Tax Alert

A focus on topical tax issues – April 2013

In this issue

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Where are we now? Update on recent employment tax issues

By Robyn Walker and Nigel Jemson

In the past few months, there has been a flurry of discussion on various issues involving the taxation of certain benefits provided by employers. Inland Revenue has been taking steps to adopt a stricter stance in this area, generating a considerable backlash from taxpayers and in the media. In particular, the recent furore surrounding proposed changes to FBT on car parks and taxation of communication payments to employees has attracted widespread attention in the press, forcing a Government back-down on the proposed changes.

In addition, a recent Issues Paper and Commissioner's Statement on accommodation allowances has changed long-standing views on how these allowances are taxed, creating uncertainty in this area of law, and highlighting potential tax implications for employers who transfer workers to Christchurch during the rebuild.

In light of these recent developments, the following table is aimed at providing a helpful summary of the proposed changes, the history behind these issues, and where the law currently stands in these areas:

	FBT on employer-provided car parks	Employee allowances – Payments for communication costs	Accommodation allowances
What changes were / are proposed?	Draft legislation proposed a widening of FBT rules to cover employer-provided car parks in Auckland and Wellington CBDs with limited exceptions. These rules would have also applied to other areas in certain circumstances.	Inland Revenue proposed in an Officials' Issues Paper that payments which employers contribute towards employee's communication costs (e.g. cell phones, home broadband / telephone service, iPads etc) should be taxed in full. This would occur when there is mixed private and work use.	An Officials' Issues Paper proposes to amend the law to provide a legislative exemption from tax where an employer makes payments to meet an employee's accommodation expenses during work travel away from the employee's normal workplace, subject to a 12-month upper time limit at a particular work location. It is proposed that the Commissioner would have a power to extend that time limit in certain exceptional circumstances. There is currently no proposed application date for these changes. In addition, the Commissioner of Inland Revenue has made interpretative changes to how employer-provided accommodation and accommodation allowances are to be taxed until the law is changed.
Previous Tax Treatment	There is currently an "on-premises" exemption from FBT for employer-provided car parks. Under this exemption, car parks which are on an employer's premises (i.e. they own or lease them) are not subject to FBT.	Payments had been taxed on an apportionment basis according to the private/work-related split. There had been a long standing rule of thumb that an employer could treat 50% of communication payments as non-taxable to the employee without having to hold documentary evidence to support the apportionment.	A 'net benefit' test existed whereby if the taxpayer was maintaining a home in another location, the allowance was not taxable because the taxpayer was not receiving a benefit from the accommodation provided. This position was set out in Inland Revenue's Technical Rulings Manual. While the Technical Rulings Manual ceased being updated in 1998, Inland Revenue had not advised of any change in interpretation until the recent release of the Commissioner's Statement (discussed below).
History	In 2009, Inland Revenue released a draft public ruling on the on-premises exemption for comment. As a result of submissions, the public ruling was put on hold pending a policy decision. In April 2012, an Officials' issues paper was released seeking feedback on the issue of untaxed non-cash benefits provided to employees as substitutes for salary. See this **Tax Alert article** for more details. In December 2012, the Minister of Revenue Peter Dunne released a supplementary order paper which introduced legislation to tax car parks. See this **Tax Alert article** for more details. Following criticism by submitters, on 18 March 2013, Minister of Finance Bill English and Minister of Revenue Peter Dunne released a **joint press statement** announcing the Government's intention not to proceed with the proposed changes to tax employer-provided car parks. In a subsequent question in Parliament, the Minister stated that the current legislative treatment of employer-provided car parks will remain unaltered.	In October 2007, Inland Revenue issued a draft interpretation statement regarding employee-related payments. An updated version was issued in December 2009 for further consultation. In November 2012, the Policy Advice Division of Inland Revenue released an Officials' Issues Paper proposing some changes to the tax treatment of employee allowances and other payments (including payments for communication costs). See this **Tax Alert article** for more details. Following criticism by submitters and other interest groups, on 19 March 2013, both the Prime Minister and Minister of Revenue indicated in Parliament that the proposed changes to taxation of communication costs would not go ahead.	In November 2012, the Policy Advice Division of Inland Revenue released an Officials' Issues Paper on the tax treatment of employee allowances and other expenditure payments, proposing changes to the taxation of accommodation allowances. See this **Tax Alert article** for more details. On 6 December 2012, the Commissioner of Inland Revenue issued a **Commissioner's Statement** on the income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances. In summary, this statement provides that accommodation should be treated as income of an employee (excluding relocations which are "temporary in nature"), and that the law does not support a 'net-benefit' approach. The Commissioner's Statement recommended that taxpayers make voluntary disclosures if accommodation / allowances had not previously been taxed in the previous two years. On 7 March 2013, the Commissioner released an **Appendix** to her previous statement which sets out factors which should be taken into account when determining whether a relocation is temporary in nature and provides further examples on this matter (see "When is the provision of accommodation likely to be non taxable?" on page 4).

	FBT on employer-provided car parks	Employee allowances – Payments for communication costs	Accommodation allowances
Where are we now?	The status quo (i.e. "on-premises" exemption) will remain for the foreseeable future. However, as noted on page 4 (under "What is the on-premises exemption"), there is some tension about how the on-premises exemption applies.	The existing law and practice on this issue will continue to apply. If an employer provides a "business tool" such as a work phone or laptop to an employee mainly for business use, the provision of this benefit will not be taxed because there is a specific exemption from FBT. However the position is different for reimbursement payments made to employees towards communication costs (for example, contribution towards a smart phone data plan). Generally, such payments are non-taxable to the employee *to the extent* that the payment is connected with the employee's work. If the payment is directed solely towards work use, the entire amount should be non-taxable in the hands of the employee. No clarity has been provided by Inland Revenue as to whether employers can continue to apply a 50% apportionment ratio as a rule of thumb in the case of mixed private/work use. Now may be a good time to reflect on what communication tools or allowances are provided to employees and the current tax positions being adopted to ensure they are optimal.	The release of the Commissioner's statement has resulted in increased uncertainty for taxpayers as to when a relocation is more than temporary in nature and the Appendix has done little to clarify matters. The Commissioner has stated for shifts of six months or less in duration, the shift is likely to be temporary in nature and therefore accommodation payments or the value of accommodation provided will not be taxable. The Inland Revenue has stated they will not devote any resources to considering these cases. It is likely that accommodation provided which is over twelve months in duration will be considered taxable in nature by Inland Revenue unless exceptional circumstances apply (for instance, see Example 10 from the Appendix to the Commissioner's Statement). We recommend that all longer-term accommodation arrangements with employees are reviewed in light of these recent developments and consideration given to whether any voluntary disclosures are warranted based on individual fact patterns.

What is the on-premises exemption?

The Regulatory Impact Statement that accompanied the FBT on car park proposals noted *"[t]here is also a long-standing interpretive issue with the current boundary to determine whether the provision of a car park is a fringe benefit. That boundary has traditionally been whether the car park is on the employer's premises, with "premises" being based on the common law interpretation, under which a leased car park, like one owned by the employer, is exempt from FBT, whereas a licensed car park is not exempt. This boundary is becoming increasingly untenable because some licensed car parks, like leased car parks, also provide substantially exclusive possession."*

When determining whether employer-provided car parks are "on premises", the rights and obligations created by the agreement (rather than the terms used by the parties to describe their agreement) must be carefully examined to determine whether an agreement is a lease or a license. A "lease" occurs when the employer has an exclusive right to possess the land containing the car park whereas under a license the employer has a mere right to enter the land for a specific purpose (i.e. parking).

The following factors indicate that a lease may exist:

- The employer is able to take corrective action should a third party occupy or block the car park (for example, arranging for the infringing car to be towed).
- The car park owner cannot relocate the car parks on a whim.
- A "reserved" sign is placed on the wall/floor of the car park.
- The car park owner acknowledges that the employer and their employees have the exclusive use of the car parks and that no one else can park their cars there.
- The agreement allows 24/7 access to the car park, rather than limiting the time of day that employees can park there.
- If the car park is allocated to a specific staff member and is not used by them, the car park remains unoccupied and no one else will use that car park.
- Use of a key or access card to access the car park.

The following factors can detract from an agreement being a lease:

- The use of the terms "license" or "rental agreement" or similar terminology.
- The fact that car parks are situated in an area/building with other car parks being served by the same entrance with common areas.
- Restrictions on use of the car park. For example, a specification that it is only for parking cars and not for cleaning or carrying out repairs to vehicles.
- Car parks are not allocated to a specific staff member.

When is the provision of accommodation or an accommodation allowance likely to be considered non-taxable?*

The Commissioner considers that the appropriate test for determining whether an employee has temporarily shifted to another location (or alternatively whether they have relocated), is to determine whether they live in their home base or in the new location. Determining where a person lives involves a weighing of all the factors. Factors to consider when determining whether a current employee has made a temporary shift include:

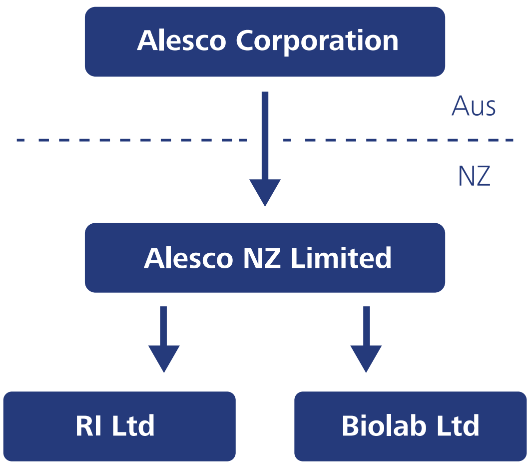
- Has the employee relocated and established that they are living in a new location?
- Does the employee retain their substantive employment position in the original location, or has the employee relocated to take up new employment?
- What is the duration of the transfer? The shorter the transfer period the more likely it is that the transfer is temporary. Equally, the longer a transfer the more likely it is that the transfer is more than temporary.
- Does the original location (where their substantive job is) remain the centre of the person's domestic life?
- Is the payment from the employer effectively paying the employee's mortgage for a property at the new location? The acquisition of property in the new location suggests a more than temporary move.
- Has the employee retained a home (either owned or rented by them) in their old location which is available to them? This is relevant not because of the costs incurred but rather what it suggests about the nature of the arrangement. Along with other factors, the retention of a home can sometimes suggest an intention to return and may imply that the arrangement is temporary and work related rather than personal. However this factor alone is not determinative.

* Taken from CS 12/01 Appendix
Commissioner's Operational Approach to Temporary Shifts

Alesco: The pendulum continues to swing in Inland Revenue's favour

In a judgment released on 5 March 2013 (available **here**), the Court of Appeal has found in favour of the Commissioner of Inland Revenue ("the Commissioner") in *Alesco New Zealand Limited and Ors v CIR*. The central issue was the deductibility of interest claimed under the financial arrangements rules ("FA rules"). This arose from the use of optional convertible notes ("OCNs") in intra-group arrangements to finance the acquisitions of two New Zealand businesses. On the basis of alleged tax avoidance, the Commissioner denied the deductions claimed by Alesco New Zealand Limited ("Alesco NZ") and reduced corresponding loss offsets with other group companies. The Commissioner also assessed Alesco NZ for abusive tax position shortfall penalties amounting to $2.4 million.

Facts and summary of outcome



The facts of the case are not, by themselves, overly complicated. Alesco Corporation ("Alesco"), an Australian incorporated company, wholly owned Alesco NZ. Alesco NZ in turn acquired Robinson Industries Ltd ("RI Ltd") (for $28.653 million) and Biolab Ltd (for $46 million). To finance the acquisitions, Alesco subscribed for OCNs issued by Alesco NZ for an aggregate issue price of $78 million.

It was the use of OCNs to fund the acquisitions that the Court focussed upon. OCNs are hybrid instruments evidencing a debt that the issuer is obliged to settle in cash at maturity or, at the holder's option, the debt may be discharged by an issuance of shares. In this case, the OCNs issued by Alesco NZ to Alesco provided that no interest was payable and, on maturity, Alesco would have the option of converting some (or all) of the OCNs into shares or redeeming the OCNs for cash.

For tax purposes, a convertible note is a financial arrangement having both debt and equity components. The equity component is an excepted financial arrangement, meaning it is not subject to the FA rules. The Commissioner had released Determination G22 as a prescribed method for determining the debt component of an OCN and, therefore, its attributable income or expenditure which is taxable/deductible under the FA rules. By applying Determination G22 to the OCNs, an interest deduction arose for Alesco NZ, even although no interest was paid in cash by Alesco NZ in respect of the OCNs.

The Commissioner acknowledged that the OCNs complied technically with the FA rules, the deductibility provisions and, in particular, Determination G22. The underlying transactions being financed (i.e. the acquisition of RI Ltd and Biolab Ltd) were accepted by the Commissioner as not being entered into for a tax avoidance purpose or effect. However, the Commissioner considered that the OCNs – as intermediate steps in implementing the underlying transactions - were tax avoidance arrangements, so that the interest deductions should be voided under the general anti-avoidance provision.

The Court agreed with the Commissioner concluding that, as Alesco NZ did not incur a legal liability to pay interest or any related economic cost, the use of the FA rules and Determination G22 to claim interest deductions fell outside Parliament's contemplation when enacting those rules.

Our thoughts

Commerciality – choice of funding structure for genuine commercial transaction

Alesco NZ argued that its choice of OCNs had an underlying commercial rationale. The structure was adopted as a mechanism to fund existing financial obligations and this therefore contrasted with other tax avoidance cases, where the transactions in question would not have been entered into but for the tax benefits. That is, "the use of OCNs was an intermediate step along a pre-ordained commercial path".

However, in the Court's eyes, this feature did not protect Alesco NZ. It said "the question is whether the particular arrangement, regardless of whether it was the originating or an intermediate step, had the purpose or effect of tax avoidance".

The Court found that, in legal form and in economic substance, Alesco had made an interest free loan of $78 million to Alesco NZ. Because Alesco already owned 100% of Alesco NZ, the convertible option was of no practical value to Alesco. The alternative of redeeming the OCNs in 10 years' time without any intervening right to interest would result in a significant cost or loss to Alesco. Thus, the Court felt that the decision to use OCNs "cannot possibly have been for a predominantly commercial purpose". That said, the Court did appear to base its decision more squarely on the issue of whether Alesco NZ had incurred genuine economic cost giving rise to the interest deduction claimed (refer paragraph 57 of the judgment).

A couple of observations arise. First, it is essential that every step within an overall arrangement must have a commercial justification. The Court's finding in relation to the use of the OCNs in this structure highlights the need to ensure that there is a commercial reason justifying every step in a transaction - and that contemporaneous documentation clearly sets this out. If any step lacks a clear commercial justification then there is a risk that the Commissioner may seek to use her powers available under the general anti-avoidance rule.

Second, it was not evident that Alesco NZ had investigated alternative funding structures when deciding how to fund the acquisition of RI Ltd and Biolab Ltd. Where taxpayers consider a suite of alternative financing structures, we would suggest that they are entitled to choose the option which is the most tax advantageous, provided that it has the requisite commerciality. This does seem in keeping with comments of the Supreme Court in *Ben Nevis* and *Penny & Hooper*, to the effect that taxpayers should be able to structure transactions to their best advantage.

The counterfactual argument is discounted

Alesco NZ contended that, had the OCNs not been a funding option, it would "almost certainly" have used an interest bearing loan to fund the acquisitions. In that case the loan would have generated a similar (or greater) level of interest deductions in New Zealand (albeit there would also have been a liability for non-resident withholding tax). On this basis, Alesco NZ argued that no tax was really avoided through use of the OCNs. It also illustrated this by reference to a so-called "unbundled" transaction comprising a zero-coupon bond (issued for $38 million, but with a face value of $78 million), together with an option over shares issued for $40 million – which would have given rise to identical interest deductions.

The use of this hypothetical/counterfactual approach was rejected by the Court and is one area where New Zealand differs from Australia in its approach to tax avoidance. What was required to be focussed upon was simply the arrangement actually entered into. It would be interesting to see if the Court's decision in this respect would have been different, had there been clear and contemporaneous evidence of alternative funding structures having been seriously considered by Alesco NZ.

"Dot the i's and cross the t's"

Alesco also offers several lessons on the need to "dot the i's and cross the t's" at every step throughout a transactional process. In this regard, matters that we suggest did not assist Alesco NZ's case were as follows:

- The highlighting of the tax benefits in board minutes and board papers.
- Internal memoranda placing emphasis on the New Zealand tax advantages and the reasons why the Australian anti-avoidance provisions were unlikely to be engaged.
- Footers on advice documents suggesting that the OCNs were a "product".
- Evidence at trial about drivers for the OCN structure was inconsistent with both the tax advisor's correspondence and Alesco's internal memoranda.
- Similarly, evidence at the hearing was not consistent with Alesco NZ's Notice of Response.
- Some of Alesco NZ's evidence was not relevant and was held to have no probative value.

Aspects were described as being "no more than a detailed rationalisation of events that never occurred". This highlights the need to properly document the commercial drivers for steps and an overall transaction at the time.

The Court did emphasise that any tax avoidance enquiry is an objective one, relating to the purpose of the arrangement rather than motives or intentions of the parties. At paragraph 28 of its judgment, the Court confirmed that the enquiry must be confined to the contractual instruments rather than those extrinsic materials. However, it seems inevitable that the Commissioner, and a judge, will be influenced by such materials, which it is clear Crown Law will continue to place before the courts in arguing tax avoidance cases.

As noted in other Tax Alert articles (including in this issue – **Emails: smart ways to manage the potential minefield**), caution must therefore be exercised, to the greatest extent feasible, with emails, board papers and other contemporaneous correspondence. It also highlights the value of being audit ready, and of conducting an "internal discovery" exercise as early as possible in the dispute process so as to expose any potential areas of weakness and to ensure that a coherent, consistent and credible case theory is advanced (again, refer to **Emails: smart ways to manage the potential minefield**).

Commissioner's Power of Reconstruction

The Commissioner voided Alesco NZ's arrangement resulting in the disallowance of its interest deductions and reduction in loss offsets to other group companies. Alesco NZ argued that the Commissioner should have reconstructed and, in doing so, should consider a hypothetical alternative transaction when reconstructing, so as to clearly identify the tax benefit being counteracted. This counterfactual would have been funding the acquisitions through an interest bearing loan from Alesco.

The Court rejected this argument, stating that the Commissioner *may*, but is not required to, have regard to a hypothetical alternative transaction when counteracting any tax advantage obtained from a tax avoidance arrangement. Interestingly, the Court said that forcing the Commissioner to consider the hypothetical alternative in question (giving rise to greater deductions than actually claimed) would enable Alesco NZ to benefit from the consequences of its own "unlawful conduct". The terminology is interesting given that a tax avoidance arrangement does not actually involve any illegality or criminal culpability.

Shortfall Penalties

The Commissioner imposed shortfall penalties for taking an abusive tax position (a penalty of 100% of the tax shortfall), although this was reduced to 50% to take into account Alesco NZ's prior good behaviour. This does appear to be a harsh result.

The statutory provision under which the penalty is imposed requires:

- a taxpayer to have taken a tax position which involves an "unacceptable interpretation of a tax law";
- a tax position that, viewed objectively, is taken by the taxpayer in respect of an arrangement that is entered into with a dominant purpose of avoiding tax; and
- the tax shortfall arising from the taxpayer's tax position to exceed $10,000.

Of particular note is the first of these requirements. A tax position will be an unacceptable interpretation of a tax law if the interpretation fails to meet the standard of being "about as likely as not to be correct".

According to the Inland Revenue's own published guidance and Australian case law that the New Zealand courts have previously had regard to on this issue, this means the position taken need not necessarily be the correct position, or one that has a 50% chance of success. It must however be one capable of being seriously considered by a court. It is difficult to see how Alesco NZ's position did not meet this test, particularly when Determination G22 refers to coupon interest payments which "may be made" - implying it was contemplated that interest may not be paid on notes falling within the scope of the determination.

It is also difficult to reconcile the penalty decision in *Alesco* with other cases in which the penalty was also held to be rightly imposed – such as in the context of the forestry investment structure in *Ben Nevis*.

Conclusion

It is important to bear in mind that Alesco NZ's OCN transactions were entered into 10 years ago, in what was a very different avoidance environment – both in terms of what arrangements were most closely scrutinised by Inland Revenue on audit/investigation, and what approach the courts took in determining general anti-avoidance cases. The pendulum has swung considerably since then.

This highlights that possible litigation on a tax issue could be up to 10 years after a transaction is entered into, and that the current view on avoidance could change over time. This is effectively a crystal ball-gazing exercise without clear guidance from Inland Revenue. Speaking of which, we understand the Inland Revenue's interpretation statement on avoidance, which taxpayers have been waiting on for some years, has now been further delayed until April 2013, no doubt to take the *Alesco* judgement into account.

We do not subscribe to the view that this decision will be a barrier to foreign investment. However, what it does mean is that taxpayers, more than ever, should seriously consider locking in the view of Inland Revenue about transactions by obtaining a binding ruling at the time the transaction is entered into. On black letter law (rather than avoidance) issues, indicative views can also be obtained.

On 4 April 2013, Alesco NZ applied for leave to appeal to the Supreme Court. It will be interesting to see both whether leave is granted and, if so, how the Supreme Court deals with Determination G22 in the context of Parliamentary contemplation and application of the abusive tax position shortfall penalty. Of course it is possible that the prospect of a further Supreme Court general anti-avoidance judgment may further delay release of Inland Revenue's interpretation statement on section BG 1.

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Emails: smart ways to manage the potential minefield

Campbell Rose and Amy Duan

Some context

In our **December 2012 Tax Alert** we outlined significant changes to Inland Revenue's risk review process, which have now taken effect. The changes mean that a larger group of taxpayers must be "audit ready" sooner. Ideally, this includes preparing an "audit file" containing all advice and contractual documents, board minutes, primary email correspondence and other relevant material relevant to a transaction or tax positions generally.

The need for this readiness stems from the increasing reliance by Inland Revenue and the courts on peripheral material such as emails – particularly in an anti-avoidance context - to draw factual inferences. This is despite long-standing case law authority, and the Inland Revenue's own draft interpretation statement on section BG 1, confirming that the anti-avoidance enquiry must be objective and focussed upon the purpose or effect of the arrangement (not of the parties). Emails often form a critical part of Inland Revenue investigations because they can be a colourful – and damaging - source of evidence that is used to support the Inland Revenue's avoidance theory. In recent tax avoidance cases, emails have been relied on as evidencing relevant facts, intensely scrutinised in cross examination and fully reproduced in the courts' judgments.

Below we expand on what being "audit ready" means from a practical and technological perspective. This involves exploring some of the tools available to manage email communication and to assist in the review of voluminous email archives.

Go to the source

As the saying goes, prevention is better than cure. In our December 2012 Tax Alert Article, we outlined some basic rules of thumb which could be applied to ensure that "tax advice document" status attaches to key emails, and that unhelpful material does not come into circulation.

Of course, human behaviour is such that (even with the best of intentions, policies and procedures) potentially adverse emails may nevertheless be created. It is also apparent that, in our experience, the author of an email (particularly outside an organisation's tax function) often does not consider how the email may be interpreted by a third party such as the Inland Revenue years later.

To some extent, a solution may lie within an organisation's own IT system. The innovative leverage of existing IT infrastructure can often prevent potentially adverse emails from being produced or proliferated.

For example, email monitoring tools could be applied to automatically forward or copy to (say) the tax manager emails matching certain criteria. Better still, most large organisations already have email gateways containing filters that auto-delete or auto-block emails being sent to (or from) outside parties if particular words and/or phrases are identified in email or attachment text. This technology could be used to temporarily hold emails that contain phrases such as "tax benefit" in the organisation's email gateway, to be released to the relevant recipient(s) only after approval by particular individuals within the organisation. In a transaction context, this technology would be limited to members of the relevant project team, so that the volume of emails being forwarded/suspended did not become unwieldy.

For smaller organisations, the benefit of implementing and maintaining such gateways will obviously be weighed against the cost of doing so – but even the most elementary of IT systems may still permit some degree of filtering in this manner.

Retention obligations – the scope?

As noted above, despite the best laid plans (and monitoring/gateway tools), potentially adverse emails will inevitably slip through. This raises the issue of whether, and the extent to which, there is an obligation to retain such emails.

Section 22 of the Tax Administration Act 1994 requires any person carrying on business or other income earning activities in New Zealand to keep sufficient "records" to enable the Commissioner of Inland Revenue to readily ascertain that person's income, deductions etc. Subject to limited exceptions, those records must be kept for a minimum of 7 years. An equivalent obligation exists for GST purposes.

Clearly, an email is a "record", and a recent standard practice statement issued by Inland Revenue (SPS 13/01) confirms this. It is not so clear, however, which particular emails forming part of the general correspondence 'traffic' during the planning and implementation of a transaction fall within the section 22 obligation.

Emails circulating executed copies of transaction documents would be an obvious candidate for retention. Other emails in the formative stages of a transaction may not however provide any assistance in ascertaining a taxpayer's income or deductions – particularly if they contain subjective material which should be irrelevant to any anti-avoidance analysis. That said, there may be a desire (but not an obligation) to retain emails containing helpful material supporting the commercial rationale for a transaction or particular steps taken in the context of a transaction. Evidence of purpose or intention may be relevant to determining (say) whether assets are held on capital or revenue account, and so emails containing such evidence would appear to be within section 22's ambit.

It therefore seems difficult to formulate any "one size fits all" rule, in terms of which emails can be permanently deleted from an organisation's server and when: although, even then, such emails may still be stored in the sender's "sent items" folder or in other electronic locations. Perhaps the best that can be done, in addition to the measures discussed above, is to undertake some 'housekeeping' post-completion, to determine which categories of emails (for example, by sender/recipient) do not need to be retained – some tools in this regard are discussed further below. The question also arises as to whether an email that has been held in a gateway and not ultimately received by its intended recipient (i.e. not released) is still a "record" for section 22 purposes.

Finally, the Inland Revenue's published guidance does confirm that taxpayers must retain information that can identify the origin, destination and time when an email was sent; and such information must be kept in readily accessible form (SPS 13/01 at [37] and [39]). We note that the Commissioner may apply to extend the 7 year retention period for a further 3 years if a taxpayer is under (or intended to be under, or the Commissioner is "actively considering") an audit or investigation. For completeness, taxpayers also have a duty to preserve relevant evidence under rule 8.3 of the High Court Rules, if litigation is "reasonably contemplated". This includes preserving potentially relevant emails in readily retrievable form, even if they would otherwise be deleted in the ordinary course of business.

Credibility and consistency – filtering tools can help

It can be tempting to be drawn into providing explanations to Inland Revenue during the early phase of an audit. However, there is considerable risk in doing so without first reviewing relevant emails and other electronic material that may be uncovered in the course of the audit. This need for establishing a clear and credible position at the outset of the audit/dispute process, and consistency with that position as the audit/dispute progresses, has recently been illustrated in the Court of Appeal's judgment in Alesco. An explanation given, or position taken, which is inconsistent or at odds with material uncovered at a later stage, can quickly erode credibility and – if settlement is being pursued – bargaining position.

In our experience, "internal discovery" exercises are becoming more common at relevant stages of an audit or dispute. This involves reviewing all emails and other relevant electronic material (including, if needed, text messages and instant messages), before providing explanations to Inland Revenue and in order to fully assess the merits and weaknesses of a tax position. The main challenges in practice are:

- Volume of emails - it is reasonably common in a transaction to have "starting" email sets of 20,000 to 200,000 emails;
- Duplicate emails - in most email datasets there is often a high level of duplicates caused by emails being sent to multiple recipients, and the same email being stored in multiple locations (e.g. laptop, email server and back-up tapes);
- Review of emails - the needs of someone reviewing emails for audit/dispute purposes are different from someone reviewing emails for general business related purposes. The person reviewing must also have the requisite knowledge to tag certain emails as being relevant, discoverable, privileged, tax advice document, etc.

We have technology available that makes light(er) work of email review. The level of streamlining achievable by using specialised tools can be illustrated by a recent real example:

- We started with 450,000 emails;
- We reduced these by approximately 15% by removing duplicates (the reduction from duplicates is often closer to 50%);
- We further reduced this to approximately 4,000 emails by using a variety of keywords, date ranges and other filters.

By doing this, we were able to generate vast savings in terms of the cost and time required to review the emails. The client was able to review the 4,000 emails and attachments in less than a day, "tagging" documents as relevant, not relevant, etc. It meant that multiple layers of review could be applied to the final dataset (i.e. more than one set of eyes), in a cost efficient manner. In a section 17 notice context, it could also make what appear to be challenging deadlines both for responding and making tax advice document claims eminently achievable.

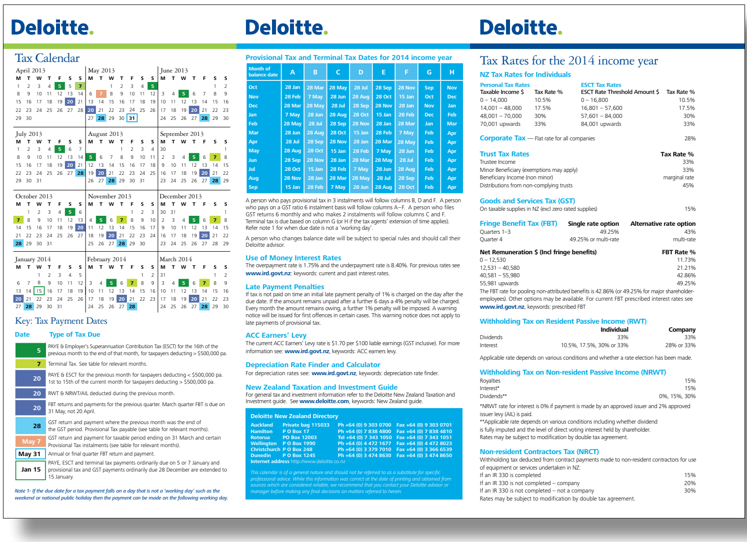
Concluding remarks

It is certainly true that email technology can contribute to a taxpayer's downfall, be it in a black letter or avoidance-related tax dispute.

However, it is equally clear that IT technology can feasibly be employed to:

- prevent the creation (or stem the proliferation) of adverse material;
- formulate policies around what electronic material can be deleted whilst maintaining compliance with record retention obligations and duties of preservation; and
- rationalise/review masses of electronic material with a view to ensuring that a credible and consistent position is taken, and that the strength and weaknesses of a position are most easily capable of assessment if settlement is plausible.

If you have any questions regarding anything discussed in this article, please contact your usual Deloitte advisor.



Tax calendar 2013-14

The Deloitte desk top tax calendar setting out key tax dates, rates and facts was posted out in early April and should have arrived by now. We send this annually to all Tax Alert subscribers for whom we have a current postal address. If you have not yet received one, please contact us so we can send one out to you. A PDF version can be downloaded from our website **here.**

STOP PRINT: Update on BEPs work

As we went to publish Tax Alert today, the Minister of Revenue, Peter Dunne, released a report outlining progress made with regard to the taxation of multinationals. The Officials' report notes that New Zealand is "well placed on this issue" and that "our tax laws are at or above world standards".

That said, he mentions that New Zealand and other countries, still have a responsibility to ensure their own domestic tax rules are sound. Historically actions such as introducing the bank minimum equity rules, re-characterisation of stapled stock, elimination of the conduit regime and tightening of the thin capitalisation rules are evidence of this. The Minister also notes that the Government will continue with any further domestic changes as necessary (such as those addressed in the recently released officials' issues paper on thin capitalisation). The Minister also notes that the ongoing OECD work will help highlight areas where New Zealand can further strengthen its domestic laws. To read the full report, click **here**.

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