Tax Alert

A focus on tropical tax issues– December 2013

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Inland Revenue proposal for minimum financial reporting requirements for SMEs: What does it mean for taxpayers?

By: Iain Bradley and Luke Redman

The amendments contained in the Financial Reporting Act 2013 will eliminate the need for many small-to-medium enterprises (SMEs) to prepare general-purpose financial statements. Commerce Minister Craig Foss commented that the changes lift the financial reporting burden from many companies, allowing them to "focus their time and energy on growing their businesses, innovating and creating jobs".

Instead of preparing general-purpose financial statements, SMEs will be required to prepare special-purpose financial statements to the minimum requirements specified by Inland Revenue. The idea is that this will result in lower compliance costs for most New Zealand SMEs. However, the Inland Revenue's proposal includes some information requirements that will actually increase compliance costs for some SMEs.

Currently under the Financial Reporting Act 1993, New Zealand companies that are not issuers and not subsidiaries (or have subsidiaries) must prepare general-purpose financial statements if they meet two or more of the following criteria:

- Total assets more than $1 million; or
- Annual turnover greater than $2 million; or
- More than 5 full-time equivalent employees.

Under the Financial Reporting Act 2013, New Zealand private companies will not have to produce general-purpose financial statements unless they are "large", defined as:

- Total assets more than $60 million; or
- Total revenue more than $30 million.

However, overseas companies conducting business in New Zealand (including their branches), and subsidiaries of overseas companies, have a lower threshold of:

- Total assets more than $20 million; or
- Total revenue more than $10 million.

Those overseas companies and subsidiaries of overseas companies that exceed the threshold will still be required to prepare audited general-purpose financial

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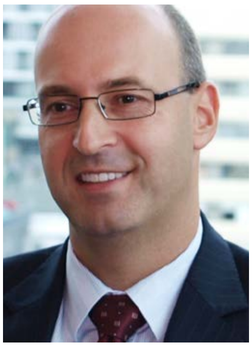

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statements and make those financial statements public by filing them with the New Zealand Companies Office.

Inland Revenue, as the largest user of financial statements in New Zealand, has had to give careful consideration to the level of information it needs now that the requirement for many SMEs to prepare general-purpose financial reports is being removed. The purpose of the minimum reporting requirements is to ensure companies accurately determine their tax positions and complete IR 10s on the basis of appropriate financial statements.

On 13 November 2013 Inland Revenue released an officials' issues paper, **Minimum financial reporting requirements for companies**, outlining the proposed minimum requirements for special-purpose financial statements. The taxpayers that will be affected by this proposal will be all active companies that do not have a statutory obligation to prepare general-purpose financial statements. The proposed minimum requirements will apply for periods commencing on or after 1 April 2014.

What are the proposed minimum financial reporting requirements for SMEs?

The Inland Revenue is proposing minimum financial reporting requirements. Hence, financial statements can still be prepared to any level above the minimum requirements. Taxpayers will be free to include additional disclosures if they choose and to produce partially or fully GAAP-compliant financial statements in addition to complying with the minimum requirements.

The minimum financial reporting requirements proposed by Inland Revenue are as follows:

- The financial statements should consist of a balance sheet and a profit and loss statement which shall be "appropriately detailed". "Appropriately detailed" has been deliberately left open to the judgement of the person preparing the financial statements. Where there is insufficient detail Inland Revenue has the power to ask for more detail.
- They should be based on double-entry historical cost-based financial statements prepared using accrual concepts.
- Where reasonably possible, tax values can be used for the determination of income and expenditure, fixed assets and depreciation, and the balance sheet.
- A statement of accounting policies and changes there to that is sufficiently detailed that a user can understand the material policies that have been applied or changed in the preparation of the financial statements.
- Comparable figures for the last year should be disclosed.

The financial statements or supporting schedules should show:

1. The relevant (for that taxpayer) IR 10 key points.
2. A fully detailed financial statement to taxable income reconciliation.
3. A reconciliation of tax losses and movements therein for the year including loss offsets and subventions, if any.
4. Certain related party transactions.

Notes should detail (qualifying companies are exempt from the first two requirements, look-though companies are exempt from all three of these requirements):

1. The available subscribed capital (shareholders' funds that can be returned tax-free to shareholders in qualifying circumstances) per class of shares issued;
2. Any amount of realised capital gains that could be distributed tax-free upon the liquidation of the company; and
3. A reconciliation of opening to closing imputation credits.

- If a forester, a statement of cost of bush as at balance date and a reconciliation of movements.
- If a specified livestock owner, detail of livestock valuation methods, valuations and calculations for taxation purposes
- A reconciliation of movements in shareholders' equity, and loans or current accounts to/from the owner and related parties.

- An appropriate note detailing "Exceptional items" – box 26 of the IR 10.
- An appropriately detailed taxation-based fixed asset and depreciation schedule.
- Interest should always be grossed up for resident withholding tax.
- Dividends should be grossed up for imputation credits to the extent that the dividend is taxable and the credits are usable to reduce the taxpayer's tax liability for that year.
- All realised and unrealised gains and losses that are recorded in the financial statements should be recorded in the profit and loss.

These financial statements would not have to be held in hard copy, as long as they are prepared as part of the tax return process. Further, there would be no requirement to annually file these financial statements with Inland Revenue. Rather, as indicated above, they would form the basis from which the IR 10 is prepared and filed and they would be available to Inland Revenue upon request.

Deloitte comment

There are a number of potential areas that taxpayers may wish to make submissions on in relation to the Inland Revenue's proposed minimum financial reporting requirements. For example, the requirement to disclose certain related party transactions will be more onerous than the current disclosure requirements for some SMEs and will increase compliance costs for those SMEs. The Inland Revenue has acknowledged the potential complexity of related party information they are asking for in the issues paper. As a consequence they propose that this disclosure requirement would be delayed 12 months and will apply for tax years commencing on or after 1 April 2015. The delayed application date recognises the additional work that will likely be required by businesses and their advisors to provide this information.

The requirement to track available subscribed capital and realised capital gains will increase compliance costs for many SMEs that do not currently track this information on an annual basis. Many SMEs would only calculate the available subscribed capital and/or realised capital gains at the time they are looking to return amounts tax-free to shareholders. Often these calculations can be complex and costly to undertake. For some SMEs they may not seek to return amounts to shareholders tax-free for many years (or not at all if, for example, they suffer losses) and yet they will be put to the initial cost of calculating these amounts and the annual cost of tracking these amounts.

The requirement to disclose certain related party transactions will be more onerous.

It is hard to argue against the merits of tracking this information given the longer the period the information is not tracked the more difficult and costly it will be to accurately calculate the available subscribed capital and realised capital gain amounts. The complexity of undertaking these calculations can often be magnified by the historic nature of the relevant transactions and the fact that older records may be missing or have been destroyed. What does seem inequitable though is the fact that SMEs will be required to track this information when it appears that large companies, that are still required to prepare general-purpose financial statements, would not be required to track and disclose the available subscribed capital and realised capital gain amounts. At the very least, a transitional period or an extension of time similar to that proposed for related party disclosures should be considered.

Taxpayers should also be aware that the income tax treatment of certain expenditure (such as the deductibility of research and development expenditure and the deferral of deductions for research and development expenditure) refers to the accounting treatment prescribed by financial reporting standards.

If the relevant financial reporting standards are not followed in the taxpayer's financial statements then this may give rise to adverse tax consequences. When this was raised with an Inland Revenue official the response was that the proposal outlines minimum financial reporting requirements and taxpayers are welcome to adopt specific financial reporting standards (either partially or fully) in their financial statements. Therefore, if SMEs wish to fall within certain aspects of the income tax legislation they may still adopt certain financial reporting standards and/or disclosures over and above the minimum requirements prescribed by the Inland Revenue.

Inland Revenue officials are participating in the New Zealand Institute of Chartered Accountants' SME Working Group which is recommending an accounting framework for special-purpose financial statements for small and medium enterprises. We understand the framework is now scheduled for release next year. It is too early to know exactly how this will integrate with Inland Revenue's minimum requirements, especially for items such as the requirement to track available subscribed capital and realised capital gains.

Clearly the minimum requirement special-purpose financial statements prescribed by Inland Revenue are not intended to satisfy all users of financial information. Businesses with loans and overdrafts from banks and other financial institutions will likely have additional financial reporting obligations. Similarly, the proposed minimum requirements are no substitute for high quality appropriately detailed financial information which gives owners and managers of businesses the tools they need to make informed decisions about the future direction of their business.

If you would like to discuss Inland Revenue's minimum financial reporting requirements for SMEs in more detail or make a submission on the officials' issues paper please contact your Deloitte tax advisor.

Submissions on the officials' issues paper are due by 20 December 2013.

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Employee allowances – the next chapter

By Robyn Walker and Hiran Patel

Employee allowances have been a topic of much debate over the last few years (see our last article on allowances **here**). Following the change in approach to the tax treatment of employee allowances by Inland Revenue, the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill ("November Tax Bill") seeks to amend and clarify the tax treatment of various expenditure payments and reimbursements to employees, the most significant being employer-provided accommodation.

The extensive consultation process and pushback from taxpayers on this hot topic has lead to some really positive changes and sensible outcomes for the tax treatment of accommodation, meal payments, and work related clothing. Bravo to Inland Revenue and the Government for coming to the party.

We outline below the key proposals, that once enacted will apply from 1 April 2015 with the option of retrospectivity for accommodation.

Accommodation

The drama around the taxation of accommodation has been well documented over the last year, so we don't dwell on it here. Suffice to say, there has been a clear difference of opinions on the appropriate interpretation.

What really matters is that the November Tax Bill proposes that the value of accommodation provided to a person when it is provided in relation to their employment or service (i.e. accommodation / accommodation allowances provided) is not taxable in a wide range of circumstances. Furthermore, in some instances the new laws will be able to be retrospectively applied in order to mitigate Inland Revenue interpretations on the current laws.

So, when will the provision of accommodation[1] be tax free?

[1] The new rules should also neutralise the tax outcomes whether an employee is provided directly with accommodation, if they receive an allowance or they are reimbursed for expenditure. In this article we talk about the provision of accommodation to cover all these scenarios.

Out-of-town secondments (two year exemption)

When an employee is required to work at a distant workplace, accommodation and associated necessary travel costs will be exempt from tax provided the employee's time spent at the new location is expected to last for a period of two years or less. These rules cover not just typical "secondment" arrangements but also other work-related trips – say an overnight stay, or a week-long visit to another workplace. Each time a new trip is undertaken the two year clock restarts; the clock doesn't however restart each time an employee on secondment returns home for the weekend or takes annual leave.

This exemption is generally limited only to accommodation provided to *existing* employees (i.e. if you hire someone with full knowledge they will need to relocate, then this exemption will not apply, but the existing relocation payment exemption may still have application). However, new employees will qualify for the two-year exemption rule if they are recruited to work at a particular location, but then are sent to work at another location temporarily (e.g. if they are immediately sent away for training). If an employee is also sent to work for another affiliated employer; i.e. they become a new employee of the affiliated employer; the exemption will also apply provided the secondment is expected to be no more than 2 years. This exemption will deal with secondments of employees between associated companies (e.g. a New Zealand head office and an Australian subsidiary)

If during the period of the project, the expectation changes and it is clear that the secondment will last for more than 2 years (including if the employee decides they want to stay in the new work location), the accommodation will become taxable at the time the expectation changes. Similarly, if at any time the employee receives a tax exempt relocation payment associated with the purchase of a new home the exemption will stop.

Projects of limited duration (three year exemption)

In circumstances where an employee is deployed to work on a project at a distant workplace and the principal purpose of the project is the creation, enhancement or demolition of a capital asset, the provision of accommodation and associated necessary travel costs may be exempt for up to three years. In order to qualify for this exemption the project must be carried out under a contract between the employer and an unassociated party (e.g. the employer has been engaged in a construction contract to build something for a third party), the employee's role must have clear expected start and end dates, the employee must be working almost exclusively on the project and there must be a clear expectation of the employer that the employee will be working on the project for no more than 3 years.

If it becomes clear that the employee will be working away from home for more than a three year period, the exemption will no longer apply (as is also the case with the two year secondment rule). The project itself can last for more than three years; however for the exemption to apply to a specific employee, the employee must have reasonably been expected to work on the project for no more than three years.

As with out-of-town secondments, the exemption will also stop if an exempt relocation payment is made in respect of the purchase of a new house. However, unlike the out-of-town secondments exemption, this exemption can be applied to new employees.

Canterbury earthquake relief

The bright-line tests mentioned above can be extended for up to five years if the employment is in relation to a Canterbury earthquake recovery project. Employees receiving accommodation while working on the recovery or rebuild in the greater Christchurch area are entitled to exemptions dependent on when they arrived, as follows:

- A five year exemption when the employee's date of arrival is in the period from 4 September 2010 (the date of the initial earthquake) to 31 March 2015;
- A four year exemption when the employee's date of arrival is in the period from 1 April 2015 to 31 March 2016; and
- A three year exemption when the employee's date of arrival is in the period from 1 April 2016 onwards (for arrivals up to 31 March 2019).

From 1 April 2019, the normal three-year rule in respect of capital projects will apply.

It is pleasing to see that the proposals seek to retrospectively apply to employees who were deployed to Christchurch at the time of the initial earthquake.

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Conferences and overnight stays

In circumstances where an employee is required to attend a work-related conference or training course that requires an overnight stay, the accommodation or accommodation payment provided to the employee is exempt from tax. The proposal covers both local and out of town conferences for employees, as there may be situations where an employee is provided accommodation in their local area of residence during a conference for reasons such as networking.

Multiple work places

The November Tax Bill proposes that the provision of accommodation to employees working in more than one workplace on an on-going basis will be exempt from tax without an upper time limit. However, this rule will not apply to employees where one of their workplaces is a home office.

What if the accommodation allowance is taxable?

When the exemptions above do not apply and accommodation allowances are to be treated as taxable, the taxable value will be based on the market rental value (less any rent paid by the employee, and adjustments for business use of the premises). Special valuation rules exist for employees deployed offshore to expensive locations to ensure taxable incomes are not disproportionately increased.

Some specific valuation rules are also proposed for ministers of religion and for accommodation provided by the New Zealand Defence Force.

Past voluntary disclosures on accommodation

As noted above, the reforms apply from 1 April 2015. However, a transitional provision applies to protect taxpayers that incurred expenditure in relation to accommodation allowances between 1 January 2011 and 31 March 2015 provided that they did not, before 6 December 2012 (the date the Commissioner of Inland Revenue released her statement on the taxation of accommodation), take a position that accommodation is taxable.

Taxpayers who have previously treated accommodation allowances as tax exempt,but made a voluntary disclosure following the Commissioner's Statement, should in theory be entitled to a refund. This point is sure to be drawn out via submissions on the November Tax Bill.

Meal payments

The November Tax Bill proposes that meal payments incurred due to work related travel are exempt for up to three months at a particular work location. Furthermore, meal payments and light refreshments incurred outside of work-related travel (such as at conferences) are also exempt in certain circumstances, without a time limit.

While officials note that there is an inherent private benefit associated with meals, the proposals seek to take a pragmatic approach and do not require taxpayers to undertake the compliance burden of apportioning amounts.

Clothing

A specific exemption is proposed in the Bill to make it clear that an allowance to cover the cost of buying and maintaining distinctive work clothing is not taxable. This will include items such as uniforms or protective clothing that are related to the employee's job.

The Bill also provides an exemption for allowances paid in respect of plain clothes to employees of a uniformed service who are required to wear ordinary clothing instead of their uniform.

The proposals seek to better align the employee expenditure rules with the equivalent fringe benefit rules. As such, the outcomes are the same from a tax perspective whether such clothing is provided directly to an employee, or whether they are paid an allowance for it.

Other allowances and determinations

There are some general tweaks being made to the general rules for expenditure payments to ensure they are working effectively and as intended. To further future-proof the legislation, a determination making power is being inserted into the tax rules to allow the Commissioner to issue determinations when it is not clear what portion of a particular type of payment should be treated as taxable (think phone allowances, for example). Determinations will be able to be applied for in respect of payments made to a wide group or class of employees which are made mainly to reimburse expenses associated with deriving employment income where the private element is hard to measure.

Salary sacrifice arrangements and gaming the system

A number of the above exemptions include an avoidance rule to ensure that the exemptions do not apply to employees when the accommodation or meal allowance is provided under an explicit salary trade-off agreement. There are also measures to prevent employees from restarting the respective time limits. For example, an employee's time away (from their secondment location) on leave, weekend breaks, rest periods, or other similar reasons, will not restart their time limits, i.e. this time is included as part of their secondment.

The way forward

The proposals in the November Tax Bill take a pragmatic approach and apply the principle that private elements in relation to allowances received should be ignored when low in value or hard to measure, and not provided as a substitute for salary or wages.

The November Tax Bill takes the employee allowances saga of past years in the right direction, and it is clear that officials have approached the proposals with a view that taxpayers should not be burdened with unnecessary compliance costs.

The November Tax Bill is expected to have its first reading this month, following this, it will be referred to the Finance and Expenditure Select Committee who will call for submissions on the Bill.

Please contact a Deloitte tax advisor if you would like to discuss the topic of employee allowances or if you would like to make a submission on the Bill.

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Investing in a chance: TrustPower secures a rare taxpayer win in the courts

Campbell Rose and Matthew Scoltock

Introduction

Just when we had given up all hope that a thought-provoking black letter law tax issue would once again reach New Zealand's courts - and that taxpayers can win tax cases - Justice Andrews delivered the High Court's judgment in *TrustPower Ltd v Commissioner of Inland Revenue*[1] on 12 November 2013.

Her Honour confirmed that TrustPower's more than $17m of costs in applying for and obtaining resource consents, as part of a feasibility process, were deductible and not to be treated as capital in nature. In doing so Justice Andrews noted it was "artificial" to regard the consents as assets in their own right (as the Commissioner had argued), but her finding does appear to be heavily grounded in the particular facts of the case.

The commercial setting

Generating roughly half of the electricity that it distributes, TrustPower has in place a "development pipeline" of wind and hydro electricity generation projects at varying stages of feasibility assessment. The development pipeline enables TrustPower to decide whether or not, at any given time, it is best placed to "build" generation capacity or "buy" electricity for sale in the retail market.

Without any guarantee that a potential generation project will proceed to a finished product, TrustPower's development pipeline provides a means to explore the viability of electricity generation or – as one of TrustPower's witnesses put it - to "invest in a chance".

TrustPower uses a three-step process in assessing the feasibility of potential electricity generation projects. The consent aspect of the feasibility process arises after potential site selection but prior to design/costing, and before business case preparation. Being in the development pipeline does not automatically mean that a potential project will ultimately be constructed.

[1] CIV 2011-404-007140, [2013] NZHC 2970 (TrustPower).

The issues

Between 2005 and 2007, TrustPower incurred costs of around $17.7million in applying for, and obtaining, resource consents in respect of four potential projects in the development pipeline that never proceeded.

In TrustPower's view, these expenses were ordinary operating costs in the nature of feasibility expenditure, and therefore deductible. The Commissioner considered that the consents were stand-alone/separate assets, and were capital in nature – so that the associated costs were non-deductible.

The Court was faced with two key issues:

- Were the resource consents "stand-alone" assets for the purposes of the capital/revenue analysis?
- If so, were they assets that were capital or revenue in nature?

The disputes/litigation process

It is evident that the disputes process in this case was somewhat frustrating. Despite TrustPower having agreed to a time bar waiver, the Adjudication Unit was unable to issue its decision in time, meaning that an assessment was issued and proceedings filed to keep the dispute "live". The Adjudication Unit issued its decision a little over two weeks after the extended time bar had expired.

It is also curious that the Adjudication Unit appeared unable to make a decision in respect of all the legal issues, and returned the dispute to the Service Delivery Group to make relevant adjustments resulting from the conclusions that the Unit had managed to make. If this was the cause for the delay, then some form of communication with TrustPower and the Commissioner may have facilitated a fully reasoned decision being issued by the Unit.

Anecdotally, we understand that (unsurprisingly) the discovery process was extensive, costly and time-consuming – bearing in mind that this was a capital/revenue case, where general anti-avoidance was not in issue. It is conceivable that tens of thousands of emails needed to be whittled down through the use of forensic tools that we have discussed in other **Tax Alerts**.

Finally, it is clear that the factual evidence provided on behalf of TrustPower by its engineers, its chair Dr Harker, and its General Manager of Generation, Mr Kedian, was instrumental to the Court's findings. The engineers had spent 10 years 'living and breathing' the development pipeline, and proved to be highly persuasive witnesses.

The general principles

At the outset her Honour noted the conceptual difficulty of capital/revenue issues, citing case law authority that the dichotomy is almost as satisfactorily decided by "the spin of a coin … as by an attempt to find reasons", "the principles are elusive", and that the area is an "intellectual minefield".

That said, Justice Andrews' thorough judgment traverses the established principles in considered detail. Her Honour ultimately focuses on the practical question of what the expenditure on the resource consents was calculated to effect from a practical and business perspective.

A "stand-alone" asset?

Although we understand that this issue did not warrant a great deal of analysis in the Adjudication Unit's findings, the case before the High Court largely turned on whether the resource consents were stand-alone assets. To answer that question, the Court looked to the nature of the consents, and specifically what they provided TrustPower with.

The Commissioner contended that the consents ought to be viewed as stand-alone assets, as they provided TrustPower with benefits both in and of themselves, and as part of a "package of rights". The Commissioner noted that the consents provided TrustPower with the ability to build now or defer construction, that they provided an effective block to competition, and that they could be sold for valuable consideration.

The Court, however, was not swayed by the Commissioner's argument. Justice Andrews preferred TrustPower's position: the resource consents were inseparable from the land to which they related; they were no more than one aspect of a "suite" of rights; the intrinsic value of the consents in blocking competition was "tenuous, at best", particularly because "the same wind will blow across the hill next to where TrustPower has resource consents"; and TrustPower was only ever interested in each site as a whole (of which the resource consents were a single component).

The Commissioner contended that the consents ought to be viewed as stand-alone assets...

For these reasons, her Honour found the Commissioner's submission that the resource consents were stand-alone assets to be "artificial" on the facts of the particular case before her. In this respect the factual evidence concerning the development pipeline was key; we do not consider that the *TrustPower* decision has necessarily established a general proposition capable of application across a number of different contexts.

The BP Australia[2] *indicia*

Despite finding in favour of TrustPower on the basis that the resource consents were not stand-alone assets, Justice Andrews went on to look in depth at "*the BP Australia indicia*" to determine (for "the sake of completeness") whether – if the resource consents were separate assets – they were capital or revenue in nature.

Again, her Honour preferred TrustPower's arguments. She found that "the need or occasion" that required expenditure on resource consents was to "advance projects along the development pipeline". Accordingly, the expenses had the same character as TrustPower's other operating costs. The expenditure on the resource consents was "recurrent in nature", as it formed part of a continual feasibility investigation. In this respect the factual finding that TrustPower had not committed to proceed with any of the projects was critical (i.e. the consents did not themselves relate to existing projects).

[2] BP Australia Ltd v Commissioner of Taxation for the Commonwealth of Australia [1966] AC 224 (PC) (BP Australia).

Although Justice Andrews found that resource consents provided an enduring benefit, the costs were clearly treated as revenue in accordance with ordinary accounting practice, and most importantly:

"… the expenditure incurred in obtaining the resource consents was indiscriminate as part of TrustPower's general business operations expenses. The expenditure was not to secure the specific consents, but to assist TrustPower in determining a source of supply of electricity. When seen from TrustPower's business and practical point of view, the resource consents are only one of the components of a particular project option, each option is part of the development pipeline as a whole, and the pipeline is only one of the possible sources of electricity to be sold by TrustPower. A grant of resource consents was necessary to advance a project along the development pipeline, but the grant was not in and of itself sufficient for a decision to be made to take any project through to the next stage."

Concluding observations

It remains to be seen whether the Commissioner will appeal this decision to the Court of Appeal.

Significantly, the Commissioner's attempt to draw adverse inferences from carefully selected email and other documentary evidence did not find favour with the High Court given the credibility of TrustPower's factual witnesses. This was undoubtedly a key to TrustPower's success.

Finally, it is noteworthy that the disputes process is just as cumbersome, time-consuming and costly even for a case involving black letter law (as opposed to general anti-avoidance) issues. The time for a further and more trenchant reform of the process must surely be fast approaching, to prevent taxpayer burn-off and develop New Zealand's tax law jurisprudence through substantive cases making it through to our courts.

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GST matters

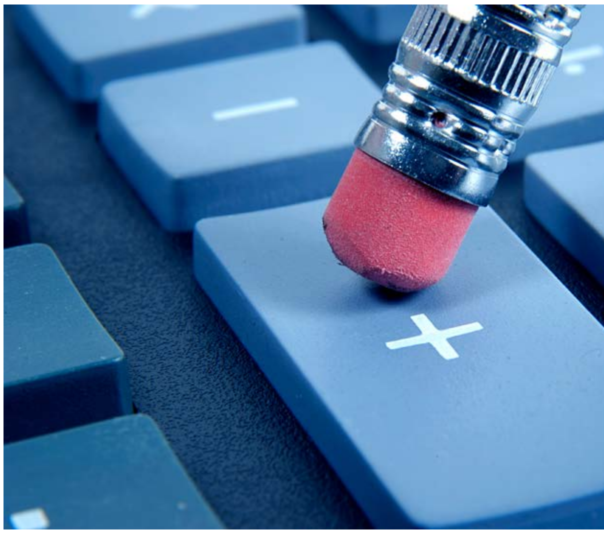
By Vlad Skibunov and Catherine Yung

The recently introduced Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill contains a number of GST remedial matters, most of which have been previously discussed in the 2012 GST issues paper. Below we have set out a summary of the main GST amendments.

The Bill:

- provides that a supply of accommodation in retirement villages or rest homes where the occupants are essentially living independently will be treated as a dwelling and therefore GST-exempt;
- extends the scope of the deeming provision in section 5(16) to require GST output tax on all sales of land (rather than just for a dwelling as is the current position) where input tax has been claimed in respect of the acquisition of the land. Currently, no output tax is payable in these circumstances if the disposal is not in the course of a taxable activity;
- deems there to be a supply of services from an employer to a third party when an employee is engaged by the third party to be a director, and the employee is required to account to the employer for any payments received. This amendment proposes to close a gap in the existing rules which currently precludes the third party from claiming input tax in relation to director fees paid to the employee;
- introduces a new rule requiring taxpayers subject to the apportionment rules to perform a 'wash up' calculation when the asset changes to 100% taxable or non-taxable. This amendment is intended to reduce the compliance cost for taxpayers from having to make on-going adjustments (especially in relation to land); and
- makes a number of other remedial changes in respect of the zero rating of land rules, GST apportionment rules, and the time of supply rules in respect of the definition of hire purchase agreements.

If you would like to know more about the above issues, please contact your Deloitte GST advisor.



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What's on the tax policy horizon?

By Robyn Walker and Alex Mitchell

On 8 November 2013 the government's new Tax Policy Work Programme (the Work Programme) was released. The Work Programme provides an insight into the areas of tax reform that are likely to be coming over the next 18 months.

The latest Work Programme lists a very ambitious suite of areas where the government believes tax reform is required (or should at least be considered). It will be a real challenge for Inland Revenue to make headway through the sheer number of items that they have signed up for, some of which are very challenging technically and will require a "tread carefully" approach from a political perspective – think GST on online shopping.

Outside of the traditional tax policy items on the Work Programme, and not to be underestimated for its ability to consume Inland Revenue resources on the policy front, is the Business Transformation project. This features heavily on the Work Programme, along with international tax reform and areas that Inland Revenue believes are necessary to address base erosion and profit shifting ("BEPS").

So what are the big ticket items for business?

Black-hole R&D expenditure

The government has recently released an issues paper proposing reforms to mitigate black hole expenditure that can arise in the context of successful and unsuccessful research and development. No business likes to be told that a business expense is not deductible, and this item is therefore another welcome step by the government to remedy an area of black hole expenditure. The discussion document is currently subject to consultation, and we are hopeful that legislation should be included in a 2014 tax bill.

Interaction of loss grouping and imputation

This item is a very welcome inclusion on the Work Programme. Inland Revenue will be considering how to preserve the benefits of loss-offsetting for shareholders of non-wholly owned groups. The issue is that majority investors are driven to acquire 100% of a company in order to access the wholly-owned dividend exemption rather than stopping once 66% commonality has been achieved.

Closely-held companies

Inland Revenue will be considering simplification, technical and base maintenance issues that arise under the current tax rules for closely-held companies. This will include a review of the look-through company rules.

Tax pooling

The tax pooling industry celebrated its 10 anniversary earlier this year. In many ways, the industry has become a victim of its own success, with Inland Revenue flagging a review of the regime to ensure that there are no regulatory issues with its operation. This is a direct result of the sheer size of the tax that flows through tax pooling intermediaries. Inland Revenue will be under

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pressure to complete this review and fix some other niggles with the regime as soon as possible, so that the next ten years can pass without incident.

Depreciation on buildings

This item involves the review of some on-going boundary and remedial issues stemming from the removal of depreciation on buildings in the 2012 income year. In particular, one of the main problem areas has been where a 'building' is part of plant or integral to plant, such that it is not traditional "building structure". Having this issue added to the work programme is a great outcome for those taxpayers that have been making to case to government for reform in this area since the initial Budget announcement in 2010.

Minimum financial reporting standards

Inland Revenue has recently released an Official's issues paper, *"Minimum financial reporting requirements for companies"*. This sets out a proposal for minimum financial reporting requirements for small and medium-sized companies which have no more than $20 million in turnover or $60 million in assets. This is a necessary consequence of changes to the Financial Reporting Act 1993 that mean such companies will not be required to file general purpose financial statements. The discussion document is currently subject to consultation, and will then proceed through the usual policy process.

Active income exemption for offshore branches

In late 2006 the review of our international tax rules commenced. Over 7 years later we have an active income exemption for Controlled Foreign Companies ("CFCs") and Non-Portfolio Foreign Investment Funds ("FIFs"), and the Work Programme signals that an active income exemption for Foreign Branches is next. Continued work in this area is very important to ensure that New Zealand businesses can continue to complete in foreign jurisdictions without excessive compliance costs.

GST and online shopping

We expect that an issues paper will be released shortly that seeks to define the concerns with the GST issues associated with the increase using of online shopping on overseas websites. There are likely to be a strong mix of views from the retailers and the general public in this debate, and we expect that the government will tread carefully and take its time. We would be very surprised to see any legislation next year on this issue.

BEPS items

The government has not yet undertaken any precipitous action or engaged a knee-jerk response to the OECD's Action Plan on BEPS released earlier this year. This cautious approach is to be welcome. However Inland Revenue has convinced Ministers' that as an initial step the following areas are worthy of consideration:

- *Profit-shifting using related-party debt* – Inland Revenue is concerned that the transfer pricing rules allow non-residents to shift profits by funding their New Zealand investment with related-party debt that can justify a higher rate of interest and associated interest deductions in New Zealand.
- *Foreign hybrid instruments and entities* – this item will consider whether New Zealand should restrict interest deductions on hybrid instruments where the interest payment is not taxed in the foreign jurisdiction. It will also examine the need for an anti-arbitrage rule for offshore entities to prevent double non-taxation or double deductions.

- *NRWT on related-party debt* – Inland Revenue has identified a number of arrangements that can be used to defer or circumvent NRWT on related-party interest payments. Their concern is that such payments can be used to shift profits out of New Zealand and into low-tax countries or entities. This item will consider what options are available to mitigate Inland Revenue's concerns.

Other

While not impacting directly on a wide range of businesses, the Work Programme also includes items to introduce the ability to cash-out R&D tax losses in certain circumstances; a review of the tax treatment of government grants; scoping a review of the tax treatment of annuities; a number of areas for remedial attention; and advancing work on information-sharing and Business Transformation.

Overall the Work Programme represents a good balance between reforms that are intended to improve current tax settings and assist businesses, and reforms that will look to protect that the tax base and raise revenue. While there is always more that can be done to assist businesses from a tax perspective, it is the direction of reform that is important. With the Minister of Revenue recently announcing an end to "nickel and dime" taxes, the direction of travel looks to be positive.

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Inland Revenue's ability to chase down tax evaders becomes easier

By Veronica Harley

In late November 2013, the Government announced that it had completed the final steps for ratification of the multilateral Convention on Mutual Administrative Assistance in Tax Matters. This convention, originally signed in October 2012, authorises tax authorities of the signatory countries to assist each other regarding the exchange of information, unpaid tax recovery and service of documents. New Zealand is one of 54 countries that have signed the convention.

This convention significantly increases New Zealand's ability to detect and prevent tax avoidance. A key practical benefit of New Zealand signing up is a reduction in the future resources and administration costs of having to negotiate new bilateral treaties or update existing ones. For example, at least 14 of the countries that have signed up to the convention are ones with which New Zealand does not have a double tax agreement or a tax information exchange agreement.

It should be noted however, that the convention also contains some mechanisms which allow a country to avoid working with particular countries on certain grounds. For example a country can refuse to comply with information requests, for example, on human rights grounds or if a request is at odds with its own laws.

There is growing importance of exchange of information internationally, particularly with the backdrop of base erosion and profit shifting (BEPS) concerns. It is interesting to note that in addition to specific requests by one country to another, it is becoming increasingly common for automatic exchanges to occur. For example, this is where certain tax authorities have made arrangements to provide another country with certain generic information, for example, all non-resident withholding tax deducted from interest payments. Apparently New Zealand Inland Revenue already receives one million documents in bulk from the Australian Tax Office each year in an automatic exchange arrangement. It is highly likely the New Zealand reciprocates in some way.

More spontaneous exchanges are now occurring. This is where a tax authority will pass on information uncovered during an investigation that it considers of interest to another tax authority. It is also now more common for tax authorities to conduct simultaneous tax examinations. For example, where two tax authorities investigate the affairs of a multinational company at the same time and share the information discovered.

Signing this convention is yet another tool in the Inland Revenue's armoury which it will use to tackle international tax avoidance, evasion of tax through not declaring overseas income and those taxpayers that seek to escape paying debts by absconding overseas.

This convention will come into force on 1 March 2014.

Update on the foreign super and mining tax bill

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill, introduced in May 2013, was reported back from the Finance and Expenditure Committee (FEC) on 28 November 2013. This Bill contains the new rules to replace the existing treatment for taxing foreign superannuation. It also contains new specified mineral mining rules. We reported on these two proposals in detail in our **June 2013 Tax Alert**.

The FEC has recommended that the May 2013 Bill be passed with some amendments. With respect to the taxing of foreign superannuation, the amendments are mainly aimed at ensuring the rules work as intended and so mainly concern technical clarifications. The new rules broadly mean that lump-sum amounts received from 1 April 2014 will be taxed on receipt under one of two new calculation methods – the schedule or formula methods. The FIF rules will generally cease to apply to foreign superannuation interests from 1 April 2014, unless taxpayers choose to "grandparent" and continue to use the FIF rules. In reality, if taxpayers have complied and used the FIF rules prior to 20 May 2013, they will essentially be forced to continue to apply the FIF rules, because if they switch to the new rules, double taxation could arise. Officials were not at all persuaded by submissions that taxpayers would want to switch to using the new rules.

The other major component of this tax Bill is the mineral mining reform, for which a new regime is proposed which is less concessionary than the current treatment and more in line with the rules for other taxpayers. The FEC, while in agreement with the general direction of the reforms, has suggested some amendments out of a concern it was leaning too far the other way and had the potential to penalise miners and jeopardise their international competitiveness.

At the time of writing this, this Bill was still to have its second reading before Parliament.

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Did you miss our special tax alert on the new bill?

As you may be aware, a new tax omnibus style bill was introduced into Parliament on 22 November 2013 – the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill. Besides the employees allowances and GST measures reported on in more detail in this issue, it also contains a range of other important tax measures impacting thin capitalisation, black hole expenditure, the acquisition date of land, land-related lease payments, agreements for sale and purchase, the repeal of the substituting debenture rule, FATCA , charities that deregister and more.

If you missed our special report on this Bill, it is available on our website **here.** At the time of writing this, the Bill was still to have its first reading and be referred to the Finance & Expenditure Committee, at which time a submission date will be determined.

Merry Christmas

This is the last monthly Tax Alert issue for the year, although there could still be a special Tax Alert depending on when the Government releases the expected discussion document on GST and online sales. In the meantime, we wish all our readers a merry Christmas and hope you have relaxing holiday break over the New Year. Tax Alert will be back in February 2014.

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