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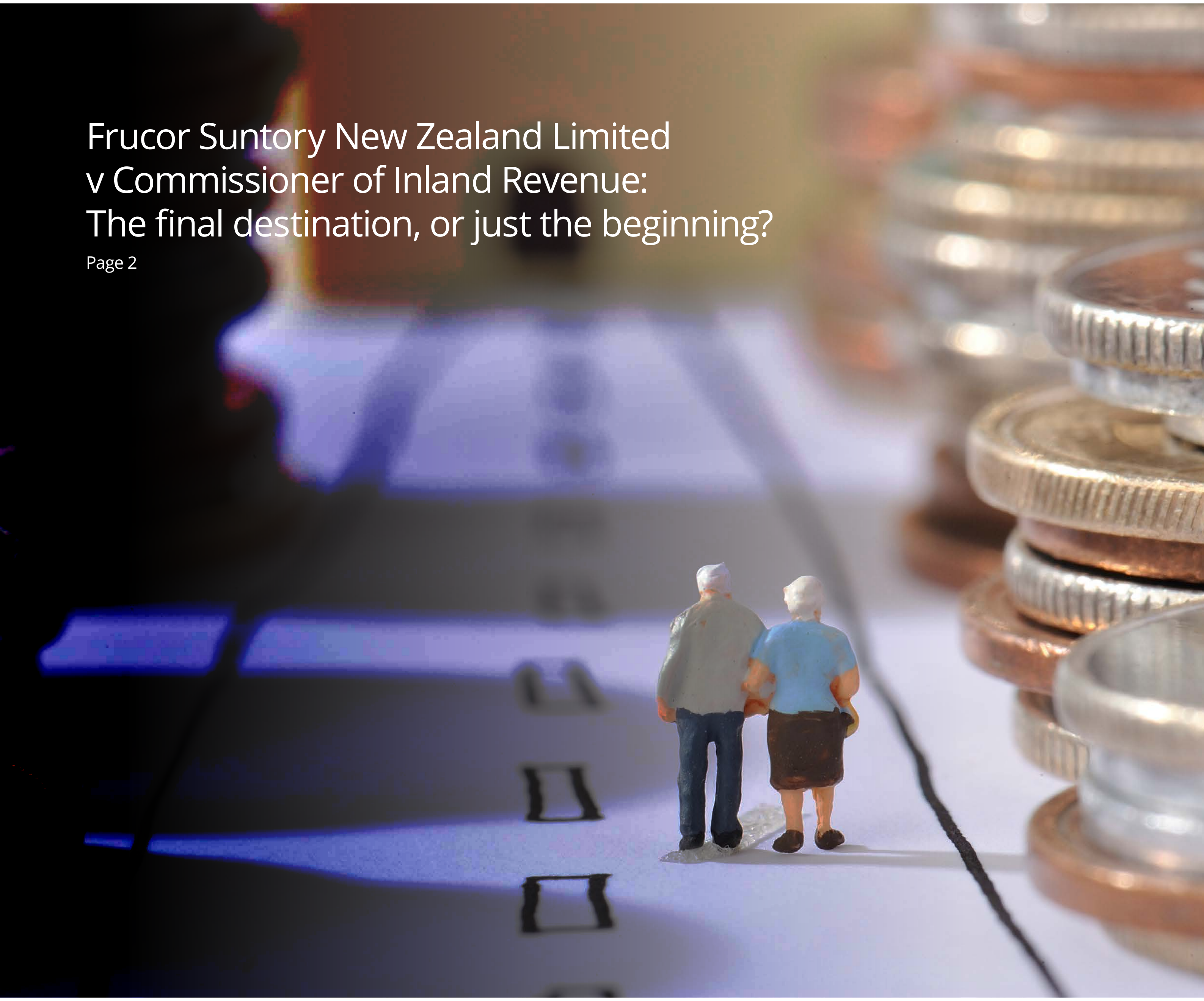
Tax Alert

October 2022



Frucor Suntory New Zealand Limited v Commissioner of Inland Revenue: The final destination, or just the beginning?

Frucor Suntory New Zealand Limited v Commissioner of Inland Revenue: The final destination, or just the beginning?

By Patrick McCalman and Claudia Layton

After much anticipation, the Supreme Court delivered its judgment in Frucor Suntory New Zealand Limited v Commissioner of Inland Revenue (*Frucor v CIR*) on 30 September 2022, signalling the end of over ten years of litigation. The Supreme Court upheld the Court of Appeal's decision that Frucor Suntory New Zealand Limited (Frucor) entered into a tax avoidance arrangement, but overturned the Court of Appeal's decision in respect of shortfall penalties, finding that shortfall penalties should be imposed as Frucor took an unacceptable tax position.

Facts

The key facts can be summarised as follows:

- Frucor (previously Danone Holdings NZ Ltd) acquired all the shares in Frucor Beverages Group Ltd in 2002. Two Frucor-related entities provided funding to Frucor to effect the acquisition. Danone Asia Pte Ltd provided $150million in equity funding and Danone Finance SA provided $148million in debt funding.
- The above arrangement was restructured in 2003 as follows (the funding arrangement):
  - Deutsche Bank advanced $204million to Frucor in exchange for a convertible note (the Note) with a maturity of 5 years at an interest rate of 6.5% per annum.
  - Frucor used the $204million advance to repay $144million of debt owed to Danone Finance SA and to redeem part of the Danone Asia Pte Ltd equity for $60million.
  - $55million of the $204million provided by Deutsche Bank came from its internal treasury. The remaining $149million came from a forward purchase agreement by Danone Asia Pte Ltd for $204million worth of shares in Frucor upon maturity of the Note.
- Over the Note's tenure, Frucor paid interest totalling $66million (being 6.5% of $204million, per annum). Frucor subsequently took deductions for these amounts in its income tax returns.

The issues before the Supreme Court were whether:

- The funding arrangement was a tax avoidance arrangement under s BG 1(1) of the Income Tax Act 2004 (the Act);
- The Commissioner of Inland Revenue (the Commissioner) was entitled to reconstruct Frucor's tax position to disallow a portion of the deductions Frucor took; and
- Frucor's tax position (that the funding arrangement was not tax avoidance) was "about as likely as not to be correct" per s 141B(1) of the Tax Administration Act 1994 (the TAA) and relatedly, whether shortfall penalties under s 141D of the TAA should be imposed.

Justice Glazebrook considered the funding arrangement was not tax avoidance and, even if it was, shortfall penalties should not be imposed as Frucor's position was "about as likely as not to be correct."

The decision of the High Court

The High Court found that the funding arrangement was not tax avoidance, as the purpose of the funding arrangement was to adjust Frucor's debt/equity ratio. Justice Muir concluded that even if he was wrong in his findings, he would not have imposed shortfall penalties on Frucor on the basis it had not taken an unacceptable tax position.

We have previously commented on the High Court's decision.

The decision of the Court of Appeal

The Court of Appeal overturned the High Court judgement and concluded that the funding arrangement amounted to tax avoidance. The Court dismissed the Commissioner's cross-appeal on shortfall penalties, however, concluding that Frucor had not taken an unacceptable tax position.

We have previously commented on the Court of Appeal's decision.

The Decision

The Supreme Court decided 4-1 in favour of the Commissioner in respect of both the funding arrangement being tax avoidance and the imposition of shortfall penalties.

Tax avoidance

The majority considered whether the funding arrangement was a tax avoidance arrangement by undertaking an 'economic substance' analysis. The majority analysed the funding arrangement at the Group level (i.e. the transactions of Frucor, Danone Asia Pte Ltd and Danone Finance SA as a whole), concluding that the 'separate entity principle' (i.e. looking at the transactions of Frucor as a standalone entity) should not be followed when considering tax avoidance.

By analysing the funding arrangement at the Group level, the majority found that Frucor had, in 'economic substance', borrowed only $55million (being $204million less $149million from the forward purchase agreement), not $204million, from Deutsche Bank. As such, the majority found that the $66million of 'interest' Frucor paid over the tenure of the Note was not purely interest payments, but instead consisted of repayment of the $55million principal and $11million of interest. In doing so, the majority adopted a very broad assessment of the economic substance of the transaction, seeing the Note as akin to equity even before its conversion.

The Act allowed deductions to be taken for interest payments made, but not repayments of principal (deduction provisions). After finding that $55million of the $66million payment related to principal repayments, the majority concluded that the tax advantage Frucor obtained by deducting principal repayments resulted from use of the deduction provisions outside Parliament's intention. As such, the majority concluded the positions taken by Frucor constituted tax avoidance.

As the use of the deduction provisions was found to be tax avoidance, the majority held the Commissioner was entitled to reconstruct Frucor's interest deductions, denying $55million of the $66million paid.

Shortfall penalties

To impose shortfall penalties, the Supreme Court had to find that Frucor's application of the deduction provisions was not "about as likely as not to be correct" in respect of Parliament's intention behind the deduction provisions.

The majority assessed this on the facts as they found them. Based on the finding that Frucor did not "suffer the economic burden" of expenditure that the deduction provisions provided for, Frucor's position was not "about as likely as not to be correct" and the majority imposed an abusive tax position penalty of 100% of the tax shortfall (finding that tax avoidance was the dominant purpose of Frucor).

Dissenting judgment

Justice Glazebrook considered the funding arrangement was not tax avoidance and, even if it was, shortfall penalties should not be imposed as Frucor's position was "about as likely as not to be correct".

Justice Glazebrook agreed with the majority that in economic substance Deutsche Bank provided $55million to Frucor, however, disagreed with the majority's deviation from the 'separate entity principle', finding that by paying $66million to Deutsche Bank, Frucor bore an economic burden of $66million. Justice Glazebrook concluded that the fact $149million of the $204million was provided to Deutsche Bank through the forward purchase agreement by Danone Asia Pte Ltd did not change Frucor's actual outlay or economic burden.

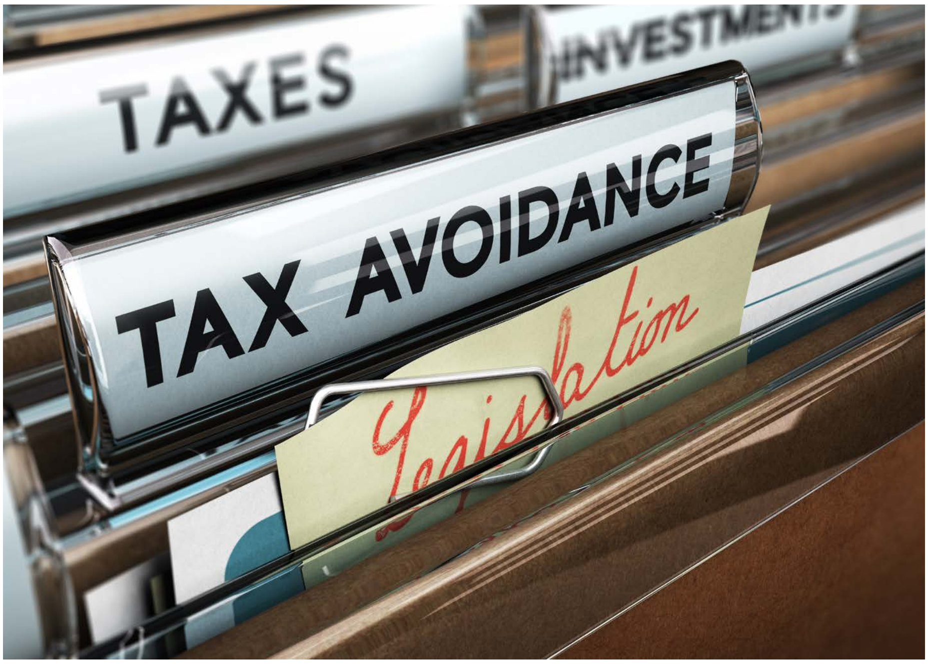
Based on the above, and the fact that if Danone Asia Pte Ltd lent $204million at 6.5% interest per annum directly to Frucor the same tax effect would have resulted, Justice Glazebrook concluded the funding arrangement and the interest deductions taken by Frucor were within Parliament's contemplated purpose of the deduction provisions.

Justice Glazebrook concluded that even if the funding arrangement was tax avoidance, she would not have imposed shortfall penalties, based on the finding that as Frucor paid $66million, it suffered the burden of expenditure Parliament contemplated under the deduction provisions. As such, Justice Glazebrook concluded that Frucor's tax positions were "about as likely as not to be correct" and therefore, were not an unacceptable tax position.

Our comments

Tax Avoidance

Despite confirming the two-step approach to analysing tax avoidance as set out in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*, the majority focused on the impression of the funding arrangement, rather than detailed consideration or analysis of whether



the funding arrangement was outside Parliament's contemplation (which *Ben Nevis* specifically provides). It also adopted a very broad assessment of the "economic substance" of the arrangement and in doing so was quite willing to move away from seeing each taxpayer in the transaction as a stand-alone taxpayer with different choices and tax impacts. This was in stark contrast to Justice Glazebrook's approach.

This impression-focused approach has become a theme in tax avoidance cases in recent years and *Frucor v CIR* continues the trend against the taxpayer, firmly signalling that New Zealand tax avoidance cases will be decided not only on a review of the legal principles but an impression of the facts of the case as a whole. Coupled with the broad approach to examining the economic substance of the transaction it might be said that the decision moves the tax avoidance boundary even further in the Commissioner's favour.

Shortfall Penalties

Shortfall penalties were never intended to be imposed on every taxpayer who entered a tax avoidance arrangement, instead only being imposed when a taxpayer enters a transaction that has no credible argument that the arrangement was not tax avoidance. The potential (and alarming) effect of Frucor v CIR is that if there is a tax avoidance arrangement, shortfall penalties will almost always be imposed. As noted by Justice Glazebrook, this is inconsistent with the scheme of the shortfall penalty regime.

Given 5 out of the 9 judges who delivered judgments in the Frucor v CIR litigation (Muir J in the High Court, Kós P, Gilbert and Courtney JJ in the Court of Appeal, and Glazebrook J in the Supreme Court) found Frucor's position to be "about as likely as not to be correct", the imposition of penalties on Frucor seems out of step with the policy intent of the shortfall penalty regime.

When the impression-focused approach to tax avoidance is coupled with the majority's willingness to impose shortfall penalties, the shortfall penalty regime as it stands following *Frucor v CIR* is concerning. For a shortfall penalty for abusive avoidance to apply there needs to be the absence of an acceptable interpretation. It is clear from this framework (and from the extrinsic materials when the regime was introduced) that penalties were not intended to apply to all cases of tax avoidance. However, if the basis of the assessment of the acceptable interpretation threshold is now to be tested on an assessment of the facts under an economic substance test, it will be very rare that an acceptable interpretation will be reached. Accordingly, we consider it critical that the shortfall penalty regime be reviewed by Inland Revenue from a policy perspective to ensure that it is meeting its original policy objective, given the way in which the Supreme Court has said the assessment of an acceptable interpretation is to be undertaken.

Final thoughts

It is unlikely that the Supreme Court will decide on another tax avoidance case in the next few years, meaning *Frucor v CIR* will be the leading tax avoidance authority for some time. It is therefore critical that taxpayers consider how to safeguard their tax positions. This is important not only because of the continued evolution of the tax avoidance boundary but because the outcome of *Frucor v CIR* now has the potential application of moving taxpayers faced with an assertion of tax avoidance to a "double or quits" world. With binding rulings now being more readily available, binding rulings or other interactions with the Inland Revenue to achieve certainty (or a degree of certainty) of tax outcomes now merit even more serious consideration. Please contact your usual Deloitte advisor if you have any further queries.

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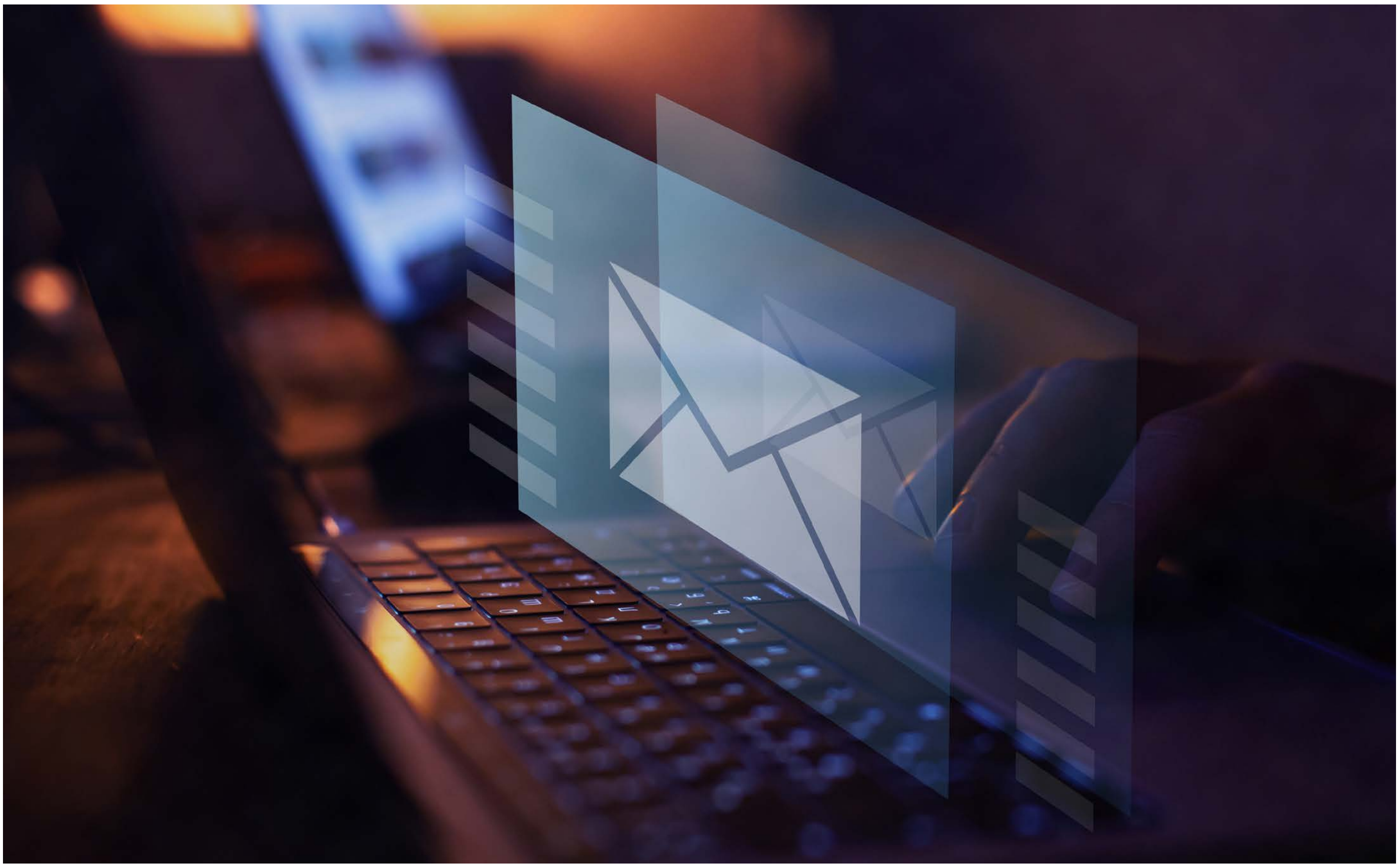
"You have mail" – What to expect from Inland Revenue

By Robyn Walker and Amy Sexton



Inland Revenue is in the process of contacting taxpayers about a range of tax matters, requesting information or providing educational material. So, what might soon be appearing in your myIR inbox?

COVID-19

Inland Revenue undertook some integrity checks prior to making payments under the various COVID-19 support payments and Small Business Cashflow Loan Scheme, but now that the dust has settled, Inland Revenue has undertaken some post-payment verification reviews. Taxpayers will be contacted where Inland Revenue has identified that some of the eligibility criteria may not have been satisfied and the taxpayer will be asked to re-confirm eligibility or to declare an error has been made and take steps to rectify it.

You can find further details about the COVID Support Payment and Resurgence Support Payment on our website, details of the eligibility criteria for the Small Business Cashflow Loan Scheme are available here.

If you have concerns about your eligibility for any payments received, please contact your usual Deloitte adviser to discuss these concerns further before making a declaration.

Fringe Benefit Tax – Common errors campaign

The FBT Stewardship Review revealed that Inland Revenue was planning to undertake an educational campaign to raise awareness of how FBT operates and the common errors Inland Revenue sees. SME and Micro businesses who are registered for FBT should expect to receive a letter in October.

The common errors which Inland Revenue call out are:

- Incorrectly treating a motor vehicle as being exempt from FBT under the work-related vehicle exemption.
- Not completing the FBT return correctly, including not including the taxable value of benefits provided.
- Calculating the GST adjustment based on the amount of FBT payable rather than the taxable value of the fringe benefits, and not correctly adjusting for benefits that don't include GST.
- The different treatment which can apply to benefits provided to shareholder-employees.
- Over or understating employee contributions towards fringe benefits, and therefore incorrectly calculating the taxable value of a fringe benefit.

- Understating FBT by incorrectly completing the complex alternative rate FBT calculations.

We commonly see a number of other FBT errors, you can read about these in our previous Alert article.

GST

Later this month Inland Revenue will begin contacting businesses to let them know about recent and upcoming changes to invoicing and recordkeeping rules. Overall, these changes are designed to relax previous prescriptive documentation requirements and to help facilitate businesses to move into e-invoicing.

As a generalisation, anyone who is currently issuing tax invoices, credit notes, etc that comply with the current rules, will also satisfy the requirements under the rules which apply from 1 April 2023. However, the key issue is that accounts payable processes will need to adapt to recognise and accept "taxable supply information" from suppliers who have moved to the new rules.

For more information about what is changing you can refer to our previous Alert article or read Inland Revenue's guidance.

Transfer Pricing Compliance Campaign

Larger multinational businesses will be used to receiving regular questionnaires from Inland Revenue, and the latest request for information is expected to be issued this month. Inland Revenue's latest campaign will be focusing on transfer pricing documentation. Selected taxpayers will be asked to provide a copy of existing transfer pricing documentation, which will be reviewed by Inland Revenue before determining whether more in-depth review work is required. Copies of documentation will be due to Inland Revenue by late November.

While there is no explicit statutory requirement to prepare or file New Zealand transfer pricing documentation, the burden of proof is on the taxpayer and therefore documentation is (in effect) required. Inland Revenue has previously stated that a failure to prepare adequate transfer pricing documentation can result in a 40% shortfall penalty for gross carelessness if there are problems with associated party transactions. You can find more information about transfer pricing documentation in our previous Alert article.

Please contact your usual Deloitte advisor if you would like to discuss any of the topics in this article.

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Will your transfer pricing documents stand up to increased scrutiny?

By Bart de Gouw, Melanie Meyer and John Alcantara

Most of the movements of goods and services in the world are governed by principles of transfer pricing. Essentially, transfer pricing refers to setting the prices for cross-border transactions between related parties. This can cover a wide variety of transactions including an arrangement that involves the supply or acquisition of goods, services, money and intangible property. Transfer pricing is a tool used to ensure the profits reported by a member of a multinational enterprise (MNE) is an actual reflection of the economic activity of that entity in the particular country.

The main principle that needs to be followed in setting the price for these related party transactions is that pricing should be on an "arm's length basis." Generally, the "arm's length principle" is satisfied if a related party pays to the other member of the MNE group an equivalent price that would be charged to a third party in a similar economic circumstance.

The OECD provides guidelines on how MNEs are to price these transactions. The most recent iteration of the OECD guidelines contains 658 pages of explanation on the arm's length principle, methods of transfer pricing, comparability analysis, and documentation requirements. The guidelines also contain granular rules on the pricing of intangibles, intra-group services, cost contribution arrangements, and business restructurings. These rules are aimed at preventing profit shifting, by ensuring that the taxable profits of MNE group members reflect their true economic circumstances.

A core principle of these rules is that MNE groups should consider, and document, the relevant facts and circumstances surrounding the pricing of transactions between related parties. The so-called "transfer pricing documentation" has three objectives (set out in the OECD Guidelines):

- To ensure that taxpayers consider the transfer pricing requirements;
- To provide tax authorities with the information necessary for a transfer pricing risk assessment; and
- To provide useful information in conducting an audit of transfer pricing (supplemented with additional information as the audit progresses).

Further, the OECD guidelines advocate for a three-tier standardised approach to documentation:

- A master file, which provides an overview of the global operations;
- A local file, which provides more detail relating to the specific intercompany transactions; and
- A country-by-country report, which contains aggregate data for countries.

Recently, the Inland Revenue has launched a campaign focusing on compliance with the transfer pricing rules by requesting taxpayers to submit their transfer pricing documentation. Taxpayers who are part of a MNE group should regularly review their transfer pricing documentation to ensure it is date and fulfils the objectives outlined above. Documentation that is not up to scratch leaves taxpayers vulnerable to increased audit activity by the Inland Revenue and should an adjustment result, be exposed to shortfall penalties and interest. If you have questions about your transfer pricing documentation please contact Bart or Melanie for further discussion.

Taxpayers who are part of a MNE group should regularly review their transfer pricing documentation to ensure it is date and fulfils the objectives outlined above. Documentation that is not up to scratch leaves taxpayers vulnerable to increased audit activity by the Inland Revenue and should an adjustment result, be exposed to shortfall penalties and interest

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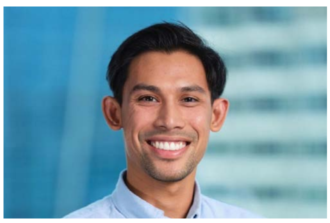

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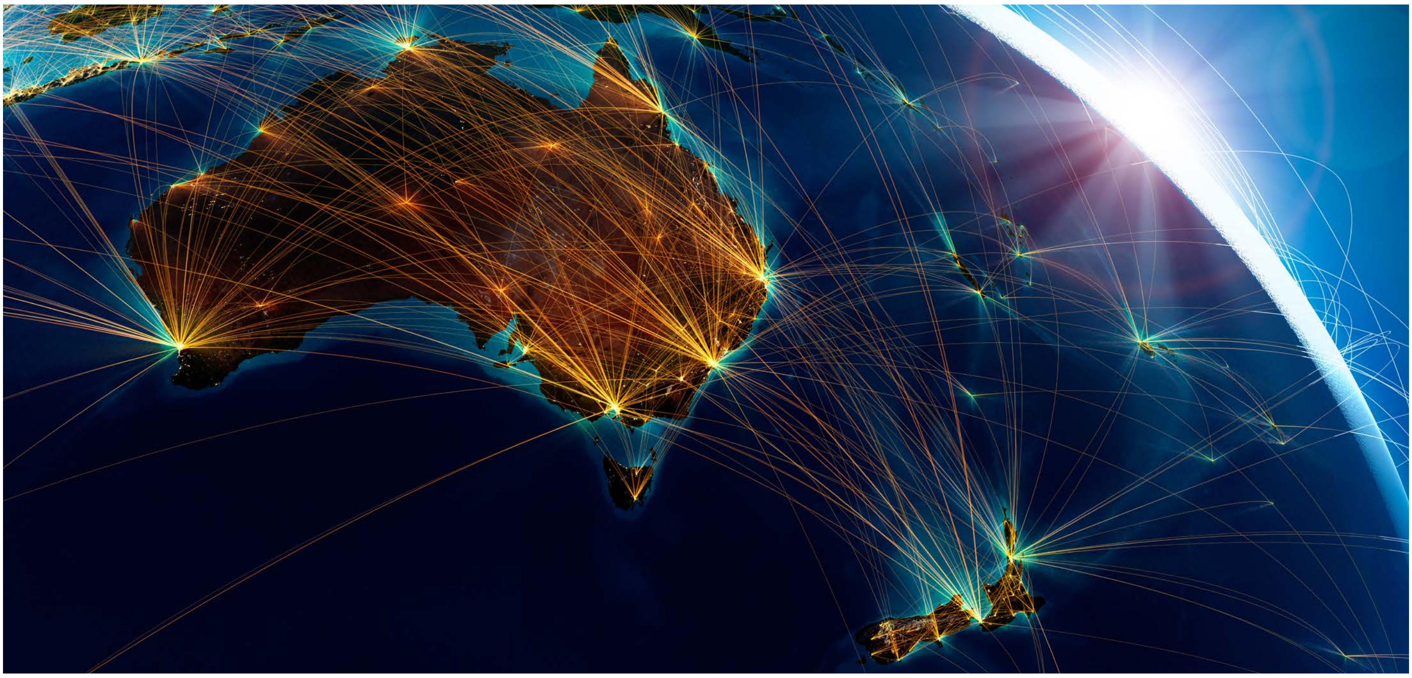
Trans-Tasman tax rules for the platform economy

By Robyn Walker and Di Williamson



Both New Zealand and Australia are in the process of introducing new tax reporting rules for digital platforms (Platforms). The proposals in each country have the potential to require material systems changes for Platforms, and unfortunately at this stage there isn't harmonisation of the rules, meaning New Zealand based Platforms could get caught having to comply with two sets of rules. In this article we explain the proposed reporting requirements in each country and also summarise how and when GST obligations also arise.

Reporting requirements – Why?

The emergence and growth of the "gig economy" through Platforms has led to concerns for tax authorities about the security of the tax base. If more people move from earning income through employment (where tax authorities get full data about income being earned) to earning income through the gig and sharing economy there is a great risk of individuals concealing or under-reporting income. The European Union (EU) has lead the charge in requiring reporting by Platforms, as they have designed and are in the process of implementing a set of reporting rules known as "DAC 7" (Directive on Administrative Cooperation in the field of taxation) which notes:

"The digitalisation of the economy has been growing rapidly over the last years. This has given rise to an increasing number of complex situations linked to tax fraud, tax evasion and tax avoidance. The cross-border dimension of the services offered through the use of digital platform operators has created a complex environment where it can be challenging to enforce tax rules and ensure tax compliance. Tax compliance is suboptimal and the value of unreported income is significant. Member States' tax administrations have insufficient information to correctly assess and control gross income earned in their country from commercial activities performed with the intermediation of digital platforms."

Historical analysis by Inland Revenue on self-employed individuals suggested that incomes may be underestimated by 20 percent on average. The chosen solution to this problem is to require Platforms which are acting as an intermediary between Sellers and the end Customer to have to collect and report information about those sellers.

Given many Platforms operate in multiple jurisdictions, there is a current risk that Platforms could be subject to numerous different regimes and requirements around the globe. To mitigate this risk, the OECD has developed a model set of rules, based on the EU approach, for countries to adopt.

New Zealand and Australia are taking different approaches to information reporting. New Zealand is adopting the OECD model rules, whereas Australia is taking a "bespoke" approach in its reporting requirements. Australia was perhaps ahead of its time, as its proposals come as an output of a Black Economy Taskforce established in 2016.

Below is a comparative summary of what is being proposed in each country:

How Platform Reporting Rules will apply in New Zealand and Australia

<table>
<tr><th></th><th>New Zealand</th><th>Australia</th></tr>
<tr><td>Status</td><td>Legislation is included in the Taxation (Annual Rates for 2022-23, Platform Economy & Remedial Matters) Bill (No 2). Submissions are currently open until 2 November and legislation is expected to be enacted in March 2023.</td><td>Legislation is included in the Treasury Laws Amendment (2022 Measures No. 2) Bill 2022

The Bill has been passed by the House of Representatives and is currently before the Senate awaiting debate.</td></tr>
<tr><td>Intended application date</td><td>1 January 2024

The first set of reports will be due 31 January 2025</td><td>Reporting obligations will arise in relation to:
• Transactions involving the supply of taxi travel (including ride-sourcing services) that are entered into on or after 1 July 2023;
• Transactions involving the supply of short-term accommodation that are entered into on or after 1 July 2023; and Transactions relating to other supplies that are entered into on or after 1 July 2024.

At this stage it is unknown when the first set of reports will be due, because the reporting period and the due date for reports are matters yet to be determined by the Commissioner of Taxation.</td></tr>
<tr><td>Who is caught by the rules</td><td>Platforms who are resident in New Zealand

A Platform is any software (include a website or app) which allows Sellers to be connected to Users for the provision of relevant services or the sale of goods directly or indirectly to Users. A Platform is not caught if its software exclusively processes payments, lists or advertises goods or services or redirects/transfers Users to a Platform without further intervention into the provision of the services or goods.</td><td>Any Platform, regardless of residence, facilitating supplies made though the Platform by a seller to a buyer for payment, to the extent that the supplies are “connected with…[Australia or its external territories]” (within the meaning of the GST law).

A Platform is an “electronic distribution platform” (EDP), being a service delivered by means of electronic communication, and includes platforms operating over the internet, including through apps, websites, or other software. To be an EDP, a platform must allow entities to make supplies available to an end-user consumer through the platform. A service is not an EDP if it only advertises or creates awareness of possible supplies, operates as a payment platform or serves a communications function.</td></tr>
<tr><td>What transactions are caught</td><td>• Property rental (e.g. short-stay accommodation)
• Personal services (any time- or task-based activity, which covers scenarios like ride sharing, delivery services, manual labour, tutoring, online language classes, copywriting, data manipulation, IT services and more)
• The sale of goods
• The rental of a means of transport</td><td>All transactions made through a Platform except where the supplies made are:
• The sale of goods
• The transfer of ownership of real property
• Financial supplies.
A Platform will also not be required to report transactions that:
• Involve a seller who belongs to the same consolidated or MEC group as the Platform; or
• Give rise to the Platform having a prescribed withholding obligation in relation to a payment to a seller.</td></tr>
<tr><td>What needs to be reported</td><td>The Platform is required to report data about Active Sellers to Inland Revenue annually. Data includes:
• Name
• Primary address
• Date of birth (individuals)
• IRD Number / Tax Identification Number
• Business registration number (businesses)
• Financial account identifiers (e.g bank account), if available
• Consideration paid, broken down by quarter
• Fees or commissions charged by the Platform or taxes withheld
• For property: the address of each property listing, the type of listing and number of days each listing is rented

Data will need to be transmitted in accordance with the OECD Sharing and Gig Economy XML Schema</td><td>The data required to be reported to the Australian Taxation Office (ATO) has not been made public yet.

According to the explanatory material accompanying the Bill, “all information required to be reported to the ATO must relate to the identification, collection, recovery, or reduction of a possible [Australian] taxation liability. It is expected that the [ATO] will typically request the identifying information of the seller and the details of their transactions made through the platform.”

Platforms will be required to report using an approved form yet to be published by the ATO</td></tr>
</table>

	New Zealand	Australia
Other information	Significant penalties apply to Platforms and Sellers who don't comply with the rules. Inland Revenue is likely to apply discretion in the application of penalties in the first years of operation provided Platforms are trying to comply.	These rules are an extension of the existing Taxable Payments Reporting System (TPRS) that requires entities to report information annually to the ATO about prescribed transactions relating to supplies of building and construction services, cleaning, security or surveillance services, information technology services, road freight and courier services, among other reportable transactions.

GST

Aside from proposals to require reporting of information, Platforms also have a role to play in collecting and paying GST. For a number of years now Platforms have been charging GST in both New Zealand and Australia for low value goods and services exported into the respective countries. We provide an overview of these existing rules below.

In addition, to address the issue of many 'gig' suppliers falling under the GST registration threshold of NZ$60,000, in New Zealand there are new proposals for Platforms facilitating "Listed Services" to charge GST on services facilitated through the Platform.

Listed Services are:

- The supply of accommodation services in New Zealand (other than residential accommodation); and
- The supply of transport services in New Zealand, in the form of ride-sharing and beverage and food delivery services.

Under these proposals, with effect from 1 April 2024, the Platform will charge GST on all services facilitated through the Platform. In order to approximate the GST that a vendor would be able to claim back if they were GST registered, the Platform will pass a 'flat rate credit' of 8.5% to the seller. Any GST registered suppliers will claim back GST input tax credits as normal and be deemed to make a zero-rated supply to the Platform of the Listed Services.

Deloitte commonly helps non-residents with GST compliance obligations and we are happy to provide further information about GST registration requirements in both New Zealand and Australia.

For more information please contact your usual Deloitte advisor.

How GST applies to Platforms in New Zealand and Australia

	New Zealand	Australia
Listed Services	As above	A different approach has been taken in Australia whereby suppliers of "taxi travel" (including ride-sourcing services) are required to register for GST regardless of their turnover.
Low Value Goods	Since 1 December 2019, non-residents selling goods costing NZ$1,000 or less to consumers in New Zealand have had to register and charge GST if annual New Zealand supplies exceed NZ$60,000. These rules apply to individual sellers, but also electronic marketplaces (i.e. Platforms) and redelivery services.	Since 1 July 2018, entities selling goods with a value of AU$1,000 or less and importing them in the course of a supply to a consumer in Australia have had to register and charge GST if annual turnover for their Australian supplies exceeds AU$75,000. These rules apply to individual merchants, but also to operators of electronic distribution platforms (i.e. Platforms) and redelivery services providers.
Remote Services	Since 1 October 2016, non-residents providing services to New Zealand consumers have had to register for and charge GST on services provided if annual New Zealand supplies exceed the NZ$60,000 registration threshold. These rules apply to individual sellers (for example, streaming services, apps) and also operators of electronic marketplaces (for example app stores).	Since 1 July 2017, non-resident entities supplying imported services and digital products to Australian-resident consumers have had to register and charge GST if annual turnover for their Australian supplies exceeds AU$75,000. These rules apply to individual merchants, but also to operators of electronic distribution platforms (i.e. Platforms).

The Taxation (Annual Rates for 2022–23, Platform Economy and Remedial Matters) (No 2) Bill is now open for submissions. You can make a submission on the Bill until 2 November 2022. For a refresher on the proposed tax changes in the Bill see our September Tax Alert.

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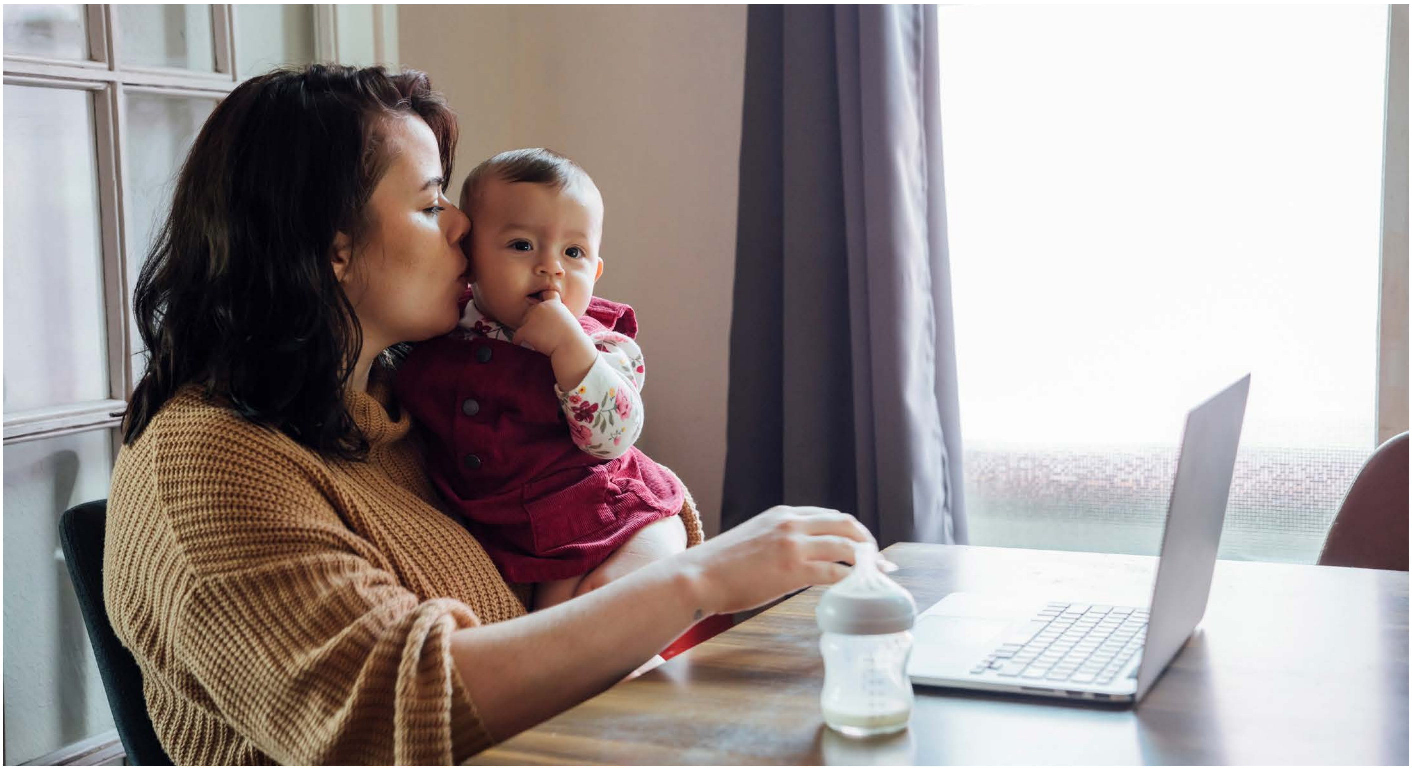
Are you a new or returning New Zealander expecting a baby? – Then the Best Start credit may not be a good start for you

By Kirsty Hallett and Charlotte Monis



Many parents joke that their child represents a tax break, but there is some truth behind it! The New Zealand government has created a range of credits and support payments, collectively known as Working for Families Tax Credits (WfFTC) to help alleviate some of the financial burdens of raising a child.

The WfFTC regime is broad and encompasses a number of entitlements for a range of family situations, including the Family tax credit, In-work tax credit, Minimum family tax credit and the Best Start tax credit.

The criteria to qualify for Working for Families is simple. You must have a dependent child in your care under the age of 18 (or 19 if they are still studying), be the principal caregiver over the age of 16, and be a New Zealand resident and tax resident. However, applicants for WfFTC who are new or returning New Zealanders must be aware that by choosing to receive WfFTC, they will be deemed to have elected out of the transitional tax residence exemption which could have broader tax implications for themselves and their spouses.

What is transitional residency and can it apply to me?

If you are new or a returning New Zealander (who has been away for 10 years or more), you are automatically entitled to transitional resident status (provided you have not previously benefited from the exemption).

As a transitional resident, you only have to pay tax in New Zealand on your New Zealand-sourced income and any income you receive that relates to the provision of your services (whether in New Zealand or offshore). This means that assets and investments offshore sit outside the New Zealand tax base for the period of the transitional tax residence. Generally, the transitional tax residence exemption lasts for a period of 48 months, however, it can be extended in some limited situations depending on when a permanent place of abode is acquired in New Zealand. Depending on what assets and investments are owned in other jurisdictions, transitional residence is a significant benefit. Having these assets outside of the New Zealand tax base saves the need to calculate and

pay tax in multiple jurisdictions and claim foreign tax credits. Having a 48-month period allows taxpayers to either get ready for complex tax returns or to transfer investments to New Zealand.

Individuals do have the option to elect out of the transitional tax residence rules, should they choose, and can do so by ensuring they comply with the New Zealand tax rules as they apply to a full New Zealand tax resident.

There are also certain actions that an individual (or their spouse) may take that can deem them to have elected out of the transitional tax residence exemption, the main action being to elect to receive WfFTC. An application for Working for Families payments, either by the individual or their spouse, will mean that they can no longer be a transitional resident and are subject to tax as a full New Zealand tax resident from the date they commence receiving WfFTCs. This election is irrevocable.

Best Start Tax Credits – Applicant Beware!

While most of the WfFTC entitlements require an individual to consciously apply for the payments, recent changes to Inland Revenue's computer system mean it is possible to apply for the Best Start tax credit (a weekly payment of $65 for families supporting a newborn baby that is not income tested until the baby turns 1) as part of the process of registering the birth of a child. Specifically, upon the birth of a child, the SmartStart website allows parents to register the birth of the child and as they work through the online registration process there is a section that allows the parent to elect to apply for Best Start Payments (administered by Inland Revenue).

This section of the application states, "If you are a New Zealand resident, you can get Best Start payments until your baby turns one, no matter what you earn". The only indication that this payment is part of the WfFTC regime or notification to transitional tax residents of the consequences of selecting yes is found in the fine print description of what Best Start payments are. We expect many are unlikely to read the fine print whilst also dealing with a newborn.

What should I do next?

If you have found yourself in the unfortunate situation of having elected to receive the Best Start tax credits without realising the implications for your transitional tax residence, it is important that you seek specialist tax advice to understand the implications for your filing obligations in New Zealand.

Further, if you are a transitional tax resident and are expecting a child, before applying for Best Start tax credits (or any other Working for Families tax credit) we recommend that you seek specialist tax advice to see if opting out of transitional residence is the best option for you – if your tax affairs are simple and all assets are already in New Zealand, claiming the WfFTC may make sense.

If any of these situations apply to you, please contact your usual Deloitte advisor.

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Snapshot of recent developments

Tax Legislation and Policy Announcements

Anti-money laundering exemption for tax transfers

On 13 September 2022, The Associate Minister of Justice granted a class exemption for accounting practices under the Anti-Money Laundering and Countering the Financing of Terrorism Act 2009 (AML/CFT Act). This class exemption is valid until 14 July 2027. Accounting practices (including accountants, bookkeepers, tax agents, and insolvency practitioners) carrying out most types of tax transfers under the Tax Administration Act 1994 on behalf of their customers are now covered by the class exemption. This exempts accounting practices from most (but not all) obligations under the AML/CFT Act.

Tax Annual Rates 2022-23 Bill – First reading & Submission due date

On 21 September 2022, the Taxation (Annual Rates for 2022–23, Platform Economy and Remedial Matters) (No 2) Bill received its first reading. The Bill has been referred to the Finance and Expenditure Committee with a report-back date of 2 March 2023. Parliament is now accepting submissions with the deadline of **2 November 2022.**

Deposit Takers Bill introduced

On 22 September 2022, the Deposit Takers Bill was introduced into Parliament. The Bill aims to guarantee New Zealander's deposits (up to $100,000) held in any eligible institution (deposit takers such as banks, credit unions, building societies and finance companies) if the institution fails. This is the third piece of legislation from the review of the Reserve Bank Act, following the Reserve Bank of New Zealand (Monetary Policy) Amendment Act 2018 and the Reserve Bank Act of New Zealand Act 2021.

The scheme will be pre-funded by levies on deposit takers and support by a Crown backstop. The levy is expected to be risk-based with deposit takers paying different rates depending on an assessment of the risks they pose.

The Bill will make consequential amendments to several Acts including the Child Support Act 1991, the Customs and Excise Act 2018, the Gambling Act 2003, the Income Tax Act 2007, the KiwiSaver Act 2006, and the Tax Administration Act 1994.

TOP announces 2023 election tax policy

On 3 October 2022, The Opportunities Party (TOP) announced its two-phase tax policy for the 2023 election which included $6.35b in income tax cuts, paid for by a land tax on residential housing. Under phase 1 of the TOP policy a tax-free threshold of $15,000 would be introduced, followed by a tax cut for middle-income earners who would only pay 20% for income earned between $15,001 and $80,000. A new 35% rate would apply for income between $80,001 and $180,000, while the current 39% rate would remain. To pay for this a land tax of 0.75% on the value of residential property would be applied. The land tax would replace the current bright-line test, would not apply to rural, Māori and conservation land and could be deferred for superannuitants. Under Phase 2, a universal basic income (UBI) will be established. The UBI will provide $16,500 annual tax free income to all citizens and residents aged between 18 and 65. This will be accompanies by single personal, company and trust tax rate of 35%. TOP says the plan would be fiscally neutral. TOP would also write off all $2b of beneficiary debt owed to the Ministry of Social Development.

Inland Revenue statements and guidance

Product Ruling (mortgage offset arrangement) – Westpac

On 14 July 2022, Inland Revenue published BR Prd 22/09 - *Westpac New Zealand Limited.* The Arrangement is a mortgage offset arrangement pursuant to which Westpac customers can elect to use the balance of eligible Westpac transaction and savings accounts to offset against home loan accounts to reduce interest payable on those home loan accounts (Choices Offset Arrangement).

Issues ruled on under the Arrangement

- Offsetting does not, of itself, give rise to any income or expenditure under the FA rules. Fees payable by a borrower to Westpac for the Choices Offset Arrangement constitute consideration for the purposes of the FA rules.
- No holder of a Linked Deposit Account derives any interest income on such accounts (section CC 4) and Westpac does not pay any interest and has no obligation to deduct resident withholding tax or non-resident withholding tax or pay approved issuer levy.
- The Arrangement is not an indirect associated funding arrangement under section RF 12I.
- No income arises under section CC 7 for Westpac or its customers
- Sections BG 1 and GB 21 do not apply

The ruling applies from 1 April 2022 to 31 March 2027

Product Ruling (FBT): Sustainable Mobility Limited (trading as Zilch)

On 3 August 2022, Inland Revenue published BR Prd 22/04 - *Sustainable Mobility Limited (trading as Zilch).* The Arrangement is the provision of primarily electric vehicles owned by Sustainable Mobility Limited (trading as Zilch) to a business customer who uses the vehicles for business purposes. The Arrangement also enables an employee of the business customer to pay Zilch a price equal to the price Zilch charges a member of the public for the use of the vehicles for their private purposes, subject to a discount of up to 15%.

How sections of the Income Tax Act 2007 apply to the Arrangement

- None of the features of the Arrangement give rise to a "benefit" to a business customer's employees for the purposes of section CX 2(1)
- Discounting Zilch provides in respect of private bookings made and paid for by a business customer's employees through the business booking portal does not give rise to a "fringe benefit" for the purposes of section CX 2(1)
- Neither section GB 31 nor section GB 32 applies to the Arrangement

The ruling applies from 1 July 2022 to 30 June 2025.

QWBA – Treatment of bloodstock breeding

On 6 September 2022, Inland Revenue published QB 22/07 - *Income Tax and Goods and Services Tax – Treatment of bloodstock breeding*. This Question We've Been Asked (QWBA) explains how the bloodstock provisions apply when a person is purchasing their first horse with a view to breeding it for profit in the future. In the meantime, they will race the horse for several years to try to improve its breeding value.

Draft Interpretation Statement: GST - Specified agents of incapacitated persons, and mortgagees in possession

On 8 September, the Inland Revenue published PUB00426 - *GST – Section 58: Specified agents of incapacitated persons, and mortgagees in possession* for public consultation, replacing a 1995 policy statement and extends the analysis further than what was previously covered. This Statement reiterates the view that where a registered person dies or is in liquidation or receivership, then their personal representative, liquidator, or receiver will be a specified agent of an incapacitated person and liable to fulfil the GST obligations related to the taxable activity in question.

The deadline for comment is on **8 November 2022.**

Draft Specification – File Specification for payment service providers

On 9 September 2022, Inland Revenue provided further details on the file specification information required for payment service providers. The purpose of this document is to provide a specification for the provision of data to Inland Revenue by Payment Service Providers (PSPs).

A payment service provider is defined as a third-party business that facilitates payments for goods and services between customers and merchants. This specification will help ensure that Inland Revenue can load and combine data received from the large number of PSPs into actionable intelligence. Further, this helps provide equality of compliance costs by requesting data in the same format from all PSPs. This specification has been aligned as closely as possible with the reporting specification of the ATO.

Tax Counsel Office current work programme 2022-23

The Tax Counsel Office at Inland Revenue has updated its Public Guidance Work Programme 2022-23 (as at 5 September 2022). Seventeen new projects have been added for 2022/23, including three re-issue projects where public items are expiring during the year. The remainder of the programme contains items rolled over from the 2021/2022 programme.

OECD Updates

OECD Forum on Tax Administration

On 28-30 September 2022, the Forum on Tax Administration held its plenary meeting in Sydney bringing together Commissioners from tax administrations across the globe. The following reports have been released during this event:

- The Bilateral Advance Pricing Arrangement Manual provides tax administrations and taxpayers with information on the operation of BAPAs and identifies 29 best practices for BAPAs without imposing a set of binding rules.
- The Digital Services report looks at how digital services can help SMEs comply with their tax obligations, leading to reduced burdens and increased compliance rates.
- Tax Administration 3.0 and Connecting with Natural Systems explores the possibilities for more seamless interaction between tax administrations and platform businesses operating in the gig economy.
- Tax Administration 3.0 and the Digital Identification of Taxpayers explores the current state of play on digital identity, the different domestic solutions adopted in several jurisdictions as well as the challenges related to cross-border processes.
- Tax Administration 3.0 and Electronic Invoicing examines the current state of play on electronic invoicing based on a global survey.

Tax Policy Reforms 2022

This publication from the OECD describes recent tax reforms across 71 countries and jurisdictions, including all OECD members and selected members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. The report finds that tax reforms – notably reductions in taxes on labour and more generous corporate tax incentives – have been among the key policy tools that countries have used to stimulate growth and promote economic recovery from the pandemic. Personal income taxes and social security contributions were reduced in 2021 in almost all countries covered in the report, with most reductions targeted at lower-income households to support employment and provide in-work benefits. Many countries also increased corporate tax incentives to stimulate investment and innovation. The most significant VAT reforms focused on the digital economy and e-commerce, including strong growth in e-invoicing and digital reporting requirements. Property tax reforms were less common in 2021, with a small number of countries implementing measures to reduce the use of properties as investment vehicles and improve equity in the housing market.

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