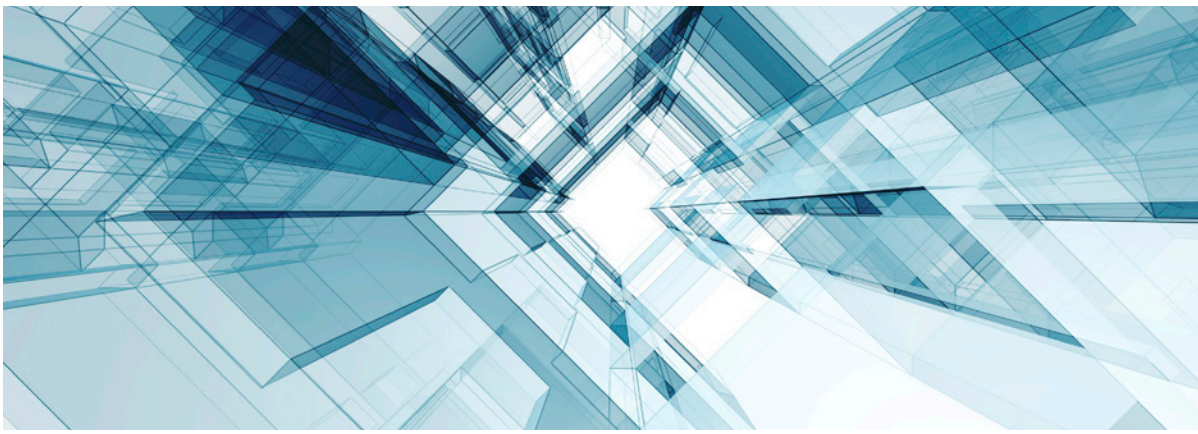
Tax Alert

A focus on topical tax issues – April 2015



Tax System set for major overhaul in modernisation project

In this issue

On 31 March 2015, the Government issued the first two of nine discussion papers for public consultation on "looking towards a better tax administration system for New Zealanders".

The scale and size of this project means that over the next few years, the tax system is in for a huge shakeup which will impact on everybody in some shape or form. The project is far more than just updating the Inland Revenue's computing system. The Government describes it as a "once in a generation opportunity" to make changes to meet current and future needs.

The first document is a green paper on tax administration which provides the overall direction of the tax modernisation programme and seeks feedback on that direction. As this is a green paper, there are no firm proposals at this stage; instead the paper simply notes areas which could be explored in more detail.

Policy considerations

Underlying the thinking is the assumption that key base taxes will remain substantially in place, that New Zealand will continue with its broad-base low rate approach and that social policy and other non-tax functions (e.g. KiwiSaver, Working for Families, Student Loans repayments and Child Support) will continue to be administered by Inland Revenue.

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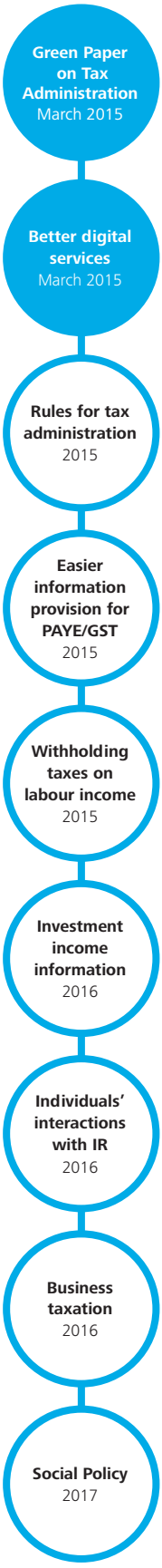


There will be a move towards relying on technology and existing business systems in order to meet tax obligations. Overall the system should:

- Be simple and easy for customers to get right, hard to get wrong
- Be quick and low effort to use
- Provide more certainty
- Not require duplication of effort by customers and associated third parties
- Be flexible enough to move with technology developments.

Reducing compliance costs, in particular for small and medium enterprises (SMEs), is an important goal. In this regard, the Government is conscious to not shift costs away from government to taxpayers, nor opt for simplistic options which produce high distortionary costs. The Government is also not about to provide tax concessions to SMEs, as providing tax breaks for a particular sector is likely to reduce economic efficiency and growth. The paper notes that providing too many options for paying tax encourages SMEs to calculate a tax liability several different ways in order to find the lowest tax payment – which conversely increases compliance costs. There is also a desire to not have tax rules that create boundaries and disincentives for successful firms increasing in size.

Overhaul of the PAYE system

The collection of PAYE from salary and wage earners is a very important part of tax administration. The paper notes that the PAYE rules have not been fundamentally reviewed since being introduced in 1957. The PAYE system will be reviewed to ensure it is fit for purpose in a future where calculations are in most cases likely to be done by software and not manually.

Specific areas that have complexity or which need clarification include extra pay calculations, holiday pay calculations, PAYE obligations for IR 56 payers, employer superannuation contribution tax, secondary tax codes and other flat PAYE codes.

It is suggested that a review could consider all forms of employment remuneration and how they should be taxed. For example, should fringe benefits, employer superannuation contributions and employee share schemes be incorporated into the PAYE rules? Should the review cover how the PAYE rules apply to cross-border relationships and to employment of workers resident in a foreign jurisdiction?

Reforms in this area will need to be carefully thought through to avoid large up-front costs that outweigh the benefits.

It has also been some time since the scope of the schedular payment and withholding tax rules and tax rates have been reviewed. There are currently issues of non-compliance and inconsistency regarding the tax rules that apply to certain industries for self-employed persons, migrants and some contractors. The Government sees this as an opportunity to expand withholding and/or reporting without significantly increasing compliance costs. In this regard, a review will likely consider taxes in situations similar to employment, such as independent contractors and whether withholding at source can be considered in a wider range of situations. A careful watch will need to be kept on any new proposals to ensure there is in fact no additional compliance for employers in meeting new rules where the scope is extended.

Separate discussion documents on PAYE and withholding tax on labour income will follow later this year. >>

Provisional tax

The document states that initial feedback suggests that the calculation and payment of provisional and terminal tax currently presents a number of problems. These include the use of money interest risk, the need to estimate annual tax liabilities part-way through a year of assessment, compliance costs associated with estimating liabilities and cash flow difficulties with the terminal tax square up process, particularly for new businesses. Ideas put forward to address these concerns include:

- A type of business PAYE where the calculation and payment of business income tax is done more on account as income is earned - akin to PAYE. This might be achieved by using interim accounting calculations and innovative third-party accounting/ tax software. For small businesses, provisional tax payments might be made based on a percentage of a business's turnover. The finer detail will be necessary to determine whether this will in fact be easier than the present options.

- Options to mitigate use-of-money (UOMI) interest issues could include providing safe-harbour rules for taxpayers using a new payment calculation as discussed above or increasing the monetary threshold (currently $50,000) for those using the standard uplift option.

- The safe harbour limit could be extended, the standard uplift method could be reviewed and UOMI rates could be re-considered. This latter point may be music to some ears as many have long campaigned for the UOMI rate on overpayments to be reviewed.

- Tax pooling might be reviewed to see if the rules can be improved and/or made available to more taxpayers. Currently only the very large taxpayers tend to use tax pooling to mitigate use of money interest charges.

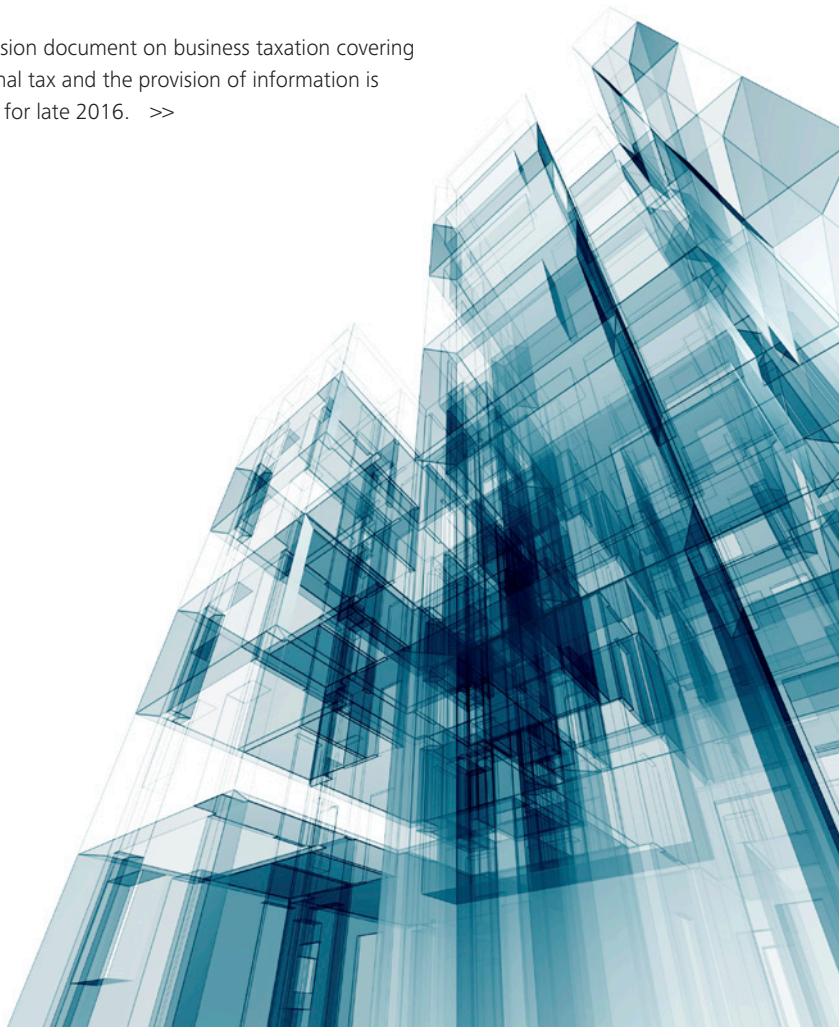
Information provision

Currently the focus is on a one-size fits all approach when it comes to collecting tax information and associated disclosures. The document explores placing more emphasis on providing key information in a digital form in a way that suits the size and nature of the individual business and the Government. Potential changes include using digital technology to rationalise current tax returns, use businesses' existing processes and systems to make it easier to provide information to Inland Revenue and introduce a differential reporting approach for the company tax return in line with the recent changes to the financial reporting requirements.

Micro and small businesses

A specific option could be explored to encourage micro and small businesses to use accounting software that meets Inland Revenue standards which help correctly classify transactions for tax purposes. The penalties regime could be amended to focus more on systems and processes so that customers are encouraged to use accounting software in order to remedy system faults that give rise to shortfalls.

A discussion document on business taxation covering provisional tax and the provision of information is planned for late 2016. >>



Resident withholding tax

Resident withholding tax (RWT) is in effect a PAYE system for collecting tax on payments of domestic interest and dividends. Current problems include slow and inaccurate annual systems, high administration and compliance costs, duplication of compliance, a lack of timely information about the dividend payments that are made and the too-easy ability for taxpayers to select an incorrect RWT rate on interest payments. It is planned that a review of RWT will occur once the PAYE review is completed. A specific discussion document on this is planned for release in 2016.

Individuals

The filing rules for individuals were changed in the late 1990's to simplify tax and remove the requirement for most individuals to file tax returns where their only income was salary and wages which was subject to PAYE deducted at source. Initially this worked well, but since 2000 there has been a steady increase in those choosing to file in order to claim tax refunds (and not filing where there is not a refund – i.e. "cherry-picking"). A whole industry of service providers has sprung up in the last ten years to provide such a service. There has also been an increase in the numbers of individuals that are required to file returns arising from the need to return, for example, rental income or losses, foreign income, interest or dividend income above certain thresholds and secondary income. Further, some in this last category are not aware of the obligation to file. All of which means the filing system for individuals is in for an overhaul.

It is envisaged that there will be a move to an electronic filing system that is pre-populated by timely and accurate withholding systems. The majority of customers would then only be required to check, confirm details and report unlisted income (such as overseas or rental income). In most cases square-up amounts of tax would be dealt with by either refunds being automatically released or debts paid by automatically adjusting withholding rates on future income sources.

Better digital services

The second paper released is about how Inland Revenue can use technology to improve services and reduce compliance costs. Although Inland Revenue has moved to embrace new technology in recent years (Voice ID, website, mobile apps, text, email, software-enabled filing, social media etc.) there are still current limitations. The main problem is that the current digital offerings exist as stand-a-lone services and are not integrated with other activities that customers carry out, or with other government services. The document cites common complaints including difficulty in accessing information, finding the processes time-consuming, using multiple channels to undertake one interaction, uncertainty about whether they have done the right thing and frustration at the lack of information sharing.

It is foreseen that businesses will only need to interact with their accounting software to meet obligations. For example, for businesses that already use a computerised payroll system, PAYE filing could be integrated into their payroll accounting software removing the need to deal with PAYE filing obligations separately. >>

Underlying the thinking is the acknowledgement that customers vary, no one size fits all and that a package of services will need to be designed that keeps pace with technology changes. It is further acknowledged that some customers will not be able to adopt digital services, but there are other groups that can but choose not to. For example, the paper asks whether employers and tax agents who choose not to use digital filing should be the first group to be required to use digital services. It is expected that customers will voluntarily move to using digital services if Inland Revenue gets the offering right.

Finally, the tax administration rules regarding the methods of communication and timing of returns and payments are likely to be reviewed for the digital age given the rules were originally designed for a paper era.

Conclusion

Successive governments have grappled with how to make the tax system simpler and reduce compliance costs. However, this project is not just tinkering at the edges and significant policy resource has been thrown at this. This Government needs to be commended for standing back and taking a good look at how tax is administered in the 21st century. There are obviously significant benefits for the Government by using technology to transfer information automatically, to reduce non-compliance and generally shore-up the tax system in the process. While an underlying objective is to not simply move compliance from government to businesses, there is a very real risk with some of these proposals of doing just that. Some of the technology changes could mean large up-front costs for businesses in adapting or purchasing software. There is also the need to balance the big brother factor of digital services with the benefits that it brings for taxpayers - such as less interaction with Inland Revenue, a reduction in compliance costs (in the long run) and more time for doing the more important stuff in life.

We've only scratched the surface in providing this overview. There is a lot to digest in these documents and therefore it is important to get involved in the consultation process if you have views on this. The documents are available **here**. In the spirit of the digital age, submissions are encouraged to be made online at: makingtaxsimpler.ird.govt.nz or by email. For the technology challenged, submissions can still be sent by post. The closing date for submissions on the green paper is 29 May 2015, whereas the closing date for submissions on the digital services paper is 15 May 2015. If you have thoughts or wish to discuss further, please contact your Deloitte advisor.

Rethinking the Customs and Excise Act - A step in the right direction

By Jeanne Du Buisson

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In broad terms, New Zealand Customs (NZ Customs) Minister Nicky Wagner describes the roll of NZ Customs as being to protect our borders, facilitate trade and travel, and collect Crown Revenue. This very important function is however made difficult for NZ Customs to enforce and for businesses / individuals to comply with as the current Customs and Excise Act is somewhat outdated and still contains elements of the 1913 Act.

It is therefore very pleasant to see the release by NZ Customs of a draft discussion document to refresh the current Customs and Excise Act 1996 (CEA). NZ Customs is considering refining and modernising many of the sections of the CEA which have become outdated in today's complex supply chains and digital era.

The full discussion document can be found **here**.

NZ Customs proposes to transform the CEA from prescriptive to principles-based legislation. This will, amongst other things, entail shifting the procedural and operational provisions from the CEA to Regulations, Rules and Schedules.

Currently the discussion document contains open-ended questions and comments proposing to introduce amendments based on the feedback that will be received on various issues from stakeholders. This is a great opportunity for businesses to come forward and discuss problems or obstacles that businesses are facing when dealing with NZ Customs and for businesses to make submissions in respect of any issues that they would like NZ Customs to address.

NZ Customs have invited submissions on or before 1 May 2015.

We have provided you below with some of our thoughts on aspects of the discussion document: >>

Valuation of imported goods

Value of goods

Currently the Customs value of imported goods is calculated with reference to the 'Free on Board' (FOB) value excluding the international freight and insurance incurred from the port of export to the country of importation. GST on the other hand is calculated on the 'Cost, Insurance, Freight' (CIF) value of the goods which is the FOB value plus international freight and insurance.

NZ Customs have requested feedback as they are considering aligning the two calculations to CIF for determining the payment of Customs duty and GST.

We consider that the alignment of the values to CIF for the payment of Customs duty and GST may resolve some compliance issues for the importers, but may trigger wider problems, for instance:

- This will be inconsistent with the principles established under the General Agreement on Tariffs and Trade which provides for levy of Customs duty on the FOB value of goods up to the port of export.
- Customs duty will be levied on a higher base which will differ depending on the mode of transportation of the goods being by air or ship.
- The Free Trade Agreements that promote low duties on cross-border transactions will likely be seen as being incidentally transgressed.

In our view, the computation of Customs duty on FOB basis should be maintained in view of the broader scheme and principles of Customs valuation.

Sale for export

The term 'sale for export' is currently not defined, however it generally refers to the contract that provides for the export to the country of importation. It is however not unusual for goods to be the subject of a number of sales of which all are destined for New Zealand, especially in the supply chains for multinational companies. Currently, NZ Customs allows the importer to choose which sale for export to use when there is more than one sale.

NZ Customs is proposing to define the sale for export in a way to prevent the importers from using the 'first sale' (and generally the lowest value) as the sale for export.

A narrow definition of sale for export is likely to be problematic for some importers with complex supply chains in place. >>

Import GST

Currently GST is levied on importation of goods into New Zealand by NZ Customs. GST registered businesses can then claim the GST paid at the time of importation of goods through their GST returns. The reporting times and payment dates for Customs and Inland Revenue do not currently align, causing cash flow issues for some businesses and additional compliance costs to importers with no benefit to NZ. NZ Customs have invited feedback from businesses to indicate practical difficulties experienced by them.

We suggest it would be worthwhile for NZ Customs to consider the Customs mechanics operating in other jurisdictions, for instance, Australia where GST registered businesses which are engaged in importation activities are not required to physically pay GST at the border. The GST payable on importation is offset against the GST claimable through the GST return, thus no actual cash is required to be paid. NZ Customs could explore the possibilities of implementing a similar model in New Zealand provided the legislative framework and policies (including for GST) are amended to support it.

Business Records

It is a welcome proposition to allow the Customs business records to be stored offshore. Inland Revenue already allows companies to store their records offshore for income tax and goods and services tax purposes. Customs legislation should take into consideration the world moving towards cloud-based storage of records. The extra havoc in arranging the storage of records at a broker's place where the non-resident importer companies do not have a fixed place of business can likely be dispensed with.

Penalties

Customs is proposing to review the financial and imprisonment penalties in the CEA. The current criminal penalties are less harsh than the administrative penalties. We expect that Customs will likely overhaul the penalty provisions. Businesses should watch this space carefully as, going forward, the application of penalty provisions is likely to become strict.

NZ Customs is proposing to extend the administrative penalties to all export entries.

In many instances, NZ Customs incur administration costs for amendment of entries and processing of voluntary disclosures. NZ Customs is proposing to recover its costs in these cases.

Excise and excise-equivalent duty

Customs is considering aligning the excise return filing periods with the GST filing frequencies.

Other Proposals

- Customs is considering revising the timeframes for providing information to NZ Customs given there has been advancement in technology and digitalisation. For instance the timeframe to submit an import entry is currently 20 days before the arrival of the vessel. This is likely to be reduced to 2-3 days so as to enable the import entry to be submitted shortly before arrival of the vessel.

- Feedback is invited to consider extending the refund of duty to importers currently unable to claim a duty refund when returning undamaged goods (for instance wrong size). Similarly there is a proposal to extend drawback where duty-free products are sold to overseas travellers.

- The proposal to incorporate provisions enabling information sharing with other government agencies such as Inland Revenue, Ministry of Business, Innovation and Employment, Ministry of Justice, etc. Currently the basis for sharing information with other agencies is unclear. >>

- There is a proposal to explicitly incorporate a provision in the CEA to provide discretionary power to the Comptroller of Customs to make management decisions in the collection of tax revenue.

- Improvements in the assessment and appeals process.

There is substantive work for NZ Customs in shifting the prescriptive provisions to the delegated legislation i.e. the Customs and Excise Regulations and Orders in Council from the legislation. This is certainly a beneficial move enabling expedited amendments to the delegated legislation which do not necessitate passing through the standard consultation process.

It is also worthwhile for NZ Customs to work through the Customs policy and procedural models prevalent in other jurisdictions including Australia, Canada, UK, etc. and look to adopt some successful measures workable within NZ Customs framework. NZ Customs have set a very strict timeline for introducing the new legislation which is proposed to be effective by early 2017. There is considerable work yet to be done in drafting the legislation once the submissions are received by 1 May 2015. We hope to see a considered draft rather than rushed legislation.

Key issues not in discussion document

- Low value import thresholds. Physical goods bought online and below the low value threshold of $400 are generally not subject to GST, if no Customs duty is applicable. Recently there have been media articles around proposals to impose GST on imported digital products and services as GST is not currently charged on imported digital products such as music and films downloaded from services including iTunes. NZ Customs is not reviewing the low value threshold which is clearly out of scope of the discussion document. There is a separate OECD study in relation to GST on digital goods and services jointly worked on by Inland Revenue and NZ Customs. We may expect some changes soon.

- No framework for providing the ability for Customs to provide certainty to importers through rulings and/or binding rulings.

- Aligning Customs valuation methodologies with methodologies acceptable to Inland Revenue.

- Formalising the voluntary disclosure process specifically in respect of transfer pricing adjustments

- No framework for a Trusted Traders Scheme.

For further information, please contact your usual Deloitte advisor.

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New Australian simplified transfer pricing record-keeping options

By Diana Maitland and Melanie Meyer

Transfer pricing has been an area of focus for the Australian Taxation Office ("ATO") in the last few years.

In mid-2013 new Australian transfer pricing laws were passed impacting Australian members of multinational groups. In essence, the new rules have had the effect of increasing the transfer pricing compliance burden on the taxpayer, while at the same time giving the ATO far reaching powers to "reconstruct" transactions if they see fit to do so and increasing the risk of review and penalties if transfer pricing documentation for the relevant income year is not prepared and held by the Australian operations by the time of filing the tax return.

Acknowledging that compliance can be costly, particularly for smaller businesses, the ATO has subsequently developed some simplified transfer pricing record keeping options. Eligible businesses can opt to apply the rules and minimise some of their record-keeping and compliance costs. The options are set out in "Practice Statement Law Administration PS LA 2014/3 Simplifying transfer pricing record keeping" (PS LA 2014/3) which was released on 17 December 2014.

The rules may enable taxpayers to meet compliance obligations with a reduced level of transfer pricing documentation and, in particular, benchmarking studies. Further, certainty for taxpayers may be increased with the simplification as there is upfront knowledge of how the eligible transactions should be priced.

However there remains some uncertainty as to the extent to which the simplification options will reduce the transfer pricing documentation requirements for the taxpayer. In practice the new rules may eliminate the requirement for benchmarking in documentation but add the requirement to evidence that the criteria are met. The ATO is in the process of preparing additional guidance to clarify these matters. >>

There are four main transfer pricing documentation simplification options for specific categories of taxpayers and transactions. The categories are summarised below, along with the key eligibility criteria:

Category	Eligibility Thresholds	and Taxpayer Has
Small businesses	$0 - $25m turnover for Australian group	No related-party royalties, license fees or R&D No specified service related-party dealings* of more than 15% of turnover
Distributors	$0 - $50m turnover for Australian group	3 year average Profit Before Tax ratio of at least 3% No related-party royalties, license fees or R&D No specified service related-party dealings* of more than 15% of turnover
Intra-group services	Up to $1m of services or limited to 15 % of expenses / revenue	7.5% or less / more mark-up for services received / provided No specified service related-party dealings*
Low-value loans	Loans of $50m or less for Australian group	Interest rate on inbound related-party loans no greater than Reserve Bank of Australia indicator lending rate All principal and expenses amounts in AUD

** A specified service related party dealing is any strategic activity that contributes significantly to the creation, enhancement or maintenance of value in the Australian group*

In addition to the eligibility criteria listed above, entities are also ineligible under all categories if they have:

- Incurred operating losses for 3 consecutive years;
- Undergone a restructure within the year; or
- Related-party dealings with entities in "specified countries" (broadly, low tax rate jurisdictions).

While the new rules will certainly be helpful from a compliance perspective for some Australian taxpayers, as shown above, there are several criteria which must be met before the options can be applied, and care must be taken to confirm that a taxpayer can satisfy all the requirements of a particular category before application. This will still involve a certain level of compliance albeit at a far more simplified level.

It is therefore important for New Zealand groups with associated parties in Australia (at a minimum) to:

1. Review the Australian entity's or branch's cross border associated party transactions or dealings;
2. Assess whether the entity or any of the transactions/ dealings entered into fall within the 4 categories above, and therefore whether relief can potentially be sought;
3. Carefully consider all the eligibility criteria to confirm whether the option can be applied;
4. Consider the appropriate level of documentation that should be prepared to demonstrate compliance with the simplification option.

If you require further guidance or for more information on whether these rules will apply to your Australian operations please contact a member of the Deloitte transfer pricing team who will help you navigate your way through the new rules.

Does your company have a New Zealand director?

All companies incorporated in New Zealand on or after 1 May 2015, will be required to have at least one director that either lives in New Zealand; or lives in Australia and is a director of a company incorporated in Australia.

All New Zealand companies incorporated prior to 1 May 2015 have a grace period until 28 October 2015 to appoint at least one director that either lives in New Zealand; or lives in Australia and is a director of a company incorporated in Australia.

Additional information will now be required when filing annual returns also:

- The date and place of birth of all directors (this information will not be made public).
- Details of any ultimate holding companies if applicable

The changes were enacted last year in order to strengthen the company registration rules and to minimise the chance of offshore interests misusing the New Zealand company incorporation process to engage in criminal activties overseas.

Collection of tax on employee share schemes examined

On 31 March 2015, Revenue Minister Todd McClay welcomed the release of an Inland Revenue officials' issues paper that seeks feedback on options to simplify the way tax is collected from employees participating in employee share schemes.

"The options presented in the paper represent a small but important step in Inland Revenue's longer term business transformation programme to modernise the way the tax system is administered and make it easier for New Zealanders to get their tax right," Mr McClay said.

Employee share schemes, where employers offer shares in the company to employees, are often used to encourage staff retention and motivation. The value of the benefit from these schemes is treated as an income substitute under the current tax rules, but unlike most employment income, is not subject to PAYE. Instead, employees who receive share scheme benefits must file a tax return and account for the tax on the value of the benefit themselves.

This can be onerous for employees, many of whom do not realise they must file a return. Further, the inclusion of this income in the tax return can also flip employees into the provisional tax rules, causing added complication.

The issues paper, "Simplifying the collection of tax on employee share schemes", outlines the problem and presents options for taxing this income at source. Officials have a preliminary view that this income should be taxed at source, but the more difficult issue is how this might be achieved given it is not a cash benefit. For example, should the income be taxed at source through the PAYE or FBT rules? There are benefits and drawbacks in taxing the schemes through either route. Then there is the issue of whether taxing at source should be compulsory or elective.

Officials are also interested in hearing from employers that currently operate employee share schemes to find out how any possible changes to the rules might affect them with respect to arrangements they have already entered into with employees, with a view to minimising any related compliance costs or practical issues.

While there are wider tax issues with the taxation of employee share schemes and employee option schemes, the issues in this paper are confined to the collection of tax that arises under current rules.

Submissions close on Tuesday 5 May 2015. The issues paper can be found here. For more information, please contact your Deloitte advisor.

Use of money interest rates to increase

On 1 April 2015, the Government announced that use-of-money interest rates on underpaid and overpaid tax will rise on 8 May 2015. The interest rate charged by Inland Revenue on underpaid tax will rise from 8.40% to **9.21%**, and the rate for overpaid tax will rise from 1.75% to **2.63%**.

The rates are reviewed regularly to ensure they are aligned to market interest rates and were last updated in May 2012.

The interest rates are set as prescribed by the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997. In this regard, the taxpayer's paying rate must be set at the Reserve Bank of New Zealand floating first mortgage new customer housing rate series plus 250 basis points. The rate also takes into account that the Government is an involuntary and unsecured lender and unable to assess the credit-worthiness of the taxpayer.

The Commissioner's paying rate is set at the Reserve Bank of New Zealand 90 day bank bill rate series less 100 basis points. This rate is designed to discourage taxpayers from using Inland Revenue as a bank.

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