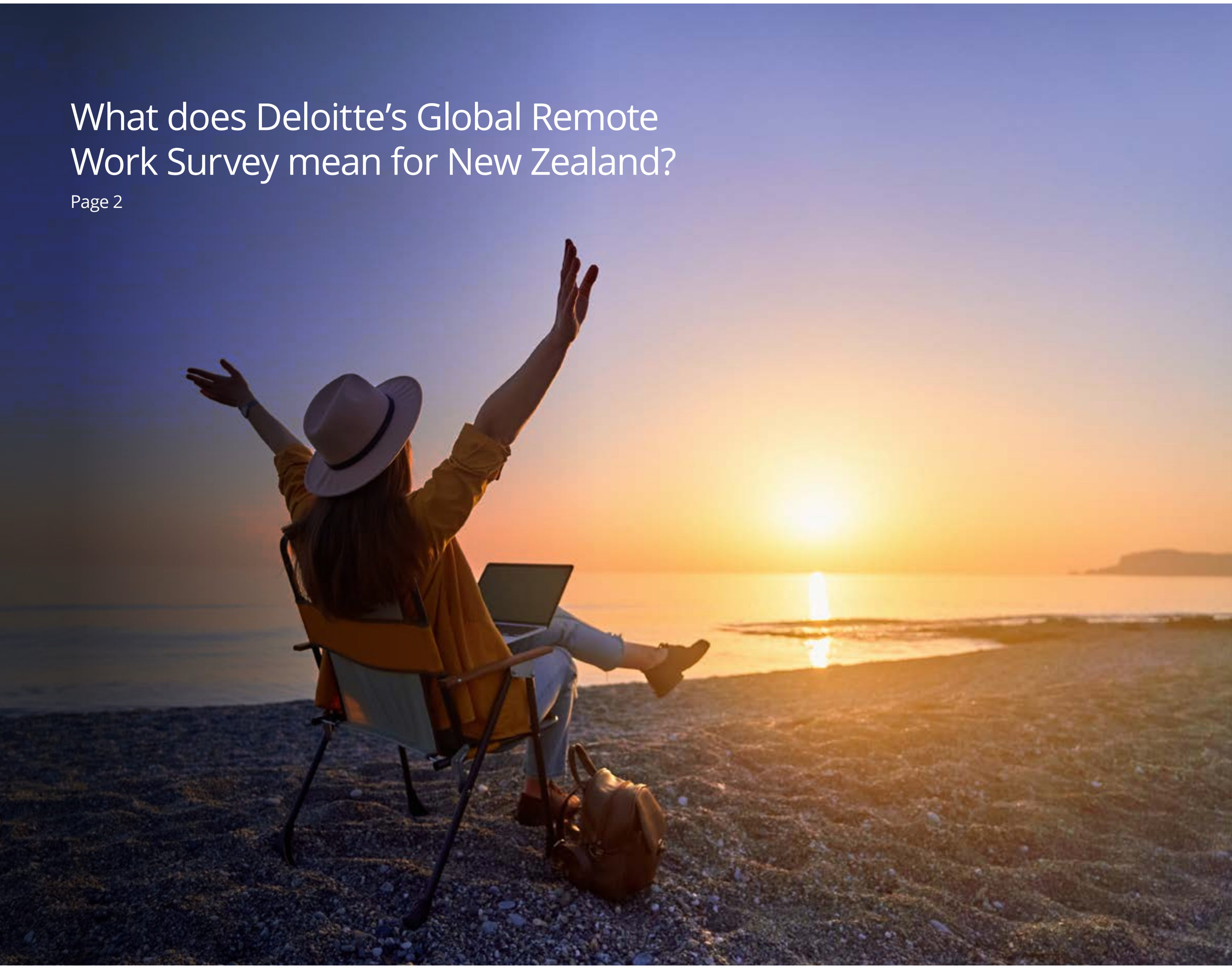
Deloitte.

Tax Alert

February 2023



What does Deloitte's Global Remote Work Survey mean for New Zealand?

What does Deloitte's Global Remote Work Survey mean for New Zealand?

By Stephen Walker

According to the more than 820 tax, HR, mobility, and payroll business professionals from 45 countries who responded to [Deloitte's global remote work survey,] remote work is now considered part of normal working practice; and over 80% of organizations have implemented some form of remote work policy.

Yet, there is evidence of a gap between the ambition behind remote work policies and the actions taken to manage or enforce them. The big challenge many organizations face is how to operationalise their remote work policy in a way that enhances their talent and culture strategies – while managing the complex tax compliance and business risks that can be created by these remote workers and fulfilling their duty of care as an employer.

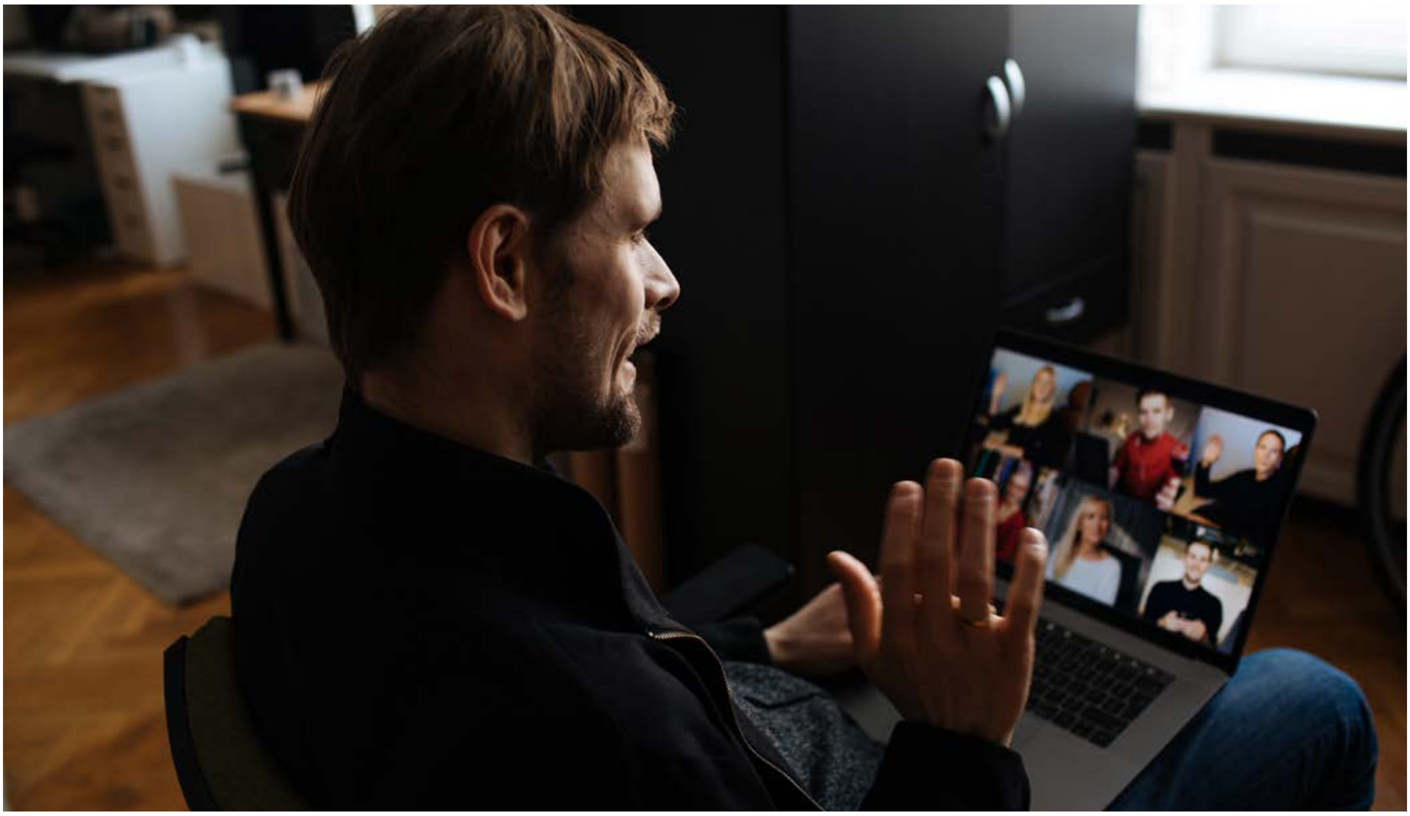
In this article, we explore some of the key survey findings and consider them through a New Zealand lens. If you and your organisation can relate to these findings, it might be reassuring for you to know that you are not alone and help is at hand.

Key remote work survey findings

The majority of organisations are enabling remote work.
Certainly, in the New Zealand setting, we are seeing a substantial increase in the number of clients reaching out to us with questions about how best to implement their remote work policies and manage the various risks that come with it, supporting that remote work is becoming an increasingly popular tool in the talent toolbox for Kiwi businesses.

Remote work is predominately driven by talent pressures.
With the tightening up of the local labour market, New Zealand has been no stranger to the pressures on businesses to seek, attract and retain talent. Coming off the back of the COVID-19 lockdowns, people have been keen to travel again, to reconnect with family and friends. Technology advancements and changes in working practices that occurred during the lockdowns have resulted in an awareness that people can work from almost anywhere, leading many to seek the ability to take their work with them. With many New Zealand employers in the market offering this new way of working, it has become imperative that businesses match or exceed employee expectations in order to stay competitive.

There is tension between talent demands and risk mitigation.
We've seen this play out here in Aotearoa, with the HR teams often seen as the 'good guys' of remote work seeking to offer amazing employee experiences and opportunities to work from anywhere in the world, and the tax or finance function are sometimes seen as the 'bad guys' for highlighting the important and sometimes



significant tax risks and putting the brakes on until these issues have been ironed out – please refer to our article "Hey Boss, can I work remotely...offshore" for more information on some of these key issues. In some instances, we have even seen policies rolled out without any consideration of the tax implications. So this is very much a local issue too.

Implementing guardrails to address legal and compliance risks

In the world of remote work, one thing is clear: There is no "one-size-fits-all" solution to the issues that remote work presents. Each individual has their own set of facts and circumstances that impacts the potential outcomes, and each country's domestic rules and international agreements differ. It is interesting the survey results show that, of those who have implemented a day count guardrail for remote work, 19% have opted for up to 20 days and 17% have not prescribed any time limit. So there is a clear gap in the risk appetites across organisations. In the New Zealand market, we're seeing this play out in the competition for talent. Those organisations with bigger risk appetites, or perhaps smaller and less sophisticated tax and legal support functions, are offering broad and unrestricted remote work opportunities when compared to those with lower risk appetites or larger support functions who are able to investigate and highlight those risks, putting these firms at a competitive advantage in the war for talent; however, the big question is at what cost from a tax risk perspective.

There's a gap between policy inception and rollout and the ability to operationalise and enforce remote work processes.

Whilst many organizations are mindful of the need for compliance and risk mitigation and are trying to do so by defining guardrails, we're seeing that the management and enforcement of these guardrails are still a work in progress for lots of Kiwi businesses, with many either not tracking their remote work requests, or in some cases being unaware of instances of remote work until after the fact.

So what should you be doing now to operationalise your remote work policy?

Combining Deloitte's own experience and those of the companies around the world we've worked with, we've distilled five key actions that Kiwi business need to be taking now to chart their course and progress regarding their remote work strategies:

1. Align your remote work model to organizational strategy;
2. Assess the risks;
3. Identify the routes to enablement;
4. Determine how to best track and govern your remote population; and
5. Stay connected to the long-term talent strategy.

If you would like to know more about these five actions, and how to implement them for your business, please contact your usual Deloitte advisor.

Contact

Stephen Walker
Director
Tel: +64 9 303 0892
Email: stewalker@deloitte.co.nz

"Hey Boss, can I work remotely… offshore?"

By Andrea Scatchard and Mihiri Nakauchi

How many requests have you had from employees wanting to work overseas? How far has your flexible working policy been stretched? Remote working has been the hot topic recently now that COVID-19 has settled down and we have seen a significant shift towards remote working locally in NZ. However, there is now an increasing trend for employees to request arrangements that involve working remotely from overseas. Why wouldn't your employees want to work in Asia while visiting family and friends, or do a big OE in Europe but stay with you for work security and a bigger travel budget?

As we can see from our other article in this Tax Alert, remote working is now seen as part of normal working practice, but this new norm may have unforeseen tax consequences for you as an employer.

Faced with a tight labour market and wanting to retain your existing people, you may be feeling pressured to agree to such arrangements but you ought to consider the tax consequences before agreeing to anything. Employees will also need to consider the potential consequences on their own tax liabilities when working offshore. Below is a short list of only some of the typical tax related issues that may need to be worked through when employees work offshore:

- **Corporate income tax –** having staff members based overseas could lead to a risk that the employer now has a permanent establishment in those countries. This can result in the employer becoming subject to the tax laws of another country and maybe needing to file returns and pay income tax on some of the business's profits. All countries will have their own rules regarding this, and while they are often similar they are seldom the same. So the more countries you have employees working in, the more countries you need to do your homework on to work out whether you have an issue. Often the outcome will be impacted by the type of work employees are doing overseas and the amount of time they spend there so the result may be different for different employees.
- **Payroll withholding –** if an employee will be subject to income tax in the overseas country, then as an employer you may face a withholding obligation similar to our PAYE rules. New Zealand has a unique mechanism (called being an IR 56 taxpayer) which essentially allows some individuals working remotely in New Zealand to calculate and report

- their income and PAYE to Inland Revenue personally, rather than it being done by the employer. However, other countries don't tend to have this mechanism, so who will pay the PAYE equivalent? And if withholding tax is payable in the other country, how will this be funded and should you continue to deduct PAYE from the employee's wages paid in New Zealand?
- **Personal income tax –** is your employee aware of the New Zealand tax consequences of their potential departure? Will they retain their tax residency in New Zealand, or will they become tax resident overseas? Will their New Zealand assets now be taxed overseas, and potentially subject to a capital gains tax? Will they still need to file a New Zealand tax return?
- **Who bears the cost of all of this? –** where employers send staff overseas on secondments or assignments, this is for the benefit of the employer and so they typically pick up the cost of sorting out the tax issues in both the home and host countries. But where offshore working is driven by the employee's desire to travel, is it fair for the employer to bear these costs?

As you can see from the short list above (and there are many more), it can quickly get very complicated. As all countries have their own tax legislation the answer you arrived at for an employee wanting to work from the Philippines for 3 months to reconnect with family and friends is almost certainly going to be different to that for another employee wanting to work from the UK for 8 months to explore neighbouring countries in her weekends.

This makes it very difficult to have generic guidelines and it is likely that each situation will need to be looked at in isolation.

Before you finalise any flexible working arrangements or even have conversations with your employees, we recommend you contact your local Deloitte Tax advisor.

Is it fair for the employer to bear compliance costs where offshore working is driven by the employee's desire to travel?

Contact

Andrea Scatchard
Partner
Tel: +64 78384808
Email: ascatchard@deloitte.co.nz

Mihiri Nakauchi
Manager
Tel: +64 7 834 7878
Email: mnakauchi@deloitte.co.nz

What happens if you fail to disclose FIFs?

By Hester Geel and Kirsty Hallett

Late last year Inland Revenue issued a draft QWBA statement for consultation and discussion clarifying when a taxpayer must use a default calculation methodology to calculate income in accordance with the Foreign Investment Fund ("FIF") rules. Many people may have overlooked this statement in the rush to close out 2022. That said, if the draft statement applies to you, you're highly unlikely to be reading tax interpretations.

Taxpayers who are not correctly filing tax returns may not know what a FIF is, let alone what FIF income is. A FIF is an offshore equity investment, such as into a foreign company, unit trust, managed fund, or exchanged traded fund (ETF) and can include some superannuation schemes and life insurance policies. Inland Revenue provides guidance on FIF investments here.

The methods for calculating FIF income are prescriptive and in most cases choices are limited. However, natural persons and certain trustees are able to choose whether to apply the comparative value method ("CV") or the default Fair Dividend Rate ("FDR") method annually, allowing taxpayers to choose the most beneficial method for calculating income from their Foreign Investment Funds.

A taxpayer chooses which method they are applying for an income tax year by including any FIF income arising under that method in their income tax return.

Where a taxpayer fails to choose a method, the default method must be applied. In most cases, this will be the FDR method which deems 5% of the market value of the taxpayers' attributable interests in FIFs at the beginning of the income tax year to be taxable income (with an adjustment for quick sales), or where no market value is available, the cost method. Neither of these methods take into account the actual movement in the market value of the income tax year which in many cases will be less than 5%.

Draft QWBA

So, what does the statement cover? Draft Questions We've Been Asked PUB00443 "Foreign investment fund (FIF) default calculation method" explains that a person who has failed to declare FIF income in an on-time tax return does not have a choice of calculation methods and **must** use a default method to calculate FIF income if they later file a voluntary disclosure, or file a late tax return.

Inland Revenue will treat a taxpayer as failing to have chosen a method if they:

- File their return by the due date but do not include the relevant FIF income; or
- Do not file their return by the due date for filing.

However, there is no apparent reference in the legislation to a timeframe for making an election as to which FIF calculation method to apply and is a change in interpretation, at least from our experience with Inland Revenue. In the past, we have been dealing with voluntary disclosures or late filings we have seen the use of the comparative value method accepted, despite not meeting the relevant timeframes prescribed above. However, we understand that this is not always the experience for all taxpayers, with divergent interpretations existing within Inland Revenue.

We understand from initial discussions with Inland Revenue that the basis for their interpretation is premised on the wording of section EX 44 of the Income Tax Act 2007 which states that a taxpayer chooses the FIF method to use by completing "their return of income accordingly"; with a return of income not completed correctly if it is not filed on time.

What is the rationale for this position?

Our thoughts:

The draft interpretation put forward by Inland Revenue has raised a number of concerns and is inconsistent with our experience in dealing with Inland Revenue which has prompted us to consider why Inland Revenue is proposing this change now.

- While it is possible Inland Revenue is simply wishing to ensure there is a consistent practice being applied within Inland Revenue, the timing of the statement and direction of the interpretation could also be indicative of the potential for an increase in future targeted review activity. We know that individual tax compliance is a specific focus area for Inland Revenue and with the increased information available to Inland Revenue through cross-border data sharing, the scale of potential non-compliance could be coming to fruition. In its most recent Annual Report, Inland Revenue noted that its compliance focus on offshore income had resulted in contact being made with almost 7,000 taxpayers with the consequence being voluntary disclosures totalling $100 million in omitted income.
- The draft interpretation raises a number of concerns when we consider some real-life scenarios, as this approach is excessively harsh for taxpayers, especially where they have tried to comply and not wilfully ignored their tax obligations. It is also unfair to taxpayers who submitted one day late. This proposed interpretation eliminates the choice of methods for all taxpayers including those who are making efforts to voluntarily comply with their obligations, not just ones who may not be making any efforts to comply. As the rules currently stand, any default assessments issued by Inland Revenue would be issued applying the default methods.
- Inland Revenue is mindful that this approach may impact voluntary compliance and taxpayers' willingness to comply. Taxpayers who have been non-compliant with their FIF obligations and face a large tax bill under the FDR method may choose not to voluntarily correct past mistakes, instead leaving it to Inland Revenue to detect the issue. However, this approach may only have a short shelf-life, as Inland Revenue utilise the information collated through automatic exchange agreements to proactively contact taxpayers to remind them of their tax obligations based on the information they hold (these are known as "nudge letters").
- Should Inland Revenue proceed with this interpretation additional guidance will be required by Inland Revenue as to the evidentiary support required to be retained by taxpayers in situations where the CV method has been applied and no income arises. As the election to use the CV method is made by including the FIF income in the taxpayer's income tax return (or in cases where FIF income is nil, by returning no FIF income), Inland Revenue will not be able to determine whether a taxpayer has omitted to return FIF income or has elected the CV method simply by reviewing the taxpayer's income tax return submission. In most cases, no other FIF disclosures are required to be made to indicate that a method has been selected. Care will need to be taken by Taxpayers to avoid an unfavourable interpretation down the track in the event Inland Revenue undertake any review activity.

We think there are arguments that the interpretation adopted in the draft statement are incorrect, and we will be making a submission to Inland Revenue about this. Submissions close on 10 February 2023 with a final statement anticipated to be released in the first half of this year.

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

The draft interpretation put forward by Inland Revenue has raised a number of concerns and is inconsistent with our experience in dealing with Inland Revenue which has prompted us to consider why Inland Revenue is proposing this change now.

Contact

Hester Geel
Manager
Tel: +64 4831 2460
Email: hgeel@deloitte.co.nz

Kirsty Hallett
Associate Director
Tel: +64 4470 3508
Email: kihallett@deloitte.co.nz

Inflation and personal tax bracket creep – a bigger picture

By Joe Sothcott and Robyn Walker

As mounting inflation continues to cause rising costs for New Zealanders, the term "bracket creep" has become part of the tax vernacular. Bracket creep, also known as "fiscal drag", refers to the inflation-driven movement of taxpayers into higher tax brackets without any real change to their earnings. This bracket creep has contributed to the recent increase in government tax revenue (from $97.4b in 2021 to $107.9b in 2022, and a forecast of $117.4b in 2023). One potential solution to this issue is tax threshold indexation (tax indexation).

What is tax indexation and how would it work?

Tax indexation refers to the adjustment of tax brackets and other tax parameters to account for changes in the cost of living caused by inflation. This is typically done to prevent taxpayers from being pushed into higher tax brackets due to wage inflation, effectively resulting in a tax increase. For example, if inflation results in someone who was earning $48,000 now earning $49,000 with no additional purchasing power, the additional $1,000 of income has had an additional $125 of tax deducted due to the taxpayer being pushed from the 17.5% tax rate to the 30% tax rate for that additional income (i.e. they are worse off).

Current personal tax rates

$0 - $14,000	10.5%
$14,001 - $48,000	17.5%
$48,001 - $70,000	30%
$70,001 - $180,000	33%
$180,000+	39%

The pain of bracket creep is particularly felt when moving from the 10.5% to the 17.5% rate and from 17.5% to 30%.

By adjusting the tax brackets and other parameters for inflation, the government can maintain the real value of the tax system, ensuring that taxpayers are not moving up tax brackets when there is no real movement in true income. This system is intended to be transparent and easy to understand for the benefit of both taxpayers and the government.

Methods of implementing tax indexation vary from country to country. Generally, brackets and parameters are adjusted in reference to a measure of inflation, such as the Consumer Price Index. The tax brackets are then updated by the government, typically on a semi-annual

basis. In New Zealand, this could happen when tax rates and thresholds are set as part of the annual taxation omnibus bill.

Sounds good. What's the twist?

A common criticism of tax indexation is that it reduces government revenue, which may negatively impact the services the central government provides. A reduction in revenue would require spending cuts; if those cuts are too substantial, there is a risk of plunging the country into austerity. Another criticism is that tax indexation can be complex and administratively burdensome for both taxpayers and the government, with constantly changing tax brackets requiring systems and software updates as well as increasing the risk of errors. There is also something nice about having tax thresholds with easy-to-remember round numbers rather than thresholds that would evolve from the application of a formulaic approach.

If tax indexation ever does see the light of day, the implementation of the policy would need to be carefully considered. Some tax policies, such as the Use of Money Interest rates and the Fringe Benefit Tax prescribed rate, are set by formulas linked to movements in Reserve Bank interest rates, so they are effectively indexed to inflation. Inland Revenue has already had to increase these rates several times in the past year to attempt to keep pace with inflation (and will continue to need to do so if interest rates continue to move). Policymakers would not want personal tax thresholds moving more than once per income year, and ideally less often than this.

An inherently political policy

Tax indexation takes up a peculiar political position. Tax indexation every three years was legislated by the Helen Clark Government following Budget 2005, however, the policy never came to fruition as it was replaced with different tax cuts before the rules took effect. More recently, the National Party has proposed a one-off tax indexation policy, however, with the caveat that automatic indexation as part of that policy is still an idea that the National will need to "give some thought". Other political parties don't currently include indexation as a priority. It is also notable that in 1981, the last time inflation was at current levels, the Reserve Bank explored tax indexation as a possible solution. In that instance, the policy was not adopted by the Muldoon government.

To date tax indexation has not been a focus of the current government.

How does New Zealand compare internationally?

Compared to other OECD countries, the statistics tell us that overall, New Zealanders currently pay a low proportion of personal income tax. The tax wedge is a measure used by the OECD to determine what level of tax a country imposes on labour income. This measure includes the tax paid by both the employee and employers as social security contributions. New Zealand currently ranks 36th out of the 38 OECD member countries, with a tax wedge of 19.4% in 2021 compared to the OECD average of 34.6%. However, to contextualise the below average taxes on labour, it's worth noting that OECD analysis also indicates New Zealanders pay a higher proportion of taxes through GST than the OECD average; and New Zealanders also pay more than the OECD average to purchase consumer goods and housing.

The bigger picture

There is an unfortunate tendency to look at tax policies in a vacuum. But individual tax policies are only a cog in a much larger economic machine; therefore, it is important to look at tax indexation in context. The decision to maintain

As noted, tax indexation is a treatment but not a cure for inflation. Indexation may only be a temporary relief for taxpayers as it could fuel more inflation, resulting in a vicious cycle. Other economic policies will always be necessary.

or index tax thresholds will have to be weighed against other considerations, such as wages. Although methodology difficulties are well documented with wage comparisons between multiple countries, some indexes, such as the International Comparison Program, suggest that New Zealand wages are trailing behind comparable countries such as Norway, Ireland, and Singapore. Low wages in New Zealand may be a part of the cost-of-living crisis, and the worry is that maintaining the current tax thresholds might only worsen things.

Not only does bracket creep tighten the cost-of-living squeeze, but the impacts of inflation can also be seen across the economy. Inflation can increase inequality, as those who own assets that benefit significantly from inflation (such as housing) receive an advantage, whilst those reliant on fixed incomes suffer. Inflation also creates significant uncertainty for investors, businesses and individuals, as unpredictable prices and values make it difficult to plan for the future. Finally, rising interest rates can be an expensive impediment to borrowing.

As noted, tax indexation is a treatment but not a cure for inflation. Indexation may only be a temporary relief for taxpayers as it could fuel more inflation, resulting in a vicious cycle. Other economic policies will always be necessary. The Reserve Bank is fighting inflation through monetary policy as it raises the Official Cash Rate to reduce economic activity. Government fiscal policy (i.e., reducing government spending) is another important tool that can be used. Finally, reducing consumer spending or increasing market competition can also help.

So what's the takeaway?

Tax indexation has pros and cons, and all elements of any potential tax indexation policy would need to be carefully considered. That being said, there remains a possibility that tax indexation could be introduced at some point in the future and would be a significant change to our current tax system.

Your usual Deloitte adviser would be happy to help if you have any questions.

Contact

Joe Sothcott
Consultant
Tel: +64 9 956 9916
Email: jsothcott@deloitte.co.nz

Robyn Walker
Partner
Tel: +64 4 470 3615
Email: robwalker@deloitte.co.nz

Don't cry about UOMI

By Joe Sothcott and Veronica Harley

Navigating the use-of-money-interest (UOMI) rules can be tricky for many taxpayers, particularly when it comes to paying and managing provisional tax. As the New Zealand Reserve Bank increases the Official Cash Rate in response to inflation, so too have Inland Revenue's UOMI rates risen. On 17 January 2023, the UOMI under payment rate increased to 9.21% (from 7.96%) while the overpayment rate increased to 2.31% (from 1.22%). So you might be wondering how the rates are set, what triggers an increase and what might be in store for 2023?

What is UOMI?

UOMI is interest that Inland Revenue charges on overdue or underpaid tax payments. UOMI applies to many taxes and duties, specifically income tax, goods and services tax (GST), and fringe benefit tax (FBT), as well as duties such as customs duty and excise duty. But most commonly taxpayers will come across these rules if they pay provisional tax.

If taxpayers fail to pay their taxes on time, Inland Revenue charges UOMI on the outstanding amount. This is in addition to any penalty that might be imposed. UOMI on underpayments of tax is set above market rates to incentivise taxpayers to pay their taxes on time and compensate the government for not receiving the payment when it was due.

UOMI also applies to overpayments. The UOMI overpayment rate is set below market rates as it is intended to be compensatory rather than providing taxpayers with a financial benefit.

While pundits may disagree given the unfavourable rates, UOMI is not actually a penalty. This means interest paid is tax deductible and conversely interest received is assessable.

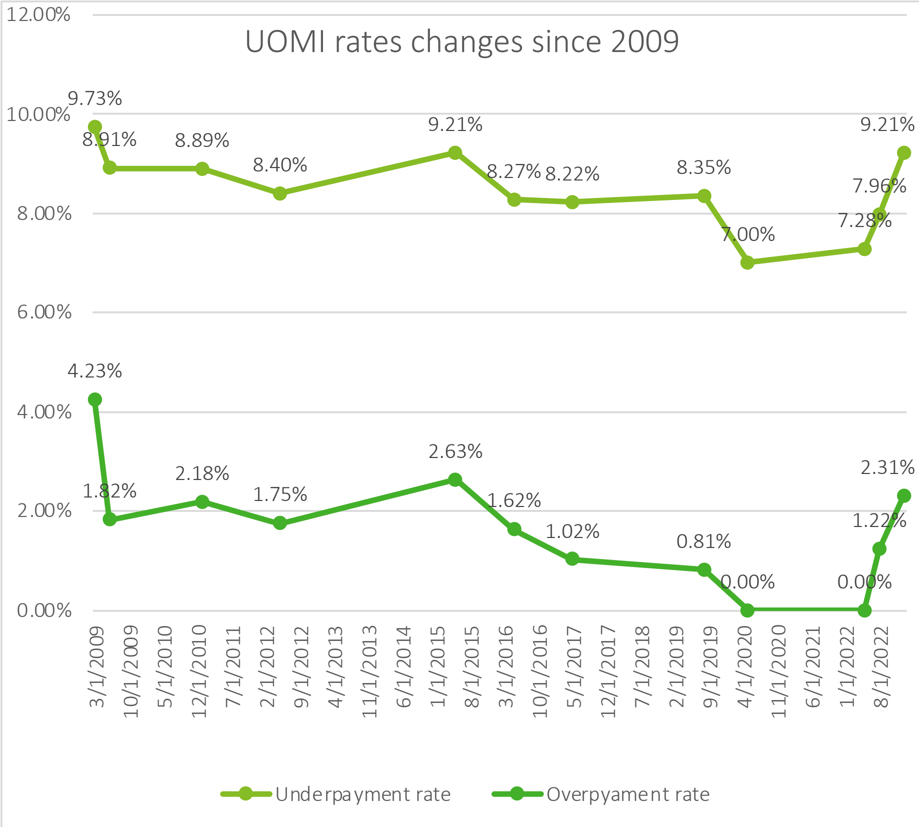
How are UOMI rates set?

The methodology for calculating rates is prescribed in a regulation. The underpayment rate is set as the Reserve Bank's floating first mortgage rate for new customers in the housing market, plus 2.5%. The overpayment rate is either 0% or the Reserve Bank's 90-day bill rate minus 1%, whichever is higher.

An adjustment to the UOMI rates happens when either:

1. The Reserve Bank's 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 1% or more from the figures used to calculate the last rate change; or
2. One of these indexes moves by 0.2% or more, and the UOMI rates haven't been adjusted in the last 12 months.

The effective date of an adjustment to UOMI rates will typically be the day after the next standard method provisional tax payment date. In the most recent increase, 17 January 2023 was the first working day following the second instalment of provisional tax for a March balance date.



What to expect in 2023

This increase in UOMI rates is actually based on data from August 2022 and because of further interest rates rises since this time, (not to mention a potential increase in late February in the Reserve Bank indexes), a further UOMI rise could be on the horizon in 2023. Inland Revenue typically want to avoid a mismatch between the UOMI rates and market interest rates, so it is possible the UOMI rates might increase again with effect from 8 May 2023, being the day following the third provisional tax payment date for the standard method.

So how to manage exposure to UOMI when it comes to provisional tax

Particular rules operate for applying UOMI on provisional tax depend on the level of residual income tax a person has in a year. If the person's residual income tax will be under $60,000 and they use the standard method of calculating provisional tax, then they qualify as a "safe harbour taxpayer". Broadly, the standard method calculates instalments using the prior year's residual income tax. A safe harbour taxpayer can pay all their residual income tax in a single instalment on their terminal tax date and is only liable to pay UOMI after this date has passed.

Taxpayers with residual income tax of more than $60,000 will be "interest concession provisional taxpayers" if the standard method has been used. In this case, UOMI will apply from the day after the final provisional tax instalment is due if there is a difference between the actual residual income tax liability and the total amount paid by the final instalment. As the last instalment of provisional tax occurs after the end of a taxpayer's year (i.e. the 13th month), theoretically the taxpayer should have better information about the year's results and so should check and top up the final instalment amount accordingly if needed. This will limit, or in

This increase in UOMI rates is actually based on data from August 2022 and because of further interest rates rises since this time, (not to mention a potential increase in late February in the Reserve Bank indexes), a further UOMI rise could be on the horizon in 2023.

some cases remove entirely, the amount of UOMI a taxpayer may be subject to.

However, many taxpayers have experienced fluctuating income over the past few years and so making payments based on the standard method throughout the year can be problematic in terms of managing cash flow as the year progresses. In these situations, tax pooling is a great option to consider.

What about tax pooling?

Tax pooling is an invaluable tool for taxpayers as it provides flexibility in managing income tax obligations, which means (amongst other things) taxpayers can pay their tax as and when suits their cashflow. Tax pooling also mitigates the uncertainty of 'uplift' payment obligations, by providing taxpayers with a means of topping up any shortfalls/ missed payments throughout the year. Tax pooling is particularly helpful in our current uncertain and turbulent economic climate and the use of tax pooling is growing steadily. Taxpayers who use tax pooling also reduce their exposure, by up to 30%, to Inland Revenue late payment penalties and UOMI. All of this is Inland Revenue-approved, enshrined in legislation, and has been part of New Zealand's tax landscape since as far back as 2003.

We recently spoke with Tax Traders on current trends in the payment of provisional tax. According to Erik Chamonte, Tax Counsel at Tax Traders, many more larger taxpayers are currently financing their tax (paying a small interest amount upfront, and settling the principal tax amount at a later date) for longer durations than previously (now typically close to, or more than, a year). Erik notes that many SMEs are still financing their tax for shorter durations, but are extending these terms and 'rolling' their finance arrangements out when they mature. It is apparent, from these trends, that keeping cash in the business is paramount to many businesses at present. At Deloitte, we have custom tax pooling software integrated into our system to efficiently access the benefits tax pooling has to offer for our clients.

If you have any queries about UOMI, please get in touch with your usual Deloitte adviser.

Contact

Joe Sothcott
Consultant
Tel: +64 9 956 9916
Email: jsothcott@deloitte.co.nz

Veronica Harley
Director
Tel: +64 9 303 0968
Email: vharley@deloitte.co.nz

Tax Governance is here to stay

By Jodee Webb, Annamaria Maclean and Kirstie Anderson

Tax governance often seems like a boring "tick the box" procedure or something "nice to have" but there is much more to it now, since Inland Revenue's renewed focus on tax governance and the key role tax governance plays in Environmental, Social and Governance (ESG) strategies.

Our March 2022 and October 2021 articles discussed Inland Revenue's renewed focus on tax governance and since then Inland Revenue has issued another round of questionnaires in late 2022, proving that tax governance is a long-term focus area for Inland Revenue.

Tax governance is not only important to Inland Revenue. Other stakeholders are valuing well-documented tax governance and policies when looking at an organisation's ESG metrics. Forsyth Barr illustrated this when they released their Carbon and ESG scores for NZX-listed companies. Companies with a publicly available tax governance policy added 5.6% to their overall rating.

Has Inland Revenue's tax governance campaign changed since the prior year?

While the questionnaire issued by Inland Revenue in 2022 asked the same 10 yes/no questions as the 2021 questionnaire its aim is deeper than solely ensuring an organisation has a tax strategy in place and reviews how it is embedded into systems and processes. Inland Revenue also focuses on senior management (i.e. the CFO) taking responsibility for tax governance.

For both the 2021 and 2022 questionnaires Inland Revenue have provided 'close-out letters', which tend to take one of two forms.

1. To inform the recipient that the review was complete and Inland Revenue had no further questions at this stage; or
2. If the questionnaire indicated the taxpayer is still working on developing/improving tax governance policies and processes, the taxpayer is notified that they are being placed on Inland Revenue's watchlist for six months. After six months, taxpayers in this category are sent a follow-up questionnaire. The follow-up questionnaire asks whether tax governance had been reviewed and documented, and asks for a copy of the documentation. If documentation is complete, taxpayers are asked to supply further information about when it will be completed.

We expect Inland Revenue to continue to issue these questionnaires to all large businesses in due course, and a proactive approach is to review the questionnaire now and consider how your organisation would answer the questions.

Meeting Inland Revenue's tax governance expectations not only helps support organisations' ESG strategies but can also improve an organisation's ESG metrics and ratings by maturing tax governance and transparency approach.

Although there are no penalties imposed for poor tax governance itself, it is a factor that will be taken into consideration by Inland Revenue when determining the frequency of risk reviews/ audits and the level of any shortfall penalties on tax reassessments.

The Deloitte global tax leader survey – How can tax teams help with ESG?
Deloitte surveyed 335 tax leaders globally and found that while tax departments are supporting their businesses' sustainability efforts through compliance and ESG reporting, they can do more to help their organisation accelerate their sustainability goals. The report provides five steps that tax teams can take to input into optimising a business' sustainability performance which is summarised below.

1. **Identify the tax implications of your business ESG strategy**
Compliance and reporting are critical, but there are also tax incentives, savings opportunities, and other sustainability-related benefits that may be available to the business. Additionally, business leaders will need to understand the tax impact of sustainability-related changes to supply chains, business models, mergers & acquisitions and other strategic shifts they may be considering.

    The business will also need to understand the tax implications of new sustainability-related processes and technologies, especially those developed in-house to help factor in the availability of grants or tax credits.

2. **Understand the tax implications of your company's value chain**
For many companies, meeting aggressive carbon and climate change goals will often mean making fundamental changes to operations. As always, these business transformations will have tax consequences. Business leaders should be aware that sustainability-related supply chain changes could require consideration of intellectual property ownership, transfer pricing, GST, and customs impacts.

    These risks and how to navigate them should be understood, but there are also opportunities by way of credits and incentives that could deliver more value back to the business.

3. **Prioritize tax transparency on ESG matters**
The area of ESG moving fastest in tax appears to be the "G". In the Deloitte survey, tax and finance leaders were asked which initiatives were most important to their ability to provide sound tax governance and visibility. Compliance with regulatory requirements for governance topped the list.

    Meeting Inland Revenue's tax governance expectations not only helps support organisations' ESG strategies but can also improve an organisation's ESG metrics and ratings by maturing tax governance and transparency approach.

4. **Transform the tax operating model as it relates to ESG**
Depending on your industry, sustainability will place significant new demands on talent in the finance and tax team and require skills in everything from indirect and transfer taxes to assessing the impact of new carbon-reducing technologies, modelling potential scenarios, and analysing governmental policies.

    In the Deloitte survey, tax leaders provided insights into the factors that would help elevate the tax point of view in sustainability conversations. The list included factors such as "greater collaboration/communication within the organization" and "more resources/information."

    The softer skills of communication and building business cases will be key to working closely with the business. Businesses can consider upskilling and diversifying the roles in their teams, acquiring new talent, increasing automation, and outsourcing/partnering to access the capabilities they need to meet increasing ESG-related business advisory needs and demands.

    ESG illustrates another reason tax department transformation may be required. The focus on transparency and the resource required to support ESG initiatives provides an incentive to free up resources by using digital and artificial intelligence technologies to automate rote tasks such as compliance and filing processes.

5. **Agree on ESG tax and responsibilities**
As businesses revisit their tax operating models to create capacity for ESG-related advisory and compliance activities, this should include clarifying the role of the tax function and how it will interface with the business in these

matters. Sustainability touches on many aspects of the company, and some of those areas may involve taxes that are beyond the traditional mandate of the tax function e.g. handled instead by HR and payroll.

Businesses should clearly establish who is responsible and accountable for ESG tax matters—which can range from (future) environmental taxes to minimum wage issues—and ensure that they have the right level of oversight in areas where they don't have day-to-day control.

Sustainability measures are likely to start to permeate every aspect of business in the not-too-distant future. The ability to embed tax into ESG strategies and investment decisions by having conversations on these topics from the outset can help businesses ensure that value isn't being left on the table.

Deloitte can help you on your tax governance journey, so if you would like to discuss tax governance further and its role in helping your organisation reach its ESG targets, please get in touch with your usual advisor.

Hot off the press: Deloitte Tax Reporting and Transparency Trends

Deloitte UK examined the trends across a sample of the FTSE350 to see how businesses are responding to the transparency and ESG reporting demands from authorities, shareholders and stakeholders. The report and their findings can be found here - https://www2.deloitte.com/uk/en/pages/tax/articles/tax-reporting-and-transparency-trends.html

Contact

Jodee Webb
Partner
Tel: +64 4 470 3561
Email: jowebb@deloitte.co.nz

Annamaria Maclean
Partner
Tel: +64 9 303 0782
Email: anmaclean@deloitte.co.nz

Kirstie Anderson
Associate Director
Tel: +64 9 303 0793
Email: kirstanderson@deloitte.co.nz

ESSTs – what are they and why there is no place for them in the tax system

By Amy Sexton and Robyn Walker

Tax evasion is never acceptable and one of the prices to pay for rapid technology development is the development of tools to aimed at helping those who are not interested in paying their fair share of tax. In mid-December 2022 the Inland Revenue issued Revenue Alert 22/01 *Consequences of acquiring, possessing or using electronic sales suppression tools*. Before then most of you will have never heard of Electronic Sales Suppression Tools (ESSTs) and so this article looks at what ESSTs are and why the Inland Revenue suddenly published a revenue alert.

What are ESSTs?

ESSTs, also known as "Phantomware" and "Zappers", facilitate tax evasion by linking into Point of Sale systems (POS) and manipulating electronic sales records to match the "skimming" of cash receipts, hiding the real revenue of a business and allowing tax evasion. The ESSTs work in several ways, including targeting the integrity of transactions, software, internal memory, external filing, or reporting to delete, change or simply not record selected sales data. The manipulation of the data can either be at the point of sale or afterwards and can produce false records which are then used to underreport sales and profit. To illustrate, a meal at a restaurant may have been \$60 with a \$40 bottle of wine, however, the ESST overrides the POS and records the meal at \$20 with a \$4 soft drink, underreporting the sale by \$76.

Why now?

On 9 December 2022 the Joint Chiefs of Global Tax Enforcement (J5) – which comprises the Australian Tax Office (ATO), the Canada Revenue Agency, the Dutch Fiscal Intelligence and Investigation Service, His Majesty's Revenue and Customs from the United Kingdom and the IRS Criminal Investigation from the United States – announced an international probe into the use of sales suppression software, which resulted in the arrest of five individuals in the United Kingdom who allegedly designed and sold the ESSTs internationally. The J5 announced that the group behind this investigation was suspected of enabling thousands of businesses to evade tax in a large-scale, technologically enabled fraud. The system was allegedly first introduced in the United Kingdom and then exported to the United States and Australia during the COVID-19 pandemic. As part of the coordinated global crackdown, the ATO and Australian police raided 35 businesses across Australia that were suspected of supplying or using ESSTs.

It is almost certain that ESST technology has already found its way into some New Zealand businesses and the Inland Revenue has stated that they are working hard to identify who has been exposed and they will "come knocking".

The Revenue Alert

In 2022 several measures were introduced into the Tax Administration Act 1994 (TAA) to respond to the threat of ESSTs, including a new civil penalty and criminal offences:

- Section 141EE (a civil penalty) establishes the ESST penalty of $5,000 for the acquisition or possession of a suppression tool;
- Section 143BB (a criminal offence) establishes an offence of manufacturing or supplying a suppression tool, with a fine of up to $250,000 on conviction;
- Section 143BC (a criminal offence) establishes an offence of acquiring or possessing a suppression tool, with a fine of up to $50,000 on conviction.

The Commissioner considers the threat from ESSTs to the integrity of the tax system is significant and is therefore increasing his focus on taxpayers who may be thinking of acquiring, creating or using ESSTs, and will consider all options available to him whenever ESSTs are found, including prosecution under the new sections 143BB and 143BC.

As well as the new penalty and offences, the use of ESSTs to reduce the income tax or GST payable is also tax evasion and so the Commissioner also has the tax evasion remedies at his disposal, including:

- Prosecution under section 143B of the TAA for tax evasion, which on conviction, can result in a term of imprisonment of a term not exceeding 5 years, or a fine not exceeding $50,000, or both;
- Imposition of a shortfall penalty of 150% on the resulting tax shortfall (with a previous good behaviour shortfall penalty reduction not being available for evasion penalties); and
- The requirement to pay the actual tax shortfall.

It should also be remembered that the Commissioner is also not able to write off any amounts owing by a taxpayer when a taxpayer is liable to pay a shortfall penalty for evasion and the four-year time-bar period does not apply for tax returns that are fraudulent or wilfully misleading.

Deloitte supports the Inland Revenue in taking a dim view of ESSTs as the use of this type of software is only detrimental to the integrity of the tax system and there is no valid excuse for their use. If you would like to discuss the issues covered in this article, please contact your usual Deloitte advisor.

Contact

Amy Sexton
Associate Director
Tel: +64 9 953 6012
Email: asexton@deloitte.co.nz

Robyn Walker
Partner
Tel: +64 4 470 3615
Email: robwalker@deloitte.co.nz

Snapshot of recent developments

Tax Legislation and Policy Announcements

Student loan annual repayment threshold increases

On 1 December 2022, the Student Loan Scheme (Repayment Threshold for 2023-24 Tax Year and Subsequent Tax Years) Regulations 2022 (SL 2022/316) were notified in the New Zealand Gazette. These regulations, which come into force on 1 April 2023, increase the annual repayment threshold for the purposes of the Student Loan Scheme Act 2011 from $21,268 to $22,828. These regulations also revoke the 2021 regulations.

Excise duties rates adjustment for tobacco products

On 1 December 2022, Excise and Excise-equivalent Duties table (Tobacco Products Indexation) Amendment Order 2022 was notified in the New Zealand Gazette and comes into force on 1 January 2023. The order adjusts the excise and excise-equivalent duties on tobacco products to reflect the movement in the Consumers Prince Index All Groups (less credit services) over the 12-month period ending on 30 September 2022.

Extension of filing deadline – Research & Development Loss Tax Credit Statements

On 22 December 2022, the Tax Administration (Extension of Deadline for Research and Development Loss Tax Credit Statements) Order 2022 (SL 2022/342) came into force. The Order in Council extends the filing deadline under section 70C(2) of the Tax Administration Act for the 2021/22 tax year to 30 April 2023. This new deadline applies to statements that must be filed with the Commissioner of Inland Revenue in relation to:

- Research & Development loss tax credits under the Income Tax Act that a person claims for the tax year
- Research & Development repayment tax that a person must pay for the tax year

Inland Revenue statements and guidance

Draft Questions We've Been Asked: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted

On 1 December 2022, Inland Revenue published PUB00418 - *Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted* (which updates QB 19/03). Submissions on PUB00418 closed on 27 January 2023.

Draft Questions We've Been Asked: Payments made by parents to childcare centres – GST and Income Tax

On December 8 2022, Inland Revenue released two draft QWBA documents (PUB00340 – GST - *Goods and Services Tax – Payments made by parents to childcare centres* and PUB00340 – Income Tax - *Income Tax – Donation tax credits and payments made by parents to childcare centres)* and a fact sheet regarding payments made by parents to childcare centres. These documents provide guidance on how these payments should be treated for the purposes of goods and services tax (GST) and income tax.

For GST purposes, the draft QWBA states that payments made by parents to their child's childcare centre are generally subject to GST at the standard rate of 15% unless the payment is considered an unconditional gift and the centre is a non-profit organization.

For income tax purposes, the draft QWBA states that payments made by parents to a childcare centre that are considered gifts may qualify for a donation tax credit (DTC) if the childcare centre is a donee organization, the payment is at least $5, the payment is made voluntarily to benefit the centre or for a specific purpose or project, and the parent or child does not receive any material benefit or advantage in return for the payment. DTCs are not available for attendance fees or additional charges paid for optional activities or goods.

The accompanying fact sheet includes a flowchart that summarizes the special rules for determining whether payments should be considered donations or fees.

Deadline for comment is on 7 February 2023.

Issues Paper: Charities and business income exemption

On December 8 2022, the Tax Counsel Office published IRRUIP17 - Charities – business income exemption. The paper discusses interpretive and practical issues that charities may encounter when applying the business exemption provided in section CW 42 of the Income Tax Act 2007. This section exempts income derived by a charity that is a "tax charity," and section CW 42 provides the test for determining what "business income" derived by a charity is exempt. However, the wording of this section is capable of more than one interpretation, which can lead to significant differences in the income subject to the exemption and whether that income is exempt or taxable. The paper presents different views on these issues and offers tentative conclusions. The issues discussed include the definition of "business income," the requirements for a charity to be considered as carrying on a business, the role of charitable purposes in New Zealand, and the requirements for a charity to be considered a "tax charity." The deadline for comments on the paper is 17 February 2023.

Inland Revenue update Trust disclosure requirements – trustees that may be able to be excused from filing returns

On 14 December 2022, Inland Revenue advised that the Taxation (Annual Rates for 2022-23, Platform Economy and Remedial Matters) Bil (No 2)l proposes changes to the Tax Administration Act for situations where a trust may be excused from filing an income tax return for a certain year or on an ongoing basis. The changes increase the thresholds of income and expenses, broaden the eligible income types, and introduce new criteria for testamentary trusts. These changes will be retroactive to the 2021/22 income tax year. As the legislative change will not be enacted until late March 2023, Inland Revenue is proposing three filing options to ensure a practical implementation, backdated to apply to the 2021-22 tax year. Trusts that are eligible to be non-active for that year can choose one of the three filing options:

1. File a return and apply the variation by supplying limited disclosure information
2. Complete the Inland Revenue spreadsheet and not file a return
3. File a return and full disclosure of information

If Option 1 or 2 is chosen – the spreadsheet must be emailed to Inland Revenue by 1 March 2023 – trust.disclosure@ird.govt.nz

Questions We've Been Asked: Deducting interest by a close company on a shareholder loan account with unknown amount

On 13 December 2022, Inland Revenue issued QB 22/10 - *Can a close company deduct interest on a shareholder loan account where the amount is not known until after balance date?* Inland Revenue concludes that a close company can deduct interest if it has a legal obligation to pay the interest on the shareholder loan account based on a previously agreed formula or method. The legal obligation, including a method of calculating the liability, must be in place and recorded before the company's balance date. The financial arrangement rules may also apply in determining when the deduction occurs. Resident withholding tax may have to be deducted from the interest payment to a shareholder, although a resident withholding tax credit can be claimed in some cases.

Companies must keep a record of the method they used to determine the amount of interest owing and of the legal obligation to pay the interest.

Inland Revenue update: Goods and Services Tax filing frequency

On 14 December 2022, Inland Revenue advised that from mid-January 2023 approximately 7,000 Goods and Services Tax customers will receive a notice advising that their filing frequency will change in 30 days. Taxpayers currently filing:

- 6 monthly with a turnover of greater than $500,000 - will move to 2 monthly (the change can be disputed within **30 days**).
- 2 and 6 monthly with a turnover of greater than $24m - will move to 1 monthly under section 15C(4) of the Goods and Services Tax Act.

These notices will now be issued periodically to monitor customers who exceed the filing frequency rules to assist customers to comply with current legislation.

Inland Revenue update: Trust disclosures – common errors

On 14 December 2022, Inland Revenue advised they have found several common errors being made in trust income tax returns for the 31 March 2022 income year in relation to the additional reporting requirements. Inland Revenue requests that if you have already filed Trust returns with any of these

Product ruling: Bank of New Zealand

On 20 December 2022, Inland Revenue issued product ruling BR 22/14 - *Bank of New Zealand.* BNZ offers a product (TotalMoney) that allows customers (individuals, companies or trusts only) to group or aggregate accounts for the purpose of either "pooling" or "offsetting" the account balances. The ruling applies in respect of sections BG 1, CC 7, EW 15, EW 21, RE 1 and RF 1 of the Income Tax Act and sections 86F and 86I of the Stamp and Cheque Duties Act 1971.

Inland Revenue update: Medium-scale adverse event for Bay of Plenty of Waikato regions

On 10 December 2022, the Minister for Rural Communities, declared a medium-scale adverse event for the Bay of Plenty and Waikato regions (severe spring frost). Inland Revenue is exercising discretion to allow late deposits for the 2022 year and early withdrawals from the income equalisation scheme.

Inland Revenue update: Medium-scale adverse event for Gisborne/Wairarapa

On 13 and 16 January 2023, the Minister for Rural Communities declared a medium-scale adverse event for the Gisborne and Wairarapa regions, as well as localised flooding and damage across other regions and districts. Inland Revenue will be using its discretion to allow late deposits for the 2022 year and early withdrawals from the income equalisation scheme, as well as providing other support and discretionary relief for affected taxpayers.

Inland Revenue update: Cost of Living letters

On 17 January 2023, Inland Revenue announced that letters would be sent to three groups of customers on 18 January 2023 who received the Cost of Living payments but whose eligibility was unclear. These groups are those who had only negative portfolio investment entity income and received payment incorrectly, those

whose eligibility is unclear, and those who may not meet the eligibility criteria for other reasons. The letters were sent directly to the customers and include advice on how to return the payments.

OECD Updates

Tax revenues rebounded as economies recovered from the COVID-19 pandemic

On 30 November 2022, the OECD published the Revenue Statistics 2022. The report shows that the OECD average tax-to-GDP ratio rose by 0.6% to 34.1% in 2021. This is the second strongest year-on-year increase since 1990. The report also shows that in OECD countries for which 2021 data on tax revenues was available, tax-to-GDP ratios increased in 24 countries, declined in 11 and remained unchanged in one. The recovery in tax revenues in 2021 was driven by corporate income tax and value-added tax. The report also includes a special feature examining the changes in revenues from different tax types in 2020 and 2021.

Consumption Tax Trends 2022

The Consumption Tax Trends 2022 have also been released which highlights that most OECD countries have implemented reforms to guarantee that value-added tax is collected effectively on online sales and in line with OECD standards.

Design elements of Amount B relating to the simplification of transfer pricing rules

As part of the ongoing work of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting to implement the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, the OECD is seeking public comments on the main design elements of Amount B under Pillar One. Interested parties were invited to send their comments by **25 January 2023.**

Tax Database Key Tax Rate Indicators

On 15 December 2022, The OECD release its Tax Database Key Tax Rate Indicators December 2022 brochure. This summary presents information on statutory tax rates and tax rate indicators in OECD countries, including personal income tax rates, social security contributions, corporate income tax rates, and value added taxes. The data covers the years 2021 and 2022, during which many countries have introduced, scaled back, or withdrawn Covid-19 measures.

OECD Investment Tax Incentives Database 2022 update

The OECD Investment Tax Incentives Database (ITID) provides insights into tax incentives in 52 emerging and developing economies, including how incentives are designed and granted to investors. The 2022 update of the ITID shows that:

- Tax exemptions are the most widely used type of corporate income tax incentives in developing and emerging economies.
- · The size, timing, and flexibility of tax relief through tax incentives varies across economies.
- The choice of tax incentive types varies depending on a country's income level.
- Incentives are often targeted based on the sector or location of the investment.
- More than half of all investment tax incentives in the database combine multiple eligibility conditions.
- The governance of investment tax incentives is complex, with multiple authorities involved in granting and administering them.
- Over a third of incentives can be linked to sustainable development goals, with a focus on environmental impact, employment, and social inclusion.

OECD plans workstream to address worker mobility tax questions

On 9 January 2023, the OECD announced it is considering how to tackle a number of worker mobility and taxation questions, including issues related to transfer pricing, treaties, tax coemption and pensions. There is currently no timeline for the work.

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

New Zealand Directory

Auckland Private Bag 115033, Shortland Street, Ph +64 (0) 9 303 0700
Hamilton PO Box 17, Ph +64 (0) 7 838 4800
Rotorua PO Box 12003, Rotorua, 3045, Ph +64 (0) 7 343 1050
Wellington PO Box 1990, Ph +64 (0) 4 470 3500
Christchurch PO Box 248, Ph +64 (0) 3 363 3800
Dunedin PO Box 1245, Ph +64 (0) 3 474 8630
Queenstown PO Box 794 Ph +64 (0) 3 901 0570
Internet address http://www.deloitte.co.nz

Sign up to Tax Alert at Deloitte.co.nz

Queries or comments regarding Alert including joining our mailing list, can be directed to the editor, Amy Sexton, ph +64 (9) 953 6012, email address: asexton@deloitte.co.nz.

This publication is intended for the use of clients and personnel of Deloitte. It is also made available to other selected recipients. Those wishing to receive this publication regularly are asked to communicate with:

The Editor, Private Bag 115033, Shortland Street, Auckland, 1140. Ph +64 (0) 9 303 0700.