonus issues (s CD 29), a flat owning company making residential property available to a person (s CD 31).

Further, as previously mentioned if a non-cash transfer is made because of an employment relationship it will not be a dividend and is subject to the employment income and/or fringe benefit rules instead.

Calculating the amount of a dividend

Section CD 38 of the Act provides that the formula for a dividend is:

Value from company – value from person

In both cases the value is the market value of the money or money's worth provided by each party. A common transfer for small and medium sized enterprises is "making property available".

With regards to making property available the interpretation statement states that the Commissioner's view is that by allowing a shareholder to use a property that the company owns, the company is providing the shareholder with a right to use that property which is a chose and action and not a service. Services are excluded from being a transfer of value under s CD 5(3) but a chose in action is not. Generally, the value of dividend should be calculated using the fringe benefit tax rules (e.g. the value that would ordinarily be charged to customers).

Where the property is a loan, the amount of the dividend is generally the difference between a market rate of interest ("benchmark rate", often using the prescribed rate of interest for fringe benefit tax purposes) and the actual amount of interest on the loan.

One special rule for loans is that an amount repaid during the tax year is treated as having been applied in repayment on the later of the start of the company's tax year or the day the loan was made if the amount is repaid by applying salary, wages, extra pay dividends or interest payable by the company to the borrower.

Imputation credits

One of the risks of not spotting potential non-cash dividends before they arise is that an ordinary company cannot attach imputation credits retrospectively to a non-cash dividend. The operation of the benchmark dividend rules means that if the non-cash dividend is the first dividend of the year and no imputation credits were attached then for all subsequent dividends there must also be no imputation credits attached. If an unimputed non-cash dividend is paid after the first benchmark dividend of the year, there will be a deemed debit to the imputation credit account despite the shareholder not receiving the credits. While the benchmark dividends rules can be overridden this can't be done retrospectively, so it creates an administrative hurdle that can be easily avoided by being aware of the non-cash dividend rules.

In summary IS 21/05 – Non-cash dividends is a good restating on the rules regarding non-cash dividends. Whilst the statement does not provide anything ground-breaking in its interpretation of the rules, it is effective in showing when the types of non-cash transactions that small and medium sized enterprises enter into should be treated as dividends for tax purposes.

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New guidance from Inland Revenue on foreign exchange rates

By Veronica Harley and Anna Zhang

In May 2021, the Commissioner of Inland Revenue changed the source from which she obtains the foreign currency exchange rates from Bloomberg to the Reserve Bank of New Zealand. As a result, the number of rates published by the Inland Revenue has decreased. This change prompted Inland Revenue to release a determination FX 21/01 on foreign exchange rates at the end of last year. Deloitte provided a submission on the draft version of the determination during public consultation and we are pleased to see many of Deloitte's submission points incorporated. Importantly, the final determination clarifies the point that alternative sources of exchange rates can still be used subject to keeping appropriate records and so acknowledges the reality of modern business practice.

When does the determination apply?

This determination only applies to situations where a foreign currency amount is required to be converted to New Zealand currency (NZD) to calculate a taxpayer's New Zealand income tax liability, and neither the Income Tax Act 2007 nor the Commissioner has prescribed a currency conversion method or a foreign exchange rate source. For example, the determination does not apply to the financial arrangements rules, foreign investment fund rules, and controlled foreign company rules, as they each have their own specified currency conversion methods and exchange rate sources. Similarly, the Goods and Services Tax Act 1985 generally prescribes that the consideration for a supply should be converted to NZD at the time of supply.

What foreign currency exchange rate sources can be used?

The sources approved under this determination are the rates published on the Inland Revenue website, the Reserve Bank of New Zealand, as well as rates provided by another country's central bank. Nevertheless, Inland Revenue is aware that there are reasons, such as long-established practices, integration with accounting software or the need to reduce compliance costs, where taxpayers may still prefer to choose their own rate sources and methods of conversion. In this case, taxpayers need to ensure the rate they use is appropriate given the nature of the transaction. The source of the rates used must be consistent over time. If a source is changed, records must be kept to show why a change in rate has been made.

What currency conversion methods can be used?

Daily rates published by the above mentioned sources are approved where a rate is required for a particular day. If the date is falls on a weekend, the daily rate for the preceding day can be used. Any timing mismatches resulting from different time zones will be disregarded.

The determination also approves the mid-month rate, the end-of-month rate, and the rolling average rate as additional conversion methods, where the sources above are used. Where foreign income is derived and foreign expenditure is incurred regularly throughout a period, using mid-month, end-of-month or rolling average rates is likely to be appropriate. However, significant, and one-off transactions should be converted at a daily rate.

Because there are less currencies quoted by the Reserve Bank, the statement provides guidance on how to find a rate (e.g. calculating a cross-rate). The other point to note is the level of accuracy required under this determination in that rates should be calculated to the nearest 4th decimal place.

Record keeping

No matter which source or method is used, sufficient records are required to be kept, including source, type, date of rate, calculations undertaken, and reasons for any changes to foreign exchange rate source.

Cryptocurrency

Cryptoassets are considered a form of property, rather than money. This means foreign exchange transactions involving cryptoassets will require taxpayers to first obtain a market value for the cryptoasset and then convert this value in NZD. The sources and methods in this determination can be used if relevant. Built-in currency conversions published on cryptoasset exchanges can only be relied on if the rates used by the exchange are appropriate for the particular transaction.

GST

For GST purposes, conversion using daily rates is necessary where an amount is consideration in money for a supply, as the conversion to NZD must generally be performed at the time of supply. The daily rates from foreign sources approved in this determination can be used for this purpose. Monthly and rolling average rates cannot be used. Non-resident suppliers of distantly taxable goods or remote services can elect to convert foreign currency amounts into NZD at their choice of dates as prescribed in s 77(3) of the Goods and Services Tax Act 1985.

Overall, the determination provides practical guidance for foreign currency conversion if you are using Inland Revenue website or Reserve Bank exchange rates for general conversion. If you need assistance in choosing the appropriate exchange rate sources and methods, please contact your usual Deloitte advisor.

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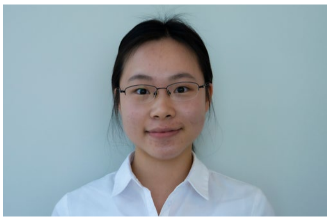

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Charities and Donee Organisations

By Veronica Harley and Melissa Parmar

Inland Revenue has published a new draft operational statement on charities and donee organisations, split into two parts: Part 1: Charities (ED0238a) and Part 2: Donee organisations (ED0238b). This is a second round of consultation following earlier statements (ED0207a, and ED0207b) released in early 2020. The 2021 versions have almost doubled in size with more detail and examples provided, although minimal technical changes have been made between drafts. That said, for the most part it is a pretty comprehensive resource on all matters that concern charities and donee organisations. We have outlined some of the key points from these statements below.

Charities

New Zealand has a diverse not-for-profit sector. Tax charities are a part of this not-for-profit sector and are generally treated favourably for tax purposes. Providing a favourable tax treatment is one way the Government can provide support to entities that contribute to the wellbeing of New Zealanders.

Part 1 of the Operational Statement focusses on what a charity is, what charitable purposes are, the roles of the Charities Service and Inland Revenue, registration, tax concessions, deregistration, Maori Organisations, Charitable Trusts and some administrative matters.

Charitable Purposes & Public Benefit

For an organisation to be a charity, they must have a charitable purpose that is of a public benefit. Broadly under both charities law and tax law, a charitable purpose is defined as "includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community".

To meet the public benefit test, the benefit must be available to a large section of the community and the activities must not result in a private benefit or profit to any individual. A charity does not have to be a registered charity to accept funds from the public, but it does have to be registered with Charities Services and fulfil charitable purposes to receive concessionary tax treatment.

Registration

The purpose of having registration of societies, institutions and trusts under the Charities Act 2005 is to promote public trust and confidence in the charitable sector and to encourage and promote the effective use of charitable resources. Importantly, it is the registration process that makes a charity eligible for the concessionary tax treatment.

Charities Services, part of the Department of Internal Affairs, registers and monitors charitable entities, collects, processes and make available publicly annual returns and financial information, investigates serious wrongdoing involving registered charities, supplies information to Inland Revenue and finally supports and educates charities on good governance and management practice. Charities Services also maintain a publicly searchable register of registered charities.

Concessionary Tax Treatments

Favourable tax treatment is provided in the Income Tax Act 2007, primarily through income tax exemptions, including exemptions for both non-business (passive) income and business income (subject to meeting the exemption rules). The Operational Statement provides detailed explanations on the qualifying requirements for these rules. Other tax issues also discussed in the statement include resident withholding tax (RWT) exemptions, fringe benefit tax (FBT) exclusions, goods and services tax (GST) treatments and interest-free student loans concessions. The tax treatment of both Maori organisations and charitable trusts have their own specific rules and the statement discusses these in depth. Finally, the concessionary tax treatment of non-resident charities is reviewed.

Administration

It is important that charities keep sufficient records to calculate any tax liability and/or demonstrate eligibility for tax exemptions or concessions. Depending upon the entity and its activities, this may include receipt and payment account books, bank statements and invoices. Charities must self-assess each year that they still meet the tax concession requirements. They must also comply with the usual GST, PAYE and FBT return filing requirements.

The statement also describes the circumstances when a tax charity will cease and the process for what happens in that regard.

Donee Organisations

Part 2 of the Operational Statement focuses on donee organisations, including the criteria for becoming a donee organisation and the associated obligations. It also includes the benefits available to donors. The main advantage being a donee organisation is the tax benefit it brings to donors who make charitable donations, in the form of tax credits that can be used to offset tax liability. The statement provides details on the specific tax benefits of donation tax credits, payroll giving tax credits and income tax gift deductions.

Types of donee organisations

A "donee organisation" is specifically defined in the Income Tax Act 2007 and is "a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand".

There are four types of donee organisations and the approval of donee status depends on the type of entity. The first type are "most entities registered with Charities Services". To qualify for and maintain donee status, a registered charity must apply its funds "wholly or mainly" to charitable, benevolent, philanthropic, or cultural purposes within New Zealand.

Practically speaking, entities registering with Charities Services are required to indicate if they intend to receive donations and the percentage of the entity's funds that will be applied towards carrying out charitable, benevolent, philanthropic, or cultural purposes overseas. If the registered charity intends to receive donations, then Inland Revenue uses the percentage information to determine whether the entity meets the "wholly or mainly" requirement of section LD 3(2) of the Income Tax Act 2007 and is therefore eligible for donee status, without the registered charity having to make a separate application to the Commissioner.

The second type of donee organisation is an entity with a benevolent, philanthropic, or cultural purpose that is not registered with the Charities Services and has approval by the Commissioner. There are differing requirements for different types of entities to obtain the Commissioner's approval of donee status and the statement provides details on these entities and the requirements. Once approved, the entity is listed in the Approved Donee Organisations list.

The third type of donee organisation is an entity that automatically qualifies by definition. This includes some community housing entities, school Board of Trustees and tertiary institutions. These entities do not need to seek the Commissioner's approval or be on the list of Approved Donee Organisations.

The final type are charities that are approved as donee organisations by Parliament. These entities apply their funds for other than charitable, benevolent, philanthropic, or cultural purposes within New Zealand. The Commissioner will make a recommendation to Cabinet on whether an application should be granted or not and if approved by Parliament as a donee organisation, then the entity is listed in schedule 32 of the Income Tax Act 2007.

Administration

The last part of this statement discusses the importance of record keeping, with all donee organisations required to keep sufficient records of eligibility of tax exemptions and concessions. Donee organisations are also required to self-assess their position and notify Inland Revenue of any changes. If a charity is deregistered and it was also a donee organisation, then it will also lose its donee status.

Overall, the operating statements are quite comprehensive and provide useful guidance on the tax treatment of both charities and donee organisations. Submissions on the draft statements close on 28 February 2022.

While we have summarised the main points above, the tax law around charities and done organisations can be complex and if you need assistance or want to know more, please contact your usual Deloitte advisor.

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When is interest not interest but is income?

By Amy Sexton

Way back in simpler pre-Covid times (2005 to be exact), the Commissioner lost two "income under ordinary concepts" cases in the High Court. In *CIR v Buis and Burston* (2005) 22 NZTC 19,278 (*Buis*) the taxpayers received "interest" on back payments of earnings-related compensation from ACC. While the payments were called "interest" under the then Accident Rehabilitation and Compensation Insurance Act 1992 (now the Accident Compensation Act 2001), as they were not a payment in connection with "money lent" they were not covered by the specific interest income provisions of the then Income Tax Act 1994 (now the Income Tax Act 2007).

After the *Buis* decisions, the Commissioner published a Question We've Been Asked (QWBA) 09/03 *Decisions on application of CA 1(2) - common law interest and income under ordinary concepts* which set out that the Commissioner did not accept an aspect of the decisions; that section CD 5 of the Income Tax Act 1994 (now section CA 1(2) of the 2007 Act) could not apply to tax common law interest payments, because interest could be taxed only under the provision dealing with interest so defined (section CE 1 of the 1994 Act, now section CC 4(1) of the 2007 Act). In the Judge's view, common law interest payments were not taxable because they did not come within the definition of "interest" in section OB 1 of the 1994 Act (now YA 1 of the 2007 Act).

A rethink by the Commissioner

The Commissioner has now had a rethink of the original court decision and QWBA and in December 2021 issued a new draft QWBA for consultation, PUB00414 *Can a payment that compensates for the time value of money be taxable income if it is outside the statutory definition of "interest"?* This QWBA sets out that the Commissioner now considers that the judgment in *Buis* can be read consistently with the Commissioner's existing position on how s CA 1(2) applies. The Commissioner's interpretation of the law has not changed; all that has changed is her view on whether *Buis* is consistent with that interpretation. The Commissioner's view on *Buis* is now:

- The relevant enquiry under s CA 1(2) is whether an amount has the character of income, and this is consistent with the decision in *Buis*.
- The outcome of *Buis* is confined to its particular facts.
- *Buis* does not stand for a broader proposition that common law interest cannot be income under ordinary concepts or income under another provision.
- The decision in *Buis* is not inconsistent with the role of s CA 1(2) as a supplement to the specific income provisions of the Income Tax Act 2007.

But what is common law interest?

Common law interest is a term that is used to describe a payment that is akin to "interest", but the payment is outside the statutory definition of interest. The payments are made to a person to compensate them for the time value of money that is owed to them but are not in relation to "money lent", e.g., "interest" awarded as part of a damages claim or late payment "interest" for settlement of a contract. In the *Buis* case, the payment of "interest" was a payment of a penalty imposed on ACC for administrative delay and inefficiency.

And Income under ordinary concepts?

"Income under ordinary concepts" is a common law catch-all provision that looks to include income receipts that are not specifically provided for in Part C of the Income Tax Act 2007. There are three criteria to be considered when determining if an amount is income under ordinary concepts: income is something that comes in; income imports some notion of periodicity, recurrence, and regularity; and whether the particular receipt is income depends upon its quality in the hands of the recipient.

Don't judge a book by its cover

Just because a payment you have received has been called an "interest" payment does not necessarily mean that it is income. If the payment is not connected to "money lent" and instead is in relation to a damages claim, a penalty or similar, the underlying transaction needs to be considered, to determine if it is in fact income and if it is taxable.

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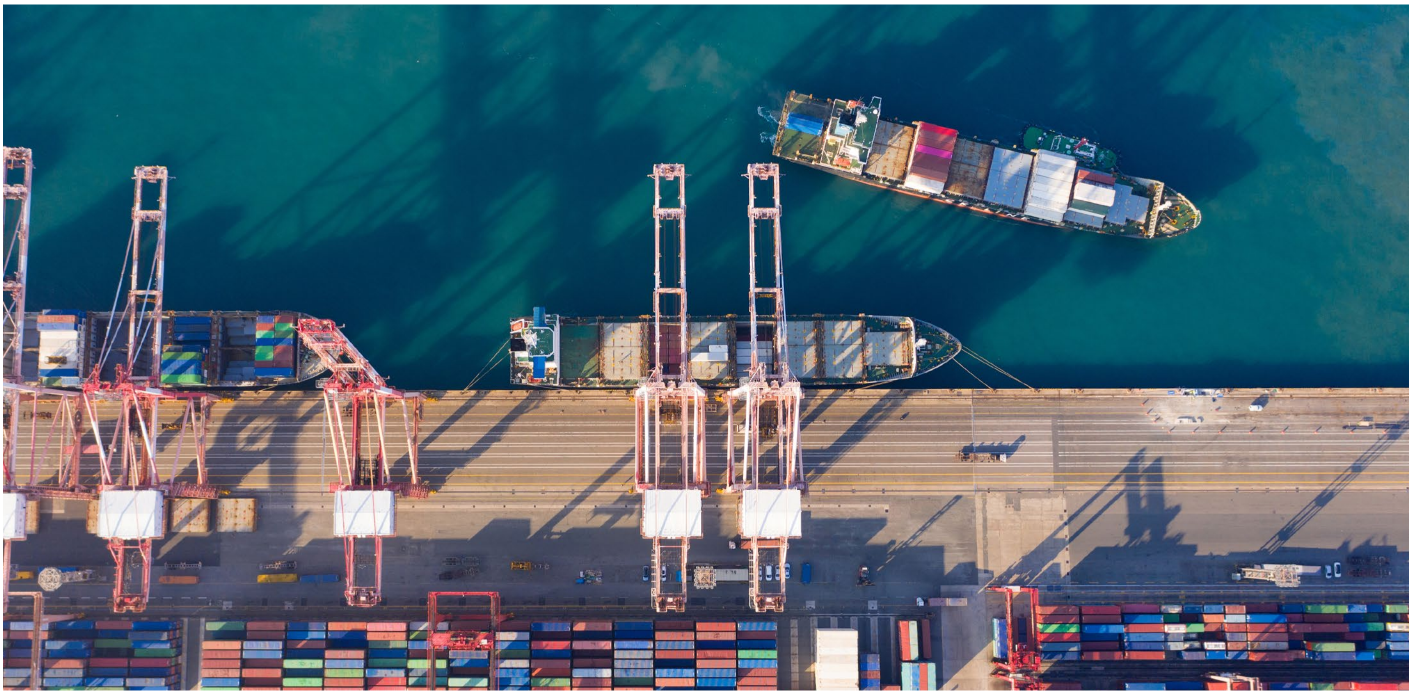
New Regional Comprehensive Economic Partnership takes effect

By Jeanne Du Buisson and Amy Sexton



The Regional Comprehensive Economic Partnership Agreement (RCEP) was signed on 15 November 2020 and took effect on 1 January 2022 after Australia and New Zealand completed their respective ratification processes. RCEP is a free trade agreement (FTA) between 15 member countries in the Asia Pacific region: the 10 ASEAN states (i.e., Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), Australia, China, Japan, New Zealand, and South Korea.

Under the terms of this long-awaited trade deal, at least six Association of Southeast Asian Nations (ASEAN) countries and three non-ASEAN countries needed to ratify the agreement before it can enter into force. In addition to Australia and New Zealand, Brunei, Cambodia, Laos, Singapore, Thailand, Vietnam, China and Japan have also ratified the RCEP with effect on 1 January 2022.

South Korea ratified the RCEP on 2 December 2021 and it is expected to have effect in early February 2022.

Overview of RCEP

Building upon the existing free trade agreements (FTAs) and economic linkages between the member countries, the practical effect of RCEP is to combine them into a single, Asia Pacific regional, multilateral pact. This will significantly reduce the compliance costs of businesses using FTAs and further enhance the trade creation effect brought by them.

RCEP is also the first FTA to connect China and Japan (Asia's largest and second-largest economies respectively) on the one hand, and Japan and South Korea on the other, laying the foundation for deeper cooperation between the three countries in the future.

RCEP is designed to eliminate as much as 90% of the tariffs on goods traded between its signatories within 20 years of the agreement coming into effect and promises to promote substantial increases in intra-regional trade and investment and bring new business opportunities.

The majority of tariffs on goods will reduce to zero immediately or within 10 years, demonstrating each country's strong commitment to liberalisation of trade in goods. Each member country will, in phases, abolish tariffs on specific products imported from other RCEP members, based on their Schedules of Tariff Commitments.

Benefits for New Zealand

- Whilst New Zealand already has several FTAs in place with RCEP members, it is expected that over the first 20 years the RCEP will result in New Zealand's annual GDP growing between 0.3% - 0.6% larger. This amounts to an increase of between NZ$1.5 billion and NZ$3.2 billion.
- New Zealand exporters in primary industries are expected to benefit from expectations that Customs authorities in RCEP countries will release perishable goods within six hours of arrival, helping to reduce spoilage and save money.
- New Zealand exporters will also see benefit from the elimination of tariffs on some food and manufactured goods entering Indonesia.

- RCEP will allow more market access opportunities for New Zealand, especially for services and investment into China and some ASEAN member states.
- Overall, RCEP will enable New Zealand businesses to be better connected via regional supply chains and provide more certainty to exporters in the current uncertain global climate.

Recommendations and opportunities

From a trade in goods perspective, lower tariffs and reduction of non-trade barriers will stimulate the flow of goods, technologies, services and capital. Further, the implementation of unified rules of origin under RCEP will contribute towards greater flexibility for companies to source from a larger pool of suppliers and the choice of where to centralise manufacturing, resulting in more cost-efficient supply chains and more trade connectivity within the region. This will be supported by the increased trade facilitation measures within RCEP that build on the WTO Trade Facilitation Agreement commitments.

From a trade in services perspective, the commitments made by member countries to liberalise services sectors and sub-sectors will encourage more service suppliers who have seen market saturation in their home country to venture out into overseas markets, comforted by regulatory changes that will formally allow market entry into the desired areas. This will further result in greater trade connectivity and integration of businesses operating within the 15 member countries.

Similarly, increased overseas investments are likely in the relevant sectors committed for opening under the investment chapters, whether via direct equity shareholdings or joint ventures with domestic partners. Commitments around freer capital flows will also provide assurance for companies to venture abroad into markets of the other member countries.

Deloitte's Global Trade Advisory specialists are part of a global network of trade professionals who can provide specialised assistance to companies that would like to understand the opportunities presented by RCEP for their business. Our professionals can assist in identifying opportunities under RCEP in several ways, including:

- Deploying Global Trade Radar (a proprietary Deloitte tool) to carry out data analytics on current supply chains and trade flows to map out companies' existing regional footprint, and to examine import/export data filed with customs authorities (i.e., export countries, import countries, product(s) traded, FTAs utilised, opportunities missed, potential compliance areas for companies and others).
- Based on results generated, identifying opportunities under RCEP and the steps required to realise them, whether structural or processes changes are required and other strategic considerations.
- Reviewing production processes, value-adding and other ancillary activities along the supply chain to determine whether goods satisfy the relevant rules of origin prescribed under RCEP, or changes to existing processes and activities are required to benefit from RCEP.
- Obtaining binding rulings from customs authorities in the relevant member countries in respect of matters such as HS classification, valuation, meeting relevant rule of origin requirements, etc., to obtain certainty about eligibility for preferential tariffs before RCEP takes effect.
- Carrying out other customs and trade-related reviews including opportunities to benefit from other trade facilitation measures available under RCEP (e.g., certified exporter registration, AEO certification, harmonised technical standards).
- Assisting with other ancillary matters that may arise during RCEP planning, whether about tariff or non-tariff barriers, the imposition of trade remedy measures, and the use of technology to simplify increasing compliance needs such as deploying GTA Review Smart (a Deloitte proprietary web-based health check tool), Trade Compass (FTA and tariff planning finder) and Trade Classifier (an AI-based HS classification solution).

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Hybrids rules and BEPS disclosures for 2021 tax returns

By Annamaria Mclean and Jeremy Beckham

Most taxpayers with cross-border operations will by now have some familiarity with the hybrid and branch mismatch rules and understand the sorts of arrangements the rules are targeting. Although the rules were enacted in 2018, the last 12 months has seen a number of important developments that will first impact 2021 tax returns and related BEPS disclosures due to be filed on or before 31 March 2022. Taxpayers should be mindful of these latest developments and consider any impact on the tax positions they take.

Additional BEPS disclosure requirements for hybrid mismatch arrangements

The first key development is that Inland Revenue has amended its BEPS disclosure guidance material in a small but significant way for when a BEPS disclosure is required. The guidance now requires New Zealand taxpayers that are subject to the hybrid rules but ultimately have no denial of deductions to still file a BEPS disclosure. Broadly, the BEPS disclosure requires a calculation of the hybrid mismatch amounts and offsets for surplus assessable income as calculated under the rules.

This small change to the guidance has significantly widened the circumstances where a BEPS disclosure must be made. Moreover, because the hybrid and branch mismatch rules were enacted in 2018, taxpayers will need to work backwards through earlier income years to determine their opening balances of hybrid mismatch amounts and surplus assessable income for the BEPS disclosure for the 2021 income year.

Among the taxpayers most impacted by the change are entities doing business in New Zealand via a branch or an Unlimited Liability Company that is treated as transparent for US tax purposes. Such taxpayers that are inbound distributors or service providers for offshore related parties often assume only limited risk and expect to be in a consistent tax paying position under their transfer pricing policies and as a result are unlikely to ever have amounts denied under the hybrid rules. It seems a fair question to ask what disclosure really achieves in these circumstances and we have raised our concerns with Officials at Inland Revenue.

Separately, we have also run into some odd outcomes with the rules not working as intended with New Zealand transparent entities of US multinational groups, to the effect that taxpayers in a taxpaying position may nevertheless have amounts denied under the hybrid rules. This is largely due to the overly prescriptive nature of the rules and it serves to highlight that the positions need to be carefully worked through.

New Zealand taxpayers with outbound branch operations or investments in overseas partnerships will also need to consider whether they are impacted by the new guidance material. In many situations a hybrid mismatch situation is not created if there is no ability to offset the expenditure or loss of the foreign branch or partnership against income of another person or entity (hence a BEPS disclosure is not required). However, there are situations where a BEPS disclosure may still be required so an analysis of the precise facts is important. We have been working closely with New Zealand corporates on these issues and documenting the conclusions reached to support the positions and in case of inquiry by Inland Revenue.

Operational Statement (OS 21/02) on imported mismatch rule now finalised

A second key development is Inland Revenue's now finalised Operational Statement OS 21/02 *Administration of the imported mismatch rule – section FH 11*. OS 21/02 applies from the 2021 income year onwards.

By way of background, the imported mismatch rule is easily the most complex of all of the hybrid rules. It also applies more widely in the 2021 income year to include unstructured arrangements for income years beginning on or after 1 January 2020 (previously only applying to structured arrangements). In broad terms, the imported mismatch rule operates as a backstop, targeted at arrangements involving offshore hybrid mismatches that are imported into the New Zealand tax base via a series of payments that can be traced back to a payment from New Zealand. The rule is extraordinarily wide and can apply to **any** related party payment made from New Zealand that indirectly funds a hybrid mismatch in a foreign country.

OS 21/02 prescribes the approach Inland Revenue expects taxpayers to take to ensure they are complying with the imported mismatch rule in relation to payments to control group members. To comply with their self-assessment obligations, Inland Revenue expects that New Zealand taxpayers will:

1. Identify payments made to non-resident control group members that are tax deductible before applying the imported mismatch rule;
2. Determine whether any such payments are to a person that is in a jurisdiction that has not implemented hybrid mismatch rules equivalent to New Zealand's; and
3. Before claiming a deduction ensure that the group head office tax function has undertaken appropriate work to identify any hybrid mismatches within the group and determine the extent to which these are funded by otherwise deductible payments from New Zealand payers.

For multinational groups that are not headquartered in New Zealand, it is envisaged that the work may be undertaken by persons outside New Zealand. Where this is the case, the Commissioner expects that the taxpayer will obtain from the group's head office tax function a written statement regarding that work. For groups headquartered in New Zealand, the expectation is that the work will generally be undertaken by group employees in New Zealand (or at their direction) and that written evidence is kept.

We have been working closely with both New Zealand head quartered and foreign multinationals to ensure any analysis undertaken of the imported mismatch rule is appropriate and has due regard to the New Zealand context. One thing we have come to appreciate is that the local domestic rules for taxing hybrid and branch mismatch arrangements vary widely between jurisdictions, even if they are all modelled on a common set of OECD recommendations (this includes differences in the Australian and New Zealand hybrid rules). If work has been undertaken offshore, then we strongly suggest taxpayers to work with their New Zealand tax advisors to review the work undertaken to ensure that the same outcomes arise under the New Zealand legislation.

It is worth emphasising Inland Revenue's position that no deduction should be claimed unless it is clear that the imported mismatch rule does not apply on the basis of reasonable enquiry/analysis. OS 21/02 provides that Inland Revenue may make use of specific administrative powers to demand information to satisfy itself that the imported mismatch rule has been appropriately considered and has been complied with (with consequences for not complying with the information demand).

Amendments proposed to imported mismatch rule in new tax bill

A final key development (and a significantly complicating factor in terms of complying with OS 21/02) relates to the amendments proposed to the hybrid imported mismatch rule by the *Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill* currently working its way through Parliament. These amendments are remedial in nature, intended to ensure the imported mismatch rule works as intended and, for the most part, are beneficial for taxpayers. That said, the changes proposed to the legislative wording are not simply minor and when added together arguably amount to a wholesale rewrite of the imported mismatch provision. Most of the proposed amendments are also retrospective in effect and will apply from 1 July 2018.

The Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill is expected to be enacted by 31 March 2022. Given the retrospective nature of the proposed amendments, due care needs to be taken on the application of the rules for tax returns due by 31 March 2022, noting that we are in the position of having proposed legislation that is not yet enacted within months of the tax return filing date. We would hope that Inland Revenue will be pragmatic and accepting of voluntary disclosures that are made regarding the application of the imported mismatch rule for tax returns filed prior to the amendments being enacted.

If you have any queries or would like to discuss this further, please contact your usual Deloitte advisor.

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Snapshot of recent developments

Tax legislation and policy announcements

Inland Revenue's RSP Post Integrity Reviews

In late December 2021, Inland Revenue announced that from the last week of January 2022 they will begin undertaking Post-Payment Verifications (PPVs) on taxpayers who received a Resurgence Support Payment (RSP) from August 2021. PPV's will be issued progressively from late January to the end of March 2022, the work is anticipated to be completed by the end of April 2022. Taxpayers will be required to supply the supporting information (such as bank statements) used to support their revenue drop calculation when making the RSP claim and/or the application of the RSP to business expenses. Where a tax agent submitted the RSP on their clients' behalf the PPV letter will be directed to the tax agent. Where the taxpayer applied directly the PPV letter will be sent directly to the taxpayer. The timeframe to respond to a PPV is **five working days**. If the review determines eligibility criteria or payment conditions have not been met, a repayment may be sought. Deloitte understands that PPV's will only be conducted on a selection of taxpayers.

Issues paper on the forestry aggregation tax issue

On 1 December 2021, the Government released an issues paper Forestry aggregation tax issue with submissions having closed on 31 January 2022. Currently, small and medium sized forest owners benefit from aggregating forests and achieve significant economies of scale when doing so. Formal aggregation involves the sale of individual forest blocks to a new entity (an aggregation entity). However, this formal aggregation triggers the disposal for tax purposes, for example, the disposal of a forest into a new entity would be a taxable event. The tax issue is that the aggregation would bring forward much of the tax liability that would normally arise later, usually at the time of harvest or upon any subsequent sale to a third party.

The proposal is for the tax system to ignore, for tax purposes, the disposal on aggregation where the foresters are simply exchanging ownership of their individual forest interests for an equivalent economic interest in a look through entity. This way, the foresters who received the deduction for planting and growing the forest, continue to be liable for taxation on the harvest or sale proceeds. Feedback was sought on whether the tax impediment to aggregation has been correctly identified and views on other potential options to address it.

EV road user charges exemption extended

Te Manatū Waka Ministry of Transport has completed amending the legislation needed to extend the light electric vehicle (EV) exemption from road user charges (RUC) until 31 March 2024. The previous deadline was 31 December 2021. The RUC exemption will save EV owners around $800 a year and has been extended as part of a package of measures to encourage the uptake of electric vehicles to reduce emissions.

ACC levy changes to ensure financial sustainability

On 10 December 2021, the Government announced changes to the Accident Compensation Corporation (ACC) levy to ensure financial sustainability of the no fault insurance scheme. The levies are currently set $1.39 billion below the projected cost of new injuries each year, which require the small change in levies now to avoid larger levies in the future. Key aspects of the ACC levies for 2022/23, 2023/24 and 2024/25 include:

- Average Work levies paid by employers and self-employed people will decrease from 67 cents to 63 cents per $100 of liable earnings in April and remain at this rate until 2025.
- Average Motor Vehicle levies, which include the annual license levy and petrol levy, will remain at $113.94. Electric vehicles will continue to receive a subsidised levy.
- Earners' levies paid through PAYE (or invoiced directly through ACC for self-employed people) will increase from

$1.21 per $100 to $1.27 next April, $1.33 in 2023 and $1.39 in 2024, excluding GST. The annual prescribed maximum liable earnings increased from $130,911 to $136,544 next April, $139,384 in 2023 and $142,283 in 2024.

Inland Revenue statements and guidance

Controlled foreign company determinations issued – Tower Insurance Limited

On 2 December 2021, Inland Revenue published five controlled foreign company (CFC) determinations. These determinations apply to Tower Insurance Limited. They grant non-attributing active CFC status to the specified insurance CFC residents in the Cook Islands (CFC 2021/01), Papua New Guinea (CFC 2021/02), Fiji (CFC 2021/03), Tonga (CFC 2021/04) and Vanuatu (CFC 2021/05).

Tax on fees paid to a member of a board, committee, panel, review group or task force

On 7 December 2021, Inland Revenue published a general article *GA 21/01 - Tax on fees paid to a member of a board, committee, panel, review group or task force* under the Cabinet Fees Framework published by the Cabinet Office. The document outlines that taxation applies to any fees paid to members depending on the personal circumstances of the individual member and the terms of their contract/appointment. Whether there is a withholding tax obligation will depend on who is treated as receiving that income for tax purposes. If a fee is classified as a schedular payment, the payer has an obligation to deduct withholding tax from the payments before they are made and pay that tax to Inland Revenue. The withholding tax rate on the payment of a fee to member is 33 cents in the dollar unless Inland Revenue has issued an exemption certificate or a special tax rate certificate to the recipient, or the recipient has chosen their own. A payment of fees to a member, in respect of their capacity as a board member, is not subject to GST. However, if a person is carrying on a taxable activity and accepts the appointment to the board as part of that taxable activity, then any service supplied by that person (as a member) is deemed to be supplied in the course or furtherance of their taxable activity. Accordingly, in that circumstance the member can charge GST on the services provided to the board, committee, panel, review group or task force.

Consultation on Available Subscribed Capital record keeping

On 9 December 2021, Inland Revenue released a draft Operational Statement *ED0239 - Available Subscribed Capital record keeping requirements*, with submissions closing on 11 February 2022. Key points discussed include what a dividend is and the purpose of available subscribed capital (ASC). The purpose of calculating ASC is to determine the amount of capital that shareholders have paid into the company when subscribing for shares. The amount is usually returned to the shareholder tax free when there is a repurchase of shares or the company is liquidated. However, there are concerns over the calculation of ASC, particularly in the case of ASC uplift. Often taxpayers been unable to provide sufficient information when requested, as they have not retained sufficient records to substantiate their tax positions taken at the time that distribution was made, especially if the time period between the ASC uplift and distribution exceeds seven years.

The Commissioner's view is that the onus of proof is on the taxpayer to show the basis for their self-assessment is correct (i.e., their tax position that the distribution is excluded from being a dividend because it is sheltered by ASC under s CD 22 or CD 26 of the Income Tax Act 2007). The formula for calculating ASC includes the 1 July 1994 balance date and consideration the company received for the issue of shares after 30 June 1994. Given this requirement, the calculation of ASC can require consideration of circumstances that happened more than seven years ago. A taxpayer taking a tax position based on the company's level of ASC would need to be able to substantiate that ASC calculation, irrespective if the events feeding into the calculation happened more than seven years ago.

New COVID-19 Variation in relation to the definition of "finance lease"

On 14 December 2021, Inland Revenue issued a new COVID-19 Variation *COV 21/06 - Variation in relation to the definition of "finance lease" in s YA 1 of the Income Tax Act 2007*. This variation applies to the time period of "more than 75% of the asset's estimated useful life" referred to in paragraph (b) of the definition of "finance lease" in s YA 1 of the Income Tax Act 2007 is extended to "more than 75% of the asset's estimated useful life plus an additional 18 months" where the term of the lease is extended between 17 August 2021 and 31 March 2022.

This variation is subject to the following conditions:

- The lease was entered into before 14 February 2020.
- The lease term was not more than 75% of the estimated useful life when the lease was entered into.
- The lease term is not extended more than 18 months beyond the end of its term as at 14 February 2020.
- The lease was extended because, in the period between 17 August 2021 and 31 March 2022, the lessee's business has experienced a significant decline in actual or predicted revenue due to COVID-19, and the lessee has been able to extend the lease term in return for reduced or deferred lease payments.

This variation applies from 14 December 2021 to 31 March 2022.

Elections not to depreciate commercial buildings

On 16 December 2021, Inland Revenue published *QB 21/11 – Elections not to depreciate commercial buildings*. Prior to 2021, the depreciation rate for commercial buildings was 0%. However, as part of the COVID-19 response, commercial building owners were able to claim a depreciation loss at either 2% diminishing value or 1.5% straight-line. This statement outlines that where a taxpayer has made an election to treat their commercial building as not being depreciable property, that election is irrevocable, and the taxpayer is bound by that election until the building is disposed of. For this election to be effective, it must be made in writing.

If the taxpayer does not make an election and claims a depreciation loss for their commercial building, then they must continue to depreciate that building at the rate the Commissioner has set. A taxpayer who does not make a written election

and has never claimed a deduction for a depreciation loss on their commercial building may make a retrospective election not to depreciate that building. This election will apply from the date the taxpayer acquired the building.

Calculating a foreign tax credit

On 22 December 2021, Inland Revenue published an *interpretation statement* *IS 21/09* - *Income tax - foreign tax credits - how to calculate a foreign tax credit* under subpart LJ of the Income Tax Act 2007. A New Zealand resident who derives assessable income from a foreign source may be entitled to a foreign tax credit for foreign income tax paid on that income. To calculate the foreign tax credit, the foreign-sourced income is divided into segments. The foreign-sourced income must first be divided by country and then further divided by source or by nature. After the foreign-sourced income has been segmented, the person's notional New Zealand income tax liability must be calculated. A formula is then applied to find the amount of New Zealand tax payable on each segment of foreign-sourced income. Any expenditure incurred must be attributed to each segment, and some adjustments may be required. The person is then entitled to a foreign tax credit for the foreign tax paid on the segment, up to a maximum of the amount of New Zealand tax payable on that segment.

Foreign investment fund

On 5 January 2022, Inland Revenue published a determination *FDR 2021/04* *– A type of interest in a foreign investment fund for which a person may not use the fair dividend rate method (Dimensional Trusts – Global Bond Sustainability Trust NZD Class)*. Any investment by a New Zealand resident investor in the NZD class of units of the Dimensional Trusts Global Bond Sustainability Trust, to which none of the exemptions in ss EX 29 to EX 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income for the interest. This determination applies for the 2022 income year and subsequent income years.

Research and Development Tax Incentive: Guidance

Inland Revenue has updated the Research and Development Tax Incentive (RDTI) guidance. Changes made in this latest version include:

- Refreshed material in response to questions received from stakeholders on topics including eligible R&D activity.
- Updated information on claiming the tax credit, to reflect further progress on operational design.

Inland Revenue has also clarified that core activities begin once taxpayers have identified their scientific or technological uncertainty and decided to take a planned approach to resolving that problem. This means the core activity may start when taxpayers are designing the approach they will take to test possible solutions to the scientific / technological uncertainty.

Inland Revenue Annual Report

Inland Revenue has released its annual report for the year ended 30 June 2021. The following points may be of interest:

- Inland Revenue is always monitoring taxpayer behaviour to identify and address issues early before they become too onerous for taxpayers to deal with and before patterns of behaviour become too established. Inland Revenue adjusts and issues warnings to taxpayers attempting to adjust or repeatedly alter information in their myIR accounts to reduce their tax. This year Inland Revenue prevented over $5 million in incorrect claims for expenses related to residential rental returns and ring-fencing of losses.
- This year $16.4 million in use of money interest has been written off for 94,000 taxpayers; reintroduction of depreciation on commercial buildings from 2020-21 is forecast to provide businesses with $2 billion in 2023-24; 5,000 taxpayers have applied for a loss carry back in the 2019 or 2020 tax year with the monetary benefit of loss carry back being $158.4 million; an increase in the threshold for low value write-offs until March 2021 is forecast to provide businesses with $596 million over 2023-24.
- Inland Revenue has improved the stress of an audit by reducing the time taken to complete a pre-audit review and an audit by an average of 14 days. Inland Revenue has continued to review taxpayers with complex structures or tax interpretation issues. These reviews resulted in tax position differences of $377 million.

Inland Revenue closed approximately 16,140 audit cases, compared to 16,669 in 2019-20 and 12,294 in 2018-19. Across investigations Inland Revenue identified tax position differences of $854 million.

- Inland Revenue can confidently assure a large portion of New Zealand's corporate tax base without needing to default to audits, which are expensive for IR and taxpayers. For instance, only 10% of the Multinational Enterprises contacted this year needed a more in-depth follow-up review.

OECD updates

Global Anti-Base Erosion Model Rules (Pillar Two) Proposals

On 20 December 2021, the G20/OECD Inclusive Framework on BEPS published *Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two)*. A summary of the model rules (known as GloBE) prepared by Deloitte UK and US International Tax experts can be viewed here. The rules aim to ensure that large multinational groups pay corporate income taxes at a minimum of 15% in every country in which they operate. These rules are intended to apply to multinational groups with an annual consolidated revenue of at least EUR750 million in at least two of the four immediately preceding income years.

The Income Inclusion Rule (main rule) applies on a top-down basis so tax due is calculated and paid by the ultimate parent company to the tax authority in its country. The tax due is the "top up" amount required to bring the overall tax on the profits in each country where the group operates up to the minimum effective tax rate of 15%. The Undertaxed Payments Rule applies as a secondary rule in cases where the effective tax rate in a country is below the minimum rate of 15%, but the Income Inclusion Rule has not been fully applied. The top up tax is allocated to countries which have adopted the undertaxed payments rules based on a formula. The annual effective tax rate calculation required for each country considers the total covered taxes, profits, and losses attributable to all the group companies in that country, as calculated under specific Pillar Two rules.

Transfer pricing guidelines for Multinational Enterprises and Tax Administrations

On 20 January 2022, the OECD released the January 2022 edition of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. These guidelines provide guidance on the application of the "arm's length principle" which represents the international consensus on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. This January 2022 edition includes the revised guidance on the application of the transactional profit method and the guidance for tax administrations on the application of the approach to hard-to-value intangibles agreed in 2018, as well as the new transfer pricing guidance on financial transactions approved in 2020.

New transfer pricing profiles for 21 countries

The OECD has released the second batch of updated transfer pricing country profiles for Austria, Belgium, Bulgaria, France, Georgia, Germany, Indonesia, Ireland, Italy, Latvia, Malaysia, Mexico, Peru, Poland, Seychelles, Singapore, South Africa and Sweden. The transfer pricing country profiles contains information on key aspects of transfer pricing legislation and practice. The information on the country profiles reflects the current state of legislation and practice in each country regarding key transfer pricing aspects, including the arm's length principle, methods, comparability analysis, intangible property, intra-group services, financial transactions, and documentation. The New Zealand transfer pricing country profile was published previously and is available here.

Measuring effective Taxation of housing

On 12 January 2022, the OECD released a working paper on *Measuring effective taxation of housing – Building the foundations for policy reform*. This paper measured the effective taxation of housing investments in 40 OECD member and partner countries. The paper finds that the level and components of housing taxation depend greatly on the investment scenario. Effective tax rates vary substantially depending on the holding period, rate of return, tenure (owner-occupied or rented), financing scenario and the inflation rate. The effective tax rates do not vary much with the taxpayer's income and wealth or with the rate of return.

Deloitte Global News Focus

An Australian perspective on the Multilateral Instrument

Deloitte Australia has published a very good summary of the *Australian perspective on the Multilateral Instrument (MLI)*. The MLI is an outcome of the BEPS Action 15 and is designed to swiftly implement the tax treaty-related measures arising from the G20/OECD BEPS project, without the need to renegotiate each double tax treaty. The MLI is expected (over time) to modify more than 1,600 double tax treaties.

The way the MLI impacts a particular double tax treaty will depend upon the respective MLI positions of the two countries – so the impact will differ between treaty to treaty. Generally, it is only where both countries have adopted a MLI position that the MLI will relevantly modify the particular tax treaty. As such, where Australia has opted out of a MLI provision, that provision will generally not impact the relevant treaty, irrespective of the position of the treaty partner.

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

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