Tax Alert

A focus on topical tax issues – April 2016

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Outsourcing payroll compliance overseas? Beware the risks

By Mike Williams and Conor Gates

As companies look to rationalise and leverage greater efficiency in back office processes, it has become common for many of the HR and finance functions of New Zealand businesses to be provided by the HR or finance team of a foreign entity. In some cases, this will be an outsourced function of the business set up specifically to deal with the back office functions on a global basis. For New Zealand businesses, this service is often carried out by an Australian parent of the New Zealand business. The functions undertaken vary from company to company, however we commonly see the New Zealand entity's payroll, GST returns, FBT returns and even corporate income tax returns being prepared by a centralised back office function based overseas. It may seem a good idea to rationalise such functions given the tax regimes in each country may seem similar. With the help of New Zealand specialised software, how hard can it be for the foreign team to complete the work? Well, in reality it can be much harder than first anticipated and does come with some risk. While the withholding and reporting regimes may be similar in name or in nature, particularly in Australia, and while the software employed can do most of the work, there are fundamental differences in New Zealand's rules

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Inland Revenue has recently turned its attention to New Zealand entities outsourcing tax compliance processes overseas

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and requirements that offshore preparers are often not aware of. This leads to an exposure that returns are prepared and filed incorrectly and reporting is either incomplete or incorrect.

We have become aware that Inland Revenue has recently turned its attention to New Zealand entities outsourcing their tax compliance processes to an overseas entity. In particular, Inland Revenue has been focusing its audit activity on Australian prepared GST and FBT returns. While Australia has both GST and FBT regimes, the tax rules within these regimes are fundamentally different in some respects. It is common for a preparer to assume a certain tax treatment based on Australian tax rules, but which is the completely incorrect treatment in New Zealand. This creates a real risk that the returns being submitted to Inland Revenue are inaccurate. In times gone by, this may not have been an issue as the detection rate was relatively low. Anecdotal evidence and recent activity we have seen indicates Inland Revenue is very focused on this area currently. Furthermore, Inland Revenue is having significant success in finding discrepancies in the audited GST and FBT returns of New Zealand companies that have been prepared in Australia.

On top of this, Inland Revenue's audit and analysis practices are becoming more sophisticated and commercialised. Where a discrepancy is identified in a particular taxpayer, Inland Revenue is seeking to find other taxpayers with a similar profile or who are in the same industry to provide a much more effective and directed approach to identifying audit targets.

Based on the success of Inland Revenue's current initiative regarding GST and FBT returns prepared from Australia, we think it highly likely that audit activity will extend to Australian prepared payroll as it is becoming increasingly common for the New Zealand payroll function to also be carried out in Australia. Like GST and FBT, New Zealand PAYE is similar to its Australian counterpart (the PAYG regime) however there are specific New Zealand rules around Holiday Pay, KiwiSaver and ACC levies which can easily trip up preparers who are not familiar with these rules.

If you are concerned that you may fall in Inland Revenue's sights, we recommend that you seek advice regarding the preparation of your New Zealand GST and FBT returns. A review of the relevant tax type can help you to identify where you may have current exposures and what steps may need to be taken to ensure that any future exposure is mitigated. If a current or historic exposure is identified, you may wish to consider preparing and submitting a voluntary disclosure to Inland Revenue before Inland Revenue identifies any underpayments of tax.

Although taxpayers that file a voluntary disclosure will generally be subject to interest charges, penalties are in most cases fully remitted. In addition, Inland Revenue generally view both the commissioning of an independent review and the submission of a voluntary disclosure as good indicators that a company has a history of good practice and a desire to be low risk in terms of its compliance obligations.

Having just rolled past 31 March, now is a good time to focus on returns due in May. The next GST returns are due for most GST filers on 7 May 2016, with the final quarter and annual FBT calculations due on 31 May 2016. This presents an ideal opportunity to consider compliance under the relevant regime and a chance to take any remedial steps if needed.

Specifically for FBT, we would also like to remind our readers of the dangers of using the final quarter FBT calculation as an opportunity to 'wash-up' the treatment of any fringe benefits provided to employees throughout the year. As discussed on our article **The danger of washing up FBT in the final quarter** Inland Revenue's view is that only adjustments with a tax impact of less than $500 can be made in the final quarter return.

Where taxpayers make more significant adjustments in the final quarter there is a risk that they will be exposed to shortfall penalties and interest.

If you wish to speak to specialists in either GST or FBT please contact your usual Deloitte advisor.

GST on "remote" services

By Jeanne du Buisson and Divya Pahwa

GST on the online purchases of goods and services continues to get attention in various jurisdictions as authorities grapple with the international challenge of taxing and collecting GST on cross-border supplies. Many countries such as Member States of the European Union, Norway, South Korea, Japan, Switzerland and South Africa have already implemented rules to deal with aspects of this often "untaxed" area of commerce.

Australia has also proposed similar rules that will apply from 1 July 2017. The application of tax on digital services indicates a global move from supplier based to destination based consumption tax.

Not one to be left behind, New Zealand will soon join these jurisdictions and start capturing GST on online services. The new rules are contained in the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill ("the Bill"), which was introduced on 16 November 2015 and reported back recently. Once enacted, the new GST rules on online services (often called the "Netflix Tax") will come into force on 1 October 2016. The rules will collect GST on services and intangibles (including digital downloads) supplied remotely by an offshore supplier to New Zealand-resident consumers. Insurance and remote gambling services provided by offshore suppliers will also be caught by the new rules.

As the rules are to apply from 1 October 2016, there will be less than 6 months to go once enacted

The new rules will mainly impact offshore businesses (who will need to register and collect the GST) and New Zealand consumers subscribing to these services (who will likely bear the increased costs). The offshore suppliers of remote services to private consumers will have a liability to register for New Zealand GST if certain supplies exceed the threshold of NZ$60,000 per annum. An area which is not addressed by these rules is the collection of GST on the purchases of goods online from overseas. This is a more complex issue that is still being considered by New Zealand Customs and Inland Revenue separately.

Key features of the New Zealand rules

The proposed new rules for GST on imported services for New Zealand will operate as follows:

- Remote services (as defined) which are supplied to New Zealand-resident consumers will be treated as being performed in New Zealand and subject to GST;
- A wide definition of remote services is proposed. This will include both digital services (downloads etc.) and more traditional services (such as consultancy and advice);
- Offshore suppliers will be required to register and return GST if their supplies of services to New Zealand-resident consumers exceed the threshold of NZ$60,000 in a 12-month period;
- As electronic marketplaces such as online app stores are generally in a better position to register and return GST on supplies compared with the underlying supplier, they will be required to register for GST instead of the principal supplier registering, where certain conditions are satisfied;
- To ensure compliance costs are minimised, the new rules will only apply to business to consumers (B2C) transactions. Business to business (B2B) transactions will be excluded (unless the offshore supplier elects that these supplies will be zero-rated in order to allow the offshore supplier to recover any New Zealand GST);

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- Significant fines, of up to NZ$50,000, would apply to New Zealand-resident consumers who deliberately and repeatedly represent that they are a business to an overseas services supplier; and

- A new proposed rule will prevent double taxation from arising on supplies of remote services performed in New Zealand to a non-resident consumer, by allowing a deduction against the supplier's liability for New Zealand GST to the extent that the supply has already been taxed in another jurisdiction.

Electronic marketplaces, such as an app or online music store, will generally be treated as the supplier and be required to register and collect GST, even if legally the marketplace is operating as an agent. This will be in situations where customers would normally consider the marketplace to be the supplier. This is a significant change from the normal manner in which GST operates, as the GST rules will disregard the legal structure of the agent / principal relationships of the parties. This is a pragmatic response to the issue of many small international suppliers operating through a central market place and follows the approach that Australia has adopted in the design of its regime for services imported by Australian consumers.

Overall we consider the proposed rules have been drafted in a pragmatic way and are aimed at broadening the base of New Zealand's GST system. We consider it is likely there is still some fine tuning required to make the provisions work in a coherent and coordinated manner with the current legislation and also with e-commerce taxation rules prevalent in other jurisdictions. There is likely to be a crucial interplay of the e-commerce taxation rules between Australia and New Zealand.

This Bill is expected to be enacted before the end of April 2016 which means there will be less than 6 months until the rules go live. It is important that offshore businesses supplying remote services to consumers in New Zealand are ready to comply. However, New Zealand businesses supplying digital services to consumers in other countries should also be aware that their sales of any remote services to other jurisdictions may trigger VAT/GST obligations in those countries. It is inevitable that more countries will look to adopt similar rules.

For more information on this area, please contact one of our indirect tax specialists.

The rise of holiday pay woes

By Christel Townley and Derek Tang

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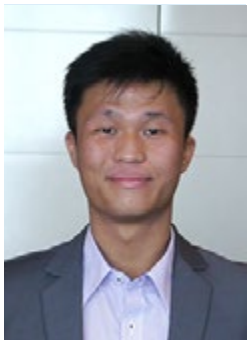

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No one enjoys being told that they have not been wholly compensated for their work, especially when it involves an extended period of time. Yet that is the reality for many Kiwis today as continuing investigations by the Labour Inspectorate show that many businesses, both public and private, have failed to fully comply with the Holidays Act 2003 ("the Act"). As it stands, there have been investigations into 20 employers for potential breaches of the Act. With further investigations currently being conducted, it should come as no surprise that the arrears of salaries and wages is predicted to run into the millions of dollars.

These issues may be attributed to the information entered into the payroll system and sometimes the system itself may not be operating as it should. In most cases, employers are to calculate holiday pay at the higher of an employee's ordinary weekly pay or average weekly earnings over the preceding 52 weeks. Common errors can be where the system has been programmed to calculate holiday pay at only one of these rates, or payments that should be included in holiday pay calculations are not marked as such, subsequently underpaying the employee. Examples of these may occur in circumstances where contractual bonuses are being incorrectly treated as discretionary payments, certain allowances are not being included in holiday pay calculations or when employees work greatly variable hours during the year. Although investigations have been in progress since 2012, the extent of the situation is only now becoming clearer as investigations are being completed. The ongoing media coverage is certainly not helpful as it impacts the reputation of businesses and the public can often be misinformed about how holiday pay operates.

Given the increased focus on employee payments, consistent with our previous article on the **taxation of allowances**, the time may be right for a review of payroll related matters.

Please contact your usual advisor to discuss further.

A step in the right direction – relaxation of the bank account requirements for IRD number / GST applications

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Since 1 October 2015, non-residents have been required to have a fully functional New Zealand bank account before applying for an IRD number. This change was introduced as part of the suite of measures to assist Inland Revenue with its enforcement of the taxation of property rules and ensure that New Zealand's full anti-money laundering rules apply to non-residents. However, the requirement to have a fully functional bank account has proved to be extremely problematic for a number of non-residents that have limited physical presence in New Zealand and no other need for a New Zealand bank account.

It is pleasing to note that Officials have listened to concerns and have proposed amending legislation which will see this rule relaxed in certain situations. The key exemption will allow non-residents to apply for an IRD/GST number without the need for a fully functional New Zealand bank account in situations where the application for an IRD number is for GST purposes only.

On 21 March 2016, the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill ("the Bill") was reported back from the Finance and Expenditure Committee. The Bill already contains an exemption to the bank account requirements for non-resident suppliers of "remote services" (who will be required to register for GST when the 'Netflix' tax is introduced – **see here**. The Bill as reported back also goes a step further to exempt the bank account requirement for all other non-resident suppliers applying to just register for GST.
This bank account exemption will particularly benefit non-residents responsible for supplying high value commercial goods into New Zealand (often with one-off supplies) as they will more easily be able to register for GST and claim back import GST incurred by them on importation. The bank account exemption will also simplify GST grouping between offshore head offices and New Zealand subsidiaries.

It must be noted that the bank account exemption will not apply to non-residents where they may have other non-GST tax obligations in New Zealand. Therefore, it is likely that many non-residents will continue to encounter issues/delays in obtaining IRD/GST numbers for the foreseeable future as they will still need to obtain a fully functional New Zealand bank account. The Bill is expected to be enacted before the end of April 2016. These exemptions will apply with effect from the date of royal assent.

For further information, please do not hesitate to contact your usual Deloitte advisor.

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FBT errors – we're only human after all, right?

By Conor Gates

Some of the most common FBT errors in FBT returns arise where the underlying information is prepared in an Excel spreadsheet. We frequently come across systemic errors in the underlying formulas with preparers relying on what has been done previously. Often the errors are repeated quarter on quarter as the FBT spreadsheet is rolled over and updated with the new information without any critical consideration of how the spreadsheet operates. Common errors in Excel spreadsheets include:

- Totals or subtotals not capturing all of the relevant data to be summed;
- Incorrect formulas being used to determine the taxable value of benefits - this is particularly prevalent in the calculation of motor vehicle benefits where the calculation of the days available is not updated for the relevant days in the quarter for instance;
- Formulas which are copied and pasted referring to incorrect cells or cells which are not locked as 'absolute' cells in a formula;
- Where an adjustment for an exceptional item in a quarter is carried forward in subsequent periods; and
- We recommend that preparers undertake a sense-check of the FBT calculation to identify anything that is unexpected. We also recommend working through the spreadsheet to follow the calculation of benefits from the input data through to the final calculation of FBT due.

And finally, just because the spreadsheet has always been done in a particular way does not necessarily mean that the spreadsheet is correct!

For further information, please contact your Deloitte tax advisor.

Use of money interest rates to reduce

On 4 April 2016, the Government announced that use-of-money interest rates on underpaid and overpaid tax will reduce from 8 May 2016. The interest rate charged by Inland Revenue on underpaid tax will decrease from 9.21% to 8.27%, and the rate for overpaid tax will decrease from 2.63% to 1.62%.

The rates are reviewed regularly to ensure they are aligned to market interest rates and were last updated in May 2015.

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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