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Tax Alert
November 2013

Tax Alert

A focus on topical tax issues – November 2013

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Multinationals come under the compliance spotlight

Last week Inland Revenue released a compliance focus document aimed at multinationals. The term multinational is used as the document draws a lot of its themes from the current global focus on multinationals and base erosion and profit shifting concerns. However, all medium to large New Zealand companies should be cognisant of the proposals in this document.

While there are some useful checklists included, this document is also peppered with statements which can effectively be interpreted as "you have been warned, so get your ducks in order before we come calling" which is no doubt intended to encourage compliant behaviour by taxpayers. Some comments however, also run the risk of frightening off those that want to do business in New Zealand or New Zealand enterprises who wish to expand internationally as tax outcomes of doing business could be less certain or more costly.

Cross-border financing arrangements

As cross-border financing typically forms a substantial part of total associated party dealings, it is top of the hit list for Inland Revenue. Particular issues include:

- Structured financing arrangements
- Hybrid instruments (e.g. mandatory convertible notes)
- Hybrid entities (e.g. certain limited partnerships)
- Unusual financing arrangements, exotic or novel financing products
- All inbound loans of more than $10 million
- Outbound loans of all sizes with no interest or where no fee is charged for a guarantee

Using these arrangements will likely attract attention and so the key message is to ensure your reasons for using these types of arrangements are commercial first and foremost and that all internal and external documentation support this.

The emerging trend is for Inland Revenue to threaten to use the general anti-avoidance provision even though taxpayers may meet the black letter tax provisions.

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> "The key message is to ensure your reasons for using these types of arrangements are commercial first and foremost"

The example cited in this document is where a taxpayer satisfies the debt to asset ratio provided for in the thin capitalisation rules. Inland Revenue go on to state that if a loan would not have taken place in the open market it may question the commerciality of the financing arrangement between the parties and would consider using the anti-avoidance provision.

Interest deductions and NRWT
There is a growing focus around interest deductions and checking to see if any corresponding non-resident withholding tax or approved issuer levy has been paid. In the latest Tax Policy Report on the Taxation of Multinationals (see article on this elsewhere in this issue) there is a further comment about being aware of the "wide range of arrangements that can be used to defer or circumvent NRWT on related party interest payments". There may well be a legitimate concern if the NRWT rules are being circumvented such that NRWT is never paid.

However it should be pointed out that the tax law states NRWT is not payable until the income on which it is payable is distributed, credited or dealt with on a lender's behalf. This is completely different from the test that is applied by the New Zealand borrower claiming the deduction for interest and so applying the legislation correctly can actually produce a timing mismatch. This position is long standing, well understood and is supported by case law. It has also been challenged and conceded by Inland Revenue in the past and so if this is what Inland Revenue are alluding to, and it is no longer considered the correct policy outcome, then it's time to change the law rather than assert there is some mischief in this.

Transfer pricing

The major transfer pricing risks are:

- Not having documentation to support transfer prices
- Having a material level of untested transactions
- A major downward shift in profitability of a New Zealand company when acquired by a multinational group
- Widely differing profits between the local company and members of the global group as a whole as well as the industry
- New Zealand management accepting prices set by overseas associates without question

Inland Revenue come right out and say they want their fair share of the multinational tax pie. The problem with this is that other countries also want their "fair share". We are not sure there is enough pie to go around! Inland Revenue acknowledge that some jurisdictions have aggressive tax policies. Regardless, it states that taxpayers should definitely not be tempted to leave more profit in that jurisdiction to avoid conflict. Best practice is therefore to negotiate an advance pricing agreement. Not having this in place could mean having to resort to the competent authority process in order to resolve any dispute which could be more costly and time-consuming.

Controlled foreign companies

Inland Revenue is closely watching to see that taxpayers are technically complying with the new controlled foreign company (CFC) rules. In particular it is monitoring any possible abuse of the rules through aggressive tax planning. Fair enough we say. However Inland Revenue say it will also look at any changes in CFC operations between the old and new CFC rules such as restructuring operations or shifting functions, assets and risks so that active CFCs qualify for total exemption. In other words the implication is that restructuring operations to fit within the active income exemption rules is not acceptable? Presumably the new focus on transfer pricing as part of the CFC rules necessitates that a review be carried out in terms of where functions, assets and risk sit and action taken to reflect the reality of operations.

The familiar red flags

Inland Revenue has compiled a list of "familiar red flags" which will attract Inland Revenue's attention. It suggests taxpayers should have explanations prepared with supporting documentation in the event these flags are raised. As Inland Revenue points out, these issues are not new and may seem obvious, but are still worth checking off before that tax return is filed.

Familiar red flags	
Is the effective tax rate below 28%?	Has the group been involved in any complicated arrangements?
Has the group participated in any material transactions involving a low or no tax jurisdiction?	Are there any untaxed profits, or high levels of foreign tax credits or imputation credits claimed?
Are there material differences between accounting and tax treatment for major items?	Have uncharacteristic losses arisen or been utilised?
Has the group taken part in any transactions where the anticipated net return is predominantly due to tax benefits?	Have any mergers, takeovers or ownership changes affected the continuity tests for losses and imputation credits?
Are there any differences in the tax treatment of a transaction or entity between countries (e.g. treated as debt in one but equity in another?)	Are there any material variances between the years in profitability, tax payable or line items in the financial statements

Addressing common GST areas

A review of GST returns over the past 12 months has revealed five key errors that need more attention. These are:

- Failing to recognise the GST implications of associated party transactions, particularly with regard to property leases, management services, the provision of employee time and supplies of trading stock.
- Incorrect treatment of non-routine transactions, for example insurance settlements which can be subject to GST.
- Time of supply issues when accounting for GST, particularly for part payments, deposits or when any invoice is received.
- Treating exported goods as zero-rated when the conditions for zero-rating are not met.
- Errors in GST returns – transposition of numbers, arithmetical errors, fields left blank and not including items in the correct return period.

Executive remuneration and payments to non-resident contractors

We have noted a new focus on executive remuneration packages (see our article on employee share schemes elsewhere in this issue) and payments to people who are not New Zealand tax residents (non-resident contractors). Inland Revenue confirm this saying they commonly find mistakes in the less common benefits provided to executives and they also recommend that care be taken around tax equalisation arrangements.

For non-resident contractors, Inland Revenue recommends close attention is paid to correctly complying with Non-Resident Contractors Tax (NRCT) rules. For example, where non-resident contractors apply for an exemption certificate from NRCT, we have noticed increased scrutiny by Inland Revenue checking and sometimes challenging the assertion that the non-resident doesn't have a permanent establishment in New Zealand.

Conclusion

On the matter of tax governance, Inland Revenue suggests that New Zealand members of a multinational group need to ask themselves the following key questions:

- Are appropriate resources applied to tax matters?
- Are sufficient internal controls, checks and balances in place and are they actually carried out?
- Is there good tax awareness in critical business areas beyond the central tax or finance team?
- Are you aware of legislation changes affecting your business?

There is also a section on bribery awareness and 10 key questions to ask in order to assess your risk.

This is an important document that companies and their executives need to be aware of. It may be timely to review and update tax governance documents – tax policies, tax management plans and tax risk profiles.

On the question of dealing with uncertainty, taxpayers will have to consider seeking advance pricing agreements, using the binding rulings process, or at the least seek indicative reviews as a matter of course.

Please contact your usual Deloitte tax advisor for more information about this document.

Regular pattern of building and selling houses catches up with trustees

In a recent Taxation Review Authority case[1], Sinclair DJ has found that the trustees of a trust failed to prove on the balance of probabilities, that they were not liable for income tax, GST and shortfall penalties in relation to various property transactions undertaken. This case perhaps sits at the obvious end of the scale in terms of what is a taxable event from carrying out land transactions. However it also highlights several interesting points and misconceptions about the rules that apply and the need to take tax advice at an early stage.

By way of background, the taxpayers were three trustees in a family trust (the trust) which over a nine year period, established a pattern of buying a vacant section, building a house and on selling that house within a short time. One of the trustees, Ms X was in fact a solicitor and independent trustee who could be described as a passive trustee who was not involved in the specifics of implementation. The other two trustees were husband and wife (Mr and Mrs B), who were also primary beneficiaries of the trust together with their children.

The trust entered into 11 transactions during the nine year period, with the family only living in each property, on average, for seven months. While not every sale resulted in a profit, the trust built up considerable equity over this period. The issues for determination in this case were:

1 TRA 019/11 [2013] NZTRA 05

- Whether the amounts received on the sale of the properties were taxable as income on the basis that:
  - The properties were acquired with the intention of resale;
  - The trust was in the business of erecting buildings;
  - Or whether the residential exemption applied to certain properties.
- Whether the trust was liable to account for GST output tax.
- Whether the trust was liable for shortfall penalties for gross carelessness or alternatively for not taking reasonable care.

Acquisition of land with the intention of resale

If a person acquires land for a purpose or intention of selling it, an amount derived from the sale will be income. The trust had the onus of proof to show on the balance of probabilities that it did not acquire the land with a purpose or intention of sale. Ascertaining this purpose involves questions of fact and degree. The reasons for selling in this case make interesting reading. For example, property 2 was sold because there was a "creepy guy" next door, property 3 was sold because the woollen carpets installed caused asthma, property 4 was sold because there was concern that the home might be leaky, property 5 was sold because they wanted to move closer to their daughter's school and so forth. Overall Sinclair DJ did not consider Mr and Mrs B to be credible witnesses. The explanations provided for the respective sales and purchases were not supported by contemporaneous documentation or other evidence and in each case the Judge felt that a reasonable person would take steps to mitigate or remedy the problems rather than making a decision to sell having only been in each house for a matter of a few months. Accordingly, it could be reasonably inferred that at the time each property was purchased, there was an intention on the part of the Trust to on sell it.

Was the trust in the business of erecting buildings?

The law states that an amount derived from the sale of land is income if at the time the land was acquired, the person carried on a business of erecting buildings, the person made improvements to the land, and either the land was acquired for the purposes of that business or it was sold within 10 years of the improvements being made.

The trust employed the same draftsman and builder to construct the houses on the sections purchased by the trust. In each building contract, the work was completed to the gib-stopping stage. Mr B obtained the building consents on most occasions, and both Mr and Mrs B played an active role in project management. Mr B was responsible for organising sub-trades and for completing the finishing work post gib stopping. Each project involved a considerable financial and time commitment by Mr and Mrs B on behalf of the trust. Other factors taken into account were:

- That the period between each purchase was short. In some cases the Trust had purchased the next section before the last one was sold.
- The sections were all located in three streets in three separate subdivisions. In some cases, the properties were adjoining. The houses were all of a similar size and construction, built on a fixed fee basis to the same stage.
- The houses were only lived in for about 7 months on average, but the time between occupying and listing each property was less.

It was held that, on examination of the evidence, by the time of the fourth property purchase, the trust was engaged in the business of erecting buildings.

Did the residential land exemption apply?

The trustees argued that as Mr and Mrs B occupied each house primarily and principally as their family home that the residential land exemption should apply. The Commissioner contended that each property was only occupied incidentally to the more significant purpose of sale and as such the properties were not occupied "primarily or principally" as a residence. Sinclair DJ agreed, holding that Mr and Mrs B only moved into the property to enable finishing work to be completed before the property was marketed and the process repeated.

Liability for GST

To be liable for GST, there must be a taxable activity and the total value of supplies made in a 12 month period must exceed the relevant threshold. The Judge had already found that the trust was engaged in the business of erecting dwelling houses by the time property 4 was purchased in 1999. Accordingly it was not difficult to find that the trust was deemed to have been registered for GST from 1 February 1999 when the threshold at that time of $30,000 was exceeded. It was held that the trust was liable to account for GST output tax on the sales of properties for 6 monthly GST periods ending 31 March 1999 to 20 September 2005.

Shortfall penalties for gross carelessness

To be liable for a shortfall penalty for gross carelessness, the taxpayer must have taken a tax position that suggests or implies a complete or high level of disregard for the consequences. In the view of Sinclair DJ, the scale and duration of the activities undertaken by the trust meant that the tax risk was obvious and serious, and that a reasonable person in the circumstances would have foreseen this risk. In addition the independent trustee, Ms X gave evidence that she was aware of the possibility of a tax liability and that she had advised Mrs B on two occasions to obtain tax advice. Mrs B denies that Ms X said this. In any event the fact remains that the risk of a tax liability had been identified by Ms X who was a trustee and despite this, no tax advice was obtained. An accountant was actually only consulted following the commencement of the Commissioner's investigation. Accordingly, Sinclair DJ reached the view that a shortfall penalty for gross carelessness should be imposed.

The independent trustee

This case really highlights the need for lawyers and accountants acting as independent trustees to take extreme care before agreeing to such appointments. Ms X, the independent trustee, was not consulted prior to entering any of the transactions and Mr and Mrs B never gave any explanations as to why they were selling a particular property. Ms X would prepare and execute resolutions for every transaction, but took no active role in the trust's affairs and left the day to day running of the trust to Mr and Mrs B. Ratification occurred formally by way of resolution and informally by way of sanction and approval. As a consequence, all the trustees are bound by the decision and actions of each other.

Accordingly Ms X has been held to be jointly and severally liable along with Mr and Mrs B for the income tax, GST and penalties arising for the period until she was replaced by an independent trustee company on 14 September 2005.

The OECD base erosion and profit shifting project – how New Zealand might respond

On 25 October 2013, the Policy Advice Division of Inland Revenue released a third tax policy report, *Taxation of multinationals*, which examines options to deal with the taxation of large multinationals and the problem of base erosion and profit shifting (BEPS). This follows the earlier reports released in December 2012 and April 2013. The report strongly endorses measures outlined in the OECD Action Plan.

The report, to the Ministers of Revenue and Finance, suggests a number of proposals for reform that New Zealand could take to play its part. The Minister of Revenue has indicated he will consider the recommendations and his decisions would be reflected in the tax policy work programme due for release later this week. The recommendations include:

- Thin capitalisation and transfer pricing: Consider directly limiting the ability to use high-priced debt. Explore the scope of the transfer pricing rules used by investors who "act together" to profit shift and so consider aligning the rules with the recently announced thin capitalisation changes for such investors.

- Hybrid instruments: Explore whether New Zealand should restrict interest deductions on hybrid instruments where the interest payment is not taxed in the foreign jurisdiction.

- NRWT on related party debt: Explore options for dealing with a wide range of arrangements that can be used to defer or circumvent NRWT on related party interest payments.

- Investment vehicles and offshore investments: Explore the need for an anti-arbitrage rule for offshore entities that seek double non-taxation of income or double deductions of expenditure by taking advantage of differences between countries' tax rules.

- Look-through vehicles and structures: Examine the incoherence relating to different tax treatment of look-through companies, limited partnerships, foreign portfolio entities and foreign trusts.

- Offshore branches: Design the active income exemption for offshore branches to ensure it does not facilitate profit shifting through repatriation of losses.

- Foreign trusts: Review the tax treatment of the foreign trust rules. This may include strengthening the regulatory framework for disclosure and record-keeping, and deciding whether NZ's rules are sustainable in the long term given the mismatch with other countries' trust rules.

- GST on goods bought online: An issues paper will be released later this year examining options for collecting GST from online shopping.

Look out for more on this in our next issue once the work program has been released.

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Chinese tax and business regulatory framework: evolving landscape and hot topics

By Jenny Liu

The tax and regulatory environment in China is an ever evolving landscape. This article aims to highlight some key recent developments in China including:

- Value Added Tax (VAT) reform;
- Relaxation of foreign exchange procedures for certain payments to non-residents; and
- The new Shanghai Free Trade Pilot Area

Value Added Tax (VAT) reform

The VAT reform pilot program for transportation and modern services sectors has been rolled out nationwide[1] from 1 August 2013,

The aim of the program was to eliminate the double taxation issues that arise under China's current indirect tax system, which includes both a VAT levied on the supply of goods, the provision of repair, processing and replacement services, and on imports, and a Business Tax (BT) levied on the provision of other services and the transfer of intangibles and real property. Different rates are imposed under the VAT and BT regimes and, unlike VAT, an input tax credit is not available under the BT regime.

The reform will gradually replace the dual tax system with a single VAT system applying to the supply of both goods and services. Under the reform, certain services that were subject to the BT system will now be subject to the VAT system instead.

Services subject to the changes and their respective VAT rates are as follows:

- Transportation services (excluding railway transportation): 11%
- R&D and technology services, creative cultural services, IT services, logistics and ancillary services, and attestation and consulting services: 6%
- Leasing of moveable and tangible goods: 17%
- Radio and film production, broadcasting, and distribution sectors (newly added to the VAT reform programme): 6%

The national implementation of the VAT reform signifies a very important milestone in the development of the VAT reform in China.

Many New Zealand businesses having operations in China have already come across these changes in relation to R&D services, logistics and ancillary services, consulting services etc. Most of these services are now subject to VAT at 6%, compared to BT at 5% in the past. Although the tax rate might seem to have increased slightly, recipients will now be able to claim VAT input tax credits which should reduce the overall tax costs.

If these services are provided to customers in China, it is likely that the customers will welcome the change as they will now be able to claim the relevant VAT as input tax credits (previously BT would not be creditable).

This change may also be relevant if you are negotiating new contracts and pricing with your customers / suppliers as the relevant VAT/BT costs should be factored in and the overall cost may be able to be reduced.

Another interesting issue is whether services provided to non-residents of China (including New Zealand group companies) could be exempt from VAT. These services were previously subject to the non-recoverable 5% BT. Although it has been clear that an exemption will be available, we are still waiting for further guidance to clarify the criteria that must be satisfied to obtain the VAT exemption.

1 The VAT reform pilot program for the transportation and modern services sectors started in Shanghai on 1 January 2012 and was later rolled out to eight other cities/provinces during 2012.

Relaxation of foreign exchange procedures on certain outbound payments

Foreign exchange controls in China have always been a difficult issue. The relevant rules are complex and the payment clearance procedures are lengthy, resulting in trapped cash, delayed payments and unexpected tax costs.

In a move to simplify the administrative burden for making payments offshore, China's State Administration of Taxation (SAT) and the State Administration of Foreign Exchange (SAFE) jointly issued a bulletin in July 2013 (SAT/SAFE [2013] No.40, (Bulletin 40)) that abolishes the tax clearance certificate requirement that applied for outbound payments exceeding USD 30,000 (or its equivalent) in relation to services and certain other items.

The new rules apply from 1 September 2013. The types of outbound payments that are subject to the new rules include most payments relating to income derived by a foreign organisation and individuals from China (other than those relating to trade in goods), including for example, income from services, salaries and wages, dividends and profits etc.

Under the old rules, domestic Chinese businesses and individuals ("Applicants") wishing to make a payment offshore for services and other items exceeding USD 30,000 were required to obtain a tax clearance certificate from the competent state and local tax authorities before the payment can be made. The tax certificate must be provided to the relevant bank to make the payment.

Obtaining a tax clearance certificate was not always a straightforward process, particularly if the Applicant and the competent state and local tax authorities were unable to reach an agreement on the relevant tax treatment of the payment. In many cases, foreign recipients would negotiate and accept a certain level of tax to be deducted from the payments in order to receive the relevant payments.

The new rules eliminate the need for an advance "review" by the tax authorities before a payment exceeding USD 30,000 is to be made offshore. Under the new rules, Applicants that intend to make payments exceeding USD 50,000 (or its equivalent) will be required to submit a "Tax Filing Form" and relevant transaction documents to the competent state tax authorities (rather than state and local tax authorities) for each payment. The competent state tax authorities will stamp the Tax Filing Form and return one copy to the Applicant and deliver another copy to the competent local tax authorities. A copy of the Tax Filing Form will then be provided to the bank before an offshore payment can be made.

It is important to remember that although the tax certificate will no longer be required, payments will not be relieved from any of the relevant tax obligations, which we expect to remain the same. The new rules are mainly a change in administrative emphasis to enable domestic entities to make outbound payments in a timely manner. Deduction of a certain level of taxes from the payment will likely continue.

The new China (Shanghai) Free Trade Pilot Area

The China (Shanghai) Pilot Free Trade Zone was officially launched on 29 September 2013. Many are excited about the introduction of this Free Trade Pilot area and it was considered that the establishment of the China (Shanghai) Free Trade Pilot Area ("China (Shanghai) FTPA") combining four customs supervision areas, is a big step towards the continued opening up of China's economy. So what exactly is the China (Shanghai) FTPA? The closest comparison to the proposed pilot is a Free Trade Zone but with much wider implications and a different area of focus. A Free Trade Zone is generally a specific area under special Customs supervision that allows free trade in a country with preferential policies.

China (Shanghai) FTPA is similar to a Free Trade Zone, but with more focus placed on policy reforms and less focus on preferential treatment.

Although China (Shanghai) FTPA is still a work in progress, the objectives and direction of the governing framework and rules are already clear. Key impacts of the pilot include:

- Finance including foreign exchange – the free conversion of RMB and foreign currencies, the removal of limitations over foreign participation in the financial industry and the offshore banking business.

- Tax system – a competitive preferential tax regime to attract businesses such as regional headquarters, offshore trading, shipping and logistics businesses, and financial leasing businesses.

- Investment controls and approvals – simplify and relax controls over investments which foreign investors are allowed to make, and operations they are allowed to conduct. In principle, all investments are allowed unless they are on the "Negative List."

- Customs supervision – customs and port supervision procedures will be updated and simplified. Administration and supervision of both foreign and domestic trade will be relaxed, and development of international shipping will be promoted.

The main beneficiaries of the change are expected to be:

- Finance sector businesses

- Regional headquarters of multinational corporation

- Regional sales and procurement centers

- Shipping and logistics sector businesses

- Cultural, creative and media sector businesses

- Retail sector

This may be of particular interest if you are currently considering investing in China or looking to set up a trading presence in the region.

If you have any questions regarding any of the recent developments in China, please contact our Deloitte China service team or your normal Deloitte contact person.

GST and mixed use assets

By Andrea Scatchard

The Taxation (Livestock Valuation, Asset Expenditure and Remedial Matters) Bill became law on 17 July 2013. The Asset Expenditure part of the title refers to the changes made to the treatment of expenditure on holiday houses, boats and aircraft for both GST and income tax purposes.

Our July Tax Alert covered the changes to the income tax treatment of these assets. It is fair to say that it is the income tax changes which have grabbed the most attention in the press since the enactment of the legislation. However the GST changes will potentially have a big impact where the owner of a mixed use asset is GST registered. As many GST registered people deal with their own GST returns throughout the year, it is important to understand the impact of the GST changes as they need to be reflected in each GST return and not left for the accountant to sort out after year end.

Historically a number of owners of these lifestyle assets will have registered for GST and claimed back the GST paid on the purchase of the asset as a way to help fund the overall cost of the asset. They will have returned GST on any income received from renting the asset out, and claimed GST on the majority of the costs on the grounds that the asset was available for rent for the majority of the time throughout the year. The mixed use asset changes are set to change this GST treatment, but perhaps not in the way that many people are expecting.

To briefly recap the key changes from an income tax perspective, expenditure is disallowed as a deduction to the extent that it relates to private days. Private days include any use by the owner, as well as any use by associates of the owner or where the user pays less than 80% of the market rent for the use. Any income that is earned from private use days is not required to be returned for income tax purposes.

While the GST rules use the same formula for apportioning GST input tax claims as that for income tax, the results can be vastly different. In fact where mixed use assets are owned in a corporate structure, private days are likely to only include situations where the assets are made available to friends (i.e. people that are not technically associated persons) for no consideration. This is because the definition of private days for GST purposes excludes days where any consideration is received, whether or not that consideration is at market value, or where the assets are used by a person associated with the asset owner. The result of this is that for those days where any consideration is received, the income is taxable for GST purposes and the GST on costs allocated to those days is able to be claimed. In many cases this will mean quite a variance between the percentage of costs able to be claimed for income tax and GST – generally the GST percentage will be higher, but so will the GST output tax due to the deeming rules.

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Affected GST registered people must estimate the percentage of GST input tax that is able to be claimed on costs as they are incurred throughout the year, and then perform a wash-up adjustment at the end of each year once the full year percentage of income earning to private days is known.

Where a mixed use asset is used by an associate of the owner, such as a shareholder, partner or beneficiary, or a relative of any of these parties, and that person did not use the asset to make taxable supplies themselves, the current GST rules deem that supply to have been made at market value. This gives rise to an output tax liability for the owner of the asset, even if no consideration has been received. This deemed supply rule has always existed but may have been overlooked by GST registered persons and the Inland Revenue alike. Given that the changes to the ability to claim input tax on mixed use assets may result in increased input tax deductibility, we expect that the Inland Revenue may also apply more focus on the output tax side of such transactions and enforce the market value rule.

The GST changes for holiday houses came into effect from 17 July 2013, and for boats and aircraft they will apply from 1 April 2014. The changes will affect both on-going costs of holding these assets, such as rates, insurance, maintenance etc, as well as the initial purchase price. It is not entirely clear how the GST changes apply to the initial input tax claim that may have been made on assets that were purchased before the respective application dates, though we understand that the Inland Revenue's view is that that component of input tax will remain subject to the regular GST change of use rules rather than the new mixed use asset apportionment rules. Hopefully guidance on this issue will be forthcoming from Inland Revenue.

We encourage anyone owning a mixed use asset in a GST registered entity to contact their usual adviser to discuss the impact of these changes.

"It is important to understand the impact of the GST changes"

Equity based remuneration

By Belinda Hagstrom

Designed to incentivise employees to take an active ownership approach to their employment, equity based schemes come in many different guises. However in general, no matter what form the scheme takes the end objective is the same – to deliver free or discounted shares to the employees.

Unlike other employment income which is taxed either by way of PAYE or FBT, the tax due on equity based income is not the responsibility of the employer[1]. Instead, the employee must report the income in their personal income tax return and settle the tax liability directly with Inland Revenue.

The tax implications can be complex and if not correctly managed can expose the employees to cash flow problems as well as the imposition of penalties and interest. Not exactly a good outcome for the employees.

While recognising that the tax liability rests solely with the individual employees, most companies provide their employees with some assistance in understanding the tax obligations that come with participating in equity based schemes. From providing a simple overview of the tax consequences to providing a round table briefing with a question and answer session, companies see providing this advice as being an integral part of offering a scheme to their employees.

Recently we have seen increased activity from Inland Revenue whereby they are requesting from the employer, details of any equity incentive schemes and a list of all employees participating in the schemes. It seems this information is then used by Inland Revenue to review the employees' personal tax returns to ensure they are reporting the income received from the schemes in their tax returns.

From a human resources perspective it can be a time consuming nightmare managing the fall-out that comes from employees' returns being audited, particularly where the company has not provided any information regarding the tax implications. The possible tax consequences for non-complying employees are significant. A scheme designed to incentivise employees can turn pretty quickly into a big disincentive and the company is left dealing with disgruntled employees who in many cases are senior level executives.

In our view, a company taking a proactive approach to helping employees understand their tax obligations is preferable to having to deal with the difficult conversations at the point Inland Revenue requests scheme information. The feedback Deloitte receives from companies who do provide assistance is that they want the employees to view their participation in the scheme as a positive experience. Companies also consider that in the interests of being a good employer, there is an obligation to make the employees fully aware of the tax implications.

If your company has an equity based scheme in place it is worth considering what, if any, advice the employees receive. If there is nothing in place, it is well worth it from both an employer and an employee perspective to provide the employee, at a minimum, with the information they need to be aware that there are personal tax implications for them. Preferably before Inland Revenue comes calling. For more information about equity based schemes, please contact your usual Deloitte advisor.

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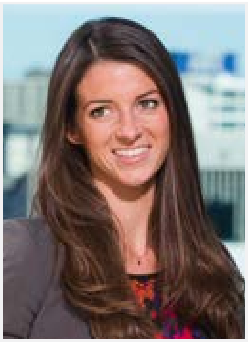
"A scheme designed to incentivise employees can turn pretty quickly into a big disincentive"

1 Please note that phantom type schemes that deliver a cash reward are subject to PAYE.



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Records in the cloud

By Hannah Howard and Tristram Fink

What was previously a theoretical concern for taxpayers holding records with cloud-computing companies has now been resolved, enabling taxpayers to continue their 'walk in the cloud' without fear of falling due to an Inland Revenue backlash.

Following on from the article in our **December 2012 Tax Alert**, the Inland Revenue has recently published a list of New Zealand companies which have been granted approval to hold their customers' electronic financial records offshore.

As readers will be aware, taxpayers are required to hold their financial records in New Zealand in order to comply with their record keeping obligations. It was and continues to be possible to be granted an exemption, however this can only be done on an individual basis. When the Inland Revenue flagged some three years ago that storing ones records in a cloud that used offshore data centres was unlikely to meet statutory requirements, it became evident that a legislative tweak was necessary.

The reason we mention that the concern was only theoretical to taxpayers is that the staggering uptake of cloud-computing accounting services made it very difficult for the Inland Revenue to act on its contention. The major cloud-computing companies considered the situation to be a prime example of technology moving at a pace unmatched by our legislative system and took steps to liaise with the Inland Revenue to resolve the issue.

Following on from the legislative change that took effect from 2 November 2012, the Inland Revenue has now listed which New Zealand companies have been granted this blanket exemption. At present only three companies have been granted authorisation – these are Xero Limited, CargoWise NZ Limited and MYOB NZ. It is anticipated that this list will be added to over time, where companies are able to prove that information and records stored offshore will remain accessible to the Commissioner and will not impede compliance activities.

Taxpayers should note that where authorisation is given to a third party, this does not replace the taxpayer's responsibility in meeting record keeping obligations. The authorisation enables a taxpayer to store records offshore without being in breach of their obligations however it is the taxpayer who is responsible for ensuring records kept are sufficient to satisfy requirements. That is, they must be adequate to enable the Commissioner to readily ascertain the amounts of tax payable.

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