Tax Alert

A focus on topical tax issues – May 2016

In this issue

Tax Bill – Reforms galore

By Robyn Walker and Nigel Jemson

The Taxation (Annual Rates for 2016-17, Closely Held Companies and Remedial Matters) Bill ("the Bill") has been introduced into Parliament by the Minister of Revenue.

The Bill contains a bonanza of reforms, some of which are a result of consultation on various issues papers released last year. This Bill is more dense than most, clocking in at 139 pages of legislation, over 200 pages of commentary, and containing over 70 different reforms.

The Bill includes tax changes in the following areas:

- Review of tax rules for closely held companies;
- Non-resident withholding tax ('NRWT") and Approved Issuer Levy ("AIL") changes;
- GST technical issues;
- Related parties debt remission;
- Interaction of loss grouping and imputation rules;
- Time bar and ancillary taxes;
- Remission income, tax losses and insolvent individuals;
- Amending the empowering provision for New Zealand's double tax agreements ("DTA") to clarify that anti-avoidance rules can still override the effect of a DTA;
- Annual setting of income tax rates for the 2016-17 tax year;
- Addition of new charities to schedule 32 of the Income Tax Act 2007;
- Various remedial changes.

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Some of the more topical reforms are discussed below.

Closely held companies
As noted in the title, the Bill includes tax changes focused on closely held companies (i.e. companies which typically have only a few shareholders). The reforms arise as a result of consultation on the issues paper "Closely held company taxation issues" (further coverage on the issues paper can be found in the **September 2015 Tax Alert Special**).

Included in the Bill are various changes to the rules for look-through companies ("LTCs") to address the complexity of these rules. In particular, the deduction limitation rule is being removed in most cases and the entry criteria expanded to allow an LTC to have more than one class of share. Various new limitations on the LTC entry criteria are also being introduced, including restrictions on charities and Māori authorities being LTC owners. There are also restrictions being introduced on foreign-controlled LTCs so that the foreign income that a foreign-controlled LTC can earn annually is limited, otherwise the company will lose LTC status.

Changes included under the closely held companies umbrella but applying to all companies include sensible changes to the general dividend rules to enable a company to opt out of deducting RWT from a fully imputed dividend paid to corporate shareholders. Other technical reforms to the dividend rules signalled in the earlier issues paper are included in the Bill.

Non Resident Withholding Tax and Approved Issuer Levy

Following on from the issues paper "NRWT: Related party and branch lending" released last year, there are a number of NRWT / AIL related proposals included in the Bill. Further coverage on the issues paper can be found in the **June 2015 Tax Alert article**.

While the substance of the original issues paper proposals has been retained, some of the "rough edges" have been removed following the consultation process. The proposals in this area are particularly complex and like, most Tax Bills, include a new acronym for taxpayers and advisors to learn – NRFAI (i.e. non-resident financial arrangement income). The application date of the various NRWT/AIL changes differ, the earliest being the enactment date of the Bill.

Included amongst the reforms is an amendment aimed at removing the ability for related taxpayers to benefit from a mismatch between when income tax deductions are available for interest expenditure and when the associated NRWT liability arises. Currently NRWT ordinarily arises when interest is actually paid whereas the financial arrangement rules can spread deductions over the life of an arrangement. The Bill includes changes aimed at ensuring that an NRWT liability will arise at approximately the same time that an income tax deduction (calculated under the financial arrangement rules) is available to the borrower for that interest. The formula used to calculate the NRWT liability does helpfully include concessions such as a de minimis threshold, which was not previously proposed in the earlier issues paper.

In a cross-border lending arrangement not involving related parties, AIL can be paid at a rate of 2% rather than NRWT. One of the key drivers behind some of these reforms is a concern that parties were structuring around the rules to pay AIL instead of NRWT. In response, changes have been introduced to define further situations as involving related parties (meaning therefore AIL cannot apply). These target back-to-back loans and multi-party arrangements where a third party is interposed in a lending arrangement to mask what would otherwise be an associated party loan. In addition, non-residents "acting together" will be defined as related parties. The concept of acting together is similar to the existing concept within the thin capitalisation rules, introduced in 2014.

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The Bill also includes limitations on when a security can be registered for AIL. Since the issues paper, the categories of who can register a security for AIL have expanded. The categories are limited to instances where Inland Revenue Officials think it is unlikely that AIL would incorrectly be paid on lending between associated persons or situations where it is easier for Inland Revenue to check that AIL is being incorrectly applied. There are three categories under which a security can be registered, which are listed in clause 330 of the Bill. The categories encompass particular types of issuers, transactions, as well as borrowers which make at least $500,000 of interest payments to non-residents. Limitations on the offshore and onshore branch exemptions are also incorporated in the Bill. Given the sheer content of these reforms, the NRWT/AIL changes will be covered in further detail in a future Deloitte Tax Alert edition.

GST technical issues

Following an issues paper last year (covered in an **October 2015 Deloitte Tax Alert article**) a number of GST changes are contained within the Bill, including:

- Proposals to enable businesses to recover GST incurred on capital raising costs. Input tax will be able to be claimed on these costs (which includes the issue, allotment or renewal of a debt or equity security) as the underlying financial service will be treated as zero-rated to the extent the funds raised are expended in an activity of making taxable supplies. This rule will come into force from 1 April 2017.

- Due to the high compliance costs some businesses experience in apportioning / adjusting input tax deductions, new reforms will make it possible for businesses with a turnover over $24million to agree an apportionment approach with the Commissioner. Alternatively industry associations will be able to agree apportionments.

- There are a number of retrospective changes to the zero-rating of land rules as they apply to the commercial leases.

- Amendments are being made to make the agency rules more flexible by allowing agents and principals to opt out of the agency rules; this will allow parties to account for GST as though the supply was two supplies between the supplier and agent and the agent and principal.

The Bill has over 70 different policy changes and clarifications

Related parties debt remission

The Bill includes a core amendment (as previously announced by the Minister of Revenue) to ensure that the debt remission rules do not produce debt remission income in circumstances where the debt remission causes no change in the net wealth of the economic group or dilution of ownership. Instead the debt will be regarded as being fully repaid. Situations where no debt remission income will arise are where:

- Companies are members of the same wholly owned group of companies; or

- The debtor is a company or partnership (including LTCs and limited partnerships); and

  - » All of the debt remitted is owed to shareholders or partners of the debtor; and

  - » The debt remitted is held and remitted pro-rata to ownership.

Further detail on the progress and content of these reforms can be found in the **March 2015 Tax Alert article** covering the issues paper announcing the reforms and the **October 2015 Tax Alert article** covering the Cabinet's approval of the finalised proposals.

Loss grouping and imputation

Reforms signalled in the issues paper "Loss grouping and imputation credits" (covered in a **October 2015 Tax Alert article**), have been included in the Bill to enable the transfer of imputation credits to another company in a commonly owned group (66 percent or more but less than 100 percent common ownership) as part of a loss grouping arrangement.

Time bar and ancillary taxes

The time bar prevents the Commissioner from increasing an income tax assessment four years from the end of the tax year in which a return has been filed and an assessment has been made (subject to some exceptions). Prior to the inclusion of these reforms in the Bill, there was a long-standing technical issue for taxpayers and advisers where it was uncertain whether the time bar would apply to ancillary taxes or AIL. Ancillary taxes are those such as PAYE, FBT, RWT and NRWT.

The amendments clarify that the time bar should apply to these tax types and will apply from the date the Bill was introduced (3 May 2016). Taxpayers who file returns under these tax types will now be subject to the time bar provided four years have passed from the end of the tax year in which the taxpayer provides the relevant return, however it is not entirely clear in the Bill whether this requirement will apply prospectively (i.e. four years must have also passed from the date the Bill was introduced) or retrospectively. We will be seeking to clarify this.

Other changes

As indicated above, the Bill has over 70 different policy changes and clarifications, some more remedial than others and many correcting rewrite and drafting errors. Other amendments include:

- Amendments to the deductibility of aircraft overhaul expenses
- Clarification that anti-avoidance rules within the Income Tax Act 2007 can still apply to counteract a tax advantage arising under a DTA
- Remedial changes to ensure tax pooling continues to work as intended
- An amendment to restrict the application of the how the 92-day count test works in relation to the exempt income from personal services rule.

The Bill has been added into the long list of legislation before Parliament and will be referred to the Finance and Expenditure Committee who will call for submissions. Given some initiatives are intended to apply from 1 April 2017 this should act as an incentive for the Bill to progress this calendar year.

For further information on the Bill's reforms, please contact your usual Deloitte advisor.

Stay tuned to Deloitte Tax@hand and Deloitte Tax Alerts for further developments.

31 May is fast approaching – It's time to focus on FBT

With the fourth quarter FBT return due on 31 May, now is the ideal time to check that all is well on the FBT front. In this article we highlight a few things for employers to consider this month as part of preparing the last quarter calculation.

Don't miss these benefits
It's not just about motor vehicles, employment related loans and medical insurance contributions. There is a wide range of benefits which can be caught by the FBT regime (as can be seen by the list of unclassified benefits below).

Putting in place controls to identify and capture all benefits (particularly new benefits) provided to employees is the key to ensuring the return is complete and accurate. A few examples which are often missed include:

- Vouchers
- Flowers and Christmas gifts
- Prescription spectacles
- Leaving gifts
- Free or discounted goods and services
- Use of employer's assets off the premises and for private purposes (e.g. use of employer's boat)
- Child care (not provided on employer's premises)
- Allocation of "frequent flyer points" if the membership is in the name of the employer
- Home newspapers

Organisations that undergo regular health checks of their compliance are perceived by Inland Revenue as having a low risk profile

- Magazine subscriptions
- Study fees (when the course is unrelated to work)
- Travel (not work related)
- Club memberships (not being work related societies and professional bodies)

Are FBT processes and systems up to scratch?
We commonly rely on what is in front of us. FBT returns are often prepared quarter on quarter relying on a spreadsheet being rolled forward and updated with preparers not critically assessing the mechanics of the calculation. A review of underlying formulas and logic in the spreadsheet is a good step toward ensuring accurate calculations.

If you find yourself in a review, Inland Revenue will generally ask questions about the company's information collection processes, preparation procedures and its review processes for the preparation of FBT returns. If Inland Revenue came knocking, how would your business fare in answering the following questions?

- Who can explain the processes involved in preparing FBT returns and describe the source documentation that is used to identify fringe benefits?
- What kind of checks are undertaken to ensure that all benefits are considered for inclusion in FBT returns?
- Do you have written procedures for the preparation of FBT returns?
- Are FBT returns reviewed before they are filed?

If there have been changes in staff responsible for preparing FBT returns, this can be an ideal trigger to review these matters.

We know from experience that Inland Revenue generally perceive an organisation to have a lower risk profile if it undergoes a regular and robust "health check" of their compliance processes. Not only does it reduce risk and save on potential penalties where FBT is underpaid, but savings can often be found where FBT is overpaid.

To attribute or not, that is the question

Employers may have chosen in the first three quarters to pay FBT at the single (and highest) rate of 49.25%. This option is the easiest from a compliance point of view but employers are likely to pay more FBT than necessary in the long run under this option. However all is not lost as employers are still able to replace the fourth quarter calculation with a full year attribution calculation subtracting the FBT paid in the first three quarters.

Our experience shows employers can and do save material amounts when going through the full attribution exercise. At the very least, rather than perform the full attribution calculation, employers should consider whether it is possible to "pool" eligible benefits at the lower rate of 42.86%.

Do I deduct PAYE or pay FBT?

A common dilemma is whether something is subject to PAYE or FBT. The general rule is that if the employee is contractually obliged to pay for something but the cost is met by the employer, excepting genuine business expense reimbursements, it is subject to PAYE. Generally where the employer is obliged to pay for the item provided to the employee, then this will be subject to FBT. One exception relates to the taxable provision of accommodation, which is always dealt with under PAYE regardless of any arrangements in place.

Correctly identifying PAYE vs. FBT is important as any amounts which should be subject to PAYE can have wider reaching implications in relation to holiday pay, Kiwisaver, Student loan repayments and child support. Where these amounts are incorrectly attributed to FBT the above ancillary items are impacted.

Is it GST on FBT or FBT on GST?

GST is payable on some fringe benefits as the employer is treated as supplying the benefit to the employee as if it was a normal sale of goods and services by the employer to the employee. The rule to remember in this regard is that what goes on the FBT return stays on the FBT return and so this GST adjustment is made in the FBT return (and not claimed on the GST return). It's quite common for the GST payable on fringe benefits to be double-counted and incorrectly included in the GST return as a GST expense.

Issues with motor vehicles

The provision of motor vehicles probably accounts for most of the FBT payable in returns. It is also an area where errors easily occur. Issues often arise with what cost basis is used, the tracking of private use and exempt days, what is a work-related vehicle and other such intricacies. It is important to review this periodically to make sure what is recorded stacks up, that appropriate logs are kept, and that work-related vehicles are treated correctly, and particularly whether they are exempt from FBT or not.

For the purpose of measuring the available days, the total number of days in the quarter is reduced by the non-usage days, but the apportionment factor is always applied over a standard 90 days.

Our experience shows employers can and do save material amounts when going through the full attribution exercise

Applying the de minimis exemption for unclassified benefits

There is an exemption from FBT for unclassified benefits provided to employees provided a de minimus threshold is not exceeded. The current de minimus threshold is $300 per quarter per employee or $22,500 per employer over the last 4 quarters for all employees. This calculation is a rolling quarterly calculation. In practice we find this opportunity is missed completely or the rolling quarterly calculation of the threshold is not done correctly.

Further, Inland Revenue's position is that the de minimis threshold applies across all associated entities and not on an entity-by-entity basis, regardless of whether the entities are providing benefits to the employees of another entity or not. This creates a risk that a group company relying on the de minimis exemption may not validly exclude unclassified benefits. This is a particular risk where there is limited or no information sharing between entities.

Did you miss our article on outsourcing payroll overseas?

In **last month's Tax Alert** we covered issues arising when FBT returns are prepared by an overseas centralised back office and the fact that this has come under scrutiny from Inland Revenue recently.

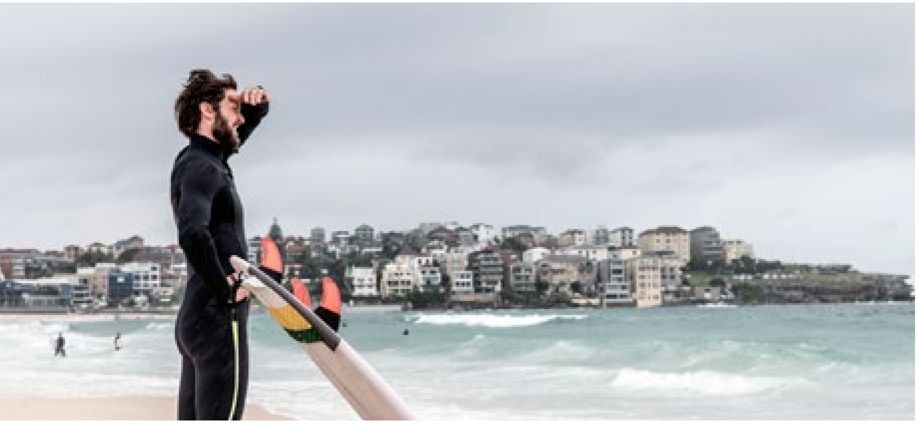
Be wary of washing up errors into the next FBT returns

And last but not least, it may be common practice to use the final fourth quarter FBT return to correct or include fringe benefits provided over the previous quarters. This is only technically permissible if the total FBT error is $500 or less. If the FBT error is greater than this, the relevant FBT returns need to be corrected and benefits returned in the correct periods, otherwise there is a risk that shortfall penalties and use of money interest will arise. To read more about this issue, see our article **here**.

Conclusion

If you require assistance with your final quarter calculations or wish to explore the benefits of an FBT health check further, please contact your usual Deloitte tax advisor.

Australian Budget – how might New Zealand's budget compare?



On 3 May 2016, the Australian Federal Budget 2016 ("the Budget") was handed down by Treasurer Scott Morrison. The Budget focuses on increasing employment and growth, addressing tax system challenges regarding multinationals and superannuation, and balancing Federal revenue and expenditure while paying down long term debt.

The key tax measures from the Budget include:

- A long term plan to reduce the company tax rate to 25%
- A modest personal tax rate cut for taxpayers earning over $80,000
- A new diverted profits tax applicable to significant global entities using artificial or contrived arrangements to reduce tax by diverting profits offshore
- A new tax avoidance taskforce led by the Commissioner of Taxation
- Changes to the superannuation system to promote flexibility and fairness

Given New Zealand's proximity to Australia and the fact that comparisons will inevitably be made, how will this budget compare to New Zealand's which is scheduled to be delivered on 26 May 2016?

With respect to the reduction in company tax rates, the staggered approach, while fiscally more appealing, will actually be a logistical nightmare to manage, as each time the tax rate changes (from 30% to 27.5% to 27% to 26% to 25%) there will be associated transitional rules for calculating what tax to pay and also working out to what extent dividends can be franked (the equivalent of imputing dividends in New Zealand). Not to mention implications for tax accounting in financial statements, where applicable. We know because we've been there and done that with our tax rate drops in 2009 (to 30%) and 2012 (to 28%). To date we have heard no murmurings of any further corporate tax rate drop in New Zealand and so the question is whether the New Zealand Government will come under pressure in the future to match these lower rates. It would be surprising at this late stage if the New Zealand National Government were to signal a similar move in Budget 2016. One reason it may not be on the cards at the moment is that overall the state of the New Zealand tax system is arguably in better shape than Australia's because of our broad-based low-rate tax system. With respect to personal tax rates, Prime Minister John Key has already firmly indicated that New Zealand's Budget 2016 will not reduce personal income tax rates.

Concerning issues of multinational tax avoidance, the Australian Budget delivers a comprehensive set of proposals in order to limit Base Erosion and Profit Shifting ("BEPS") out of Australia. The measures proposed demonstrate a continued commitment by the Federal Government to practice its "first mover approach" concerning the OECD's BEPS action plan.

Key proposals include:

- A new diverted profits tax for significant global entities using artificial or contrived arrangements to reduce tax by diverting profits offshore, supported by a 40% penalty tax rate;
- A new 1,000 person tax avoidance taskforce within the Australian Tax Office that has the aim of raising an extra AUD 3.7 billion in revenue;
- New anti-hybrid rules to close cross-border tax arbitrage (for example, instruments or entities that are treated differently in different jurisdictions) from 1 January 2018;
- Increased disclosure expectations requiring financial advisors to report potentially aggressive tax planning schemes and a tax transparency code to encourage public disclosure of tax information;
- Better whistle-blower protections for people reporting tax misconduct to the Australian Tax Office;
- Updated transfer pricing rules that correlate with the OECD's most recent guidance; and
- Penalties of AUD 450,000 (up from AUD 4,500) for a breach of tax reporting obligations for companies with over AUD 1 billion annual turnover.

Inland Revenue Officials have been heavily involved in the OECD's BEPS project over the previous two years and much work has been going on behind the scenes.

With recent media attention in New Zealand on the 'Panama papers', foreign trusts and multinational taxation, it is likely there will be some commentary in this month's New Zealand budget about how New Zealand is responding and whether it is doing enough.

Rather than going it alone like Australia, the Government has stated that this problem needs to be solved at the international level, with the Minister of Revenue, Michael Woodhouse asserting "the OECD is the best place in which to have that analysis".

What is often not mentioned in the media is that Inland Revenue Officials have been heavily involved in the OECD's BEPS project over the previous two years and much work has been going on behind the scenes. In Budget 2016 we are likely to be reminded of the work that is being undertaken, such as:

- The imminent application of GST on remote services supplied in New Zealand by offshore parties which will start to apply from 1 October 2016.
- An Issues paper is expected to be introduced this year targeting multinationals using hybrid mis-match arrangements, plus a further paper is planned on interest limitation rules.
- Just last week, the Government introduced measures in a bill to tighten up the rules around withholding taxes on the receipt of passive income by certain non-residents (NRWT) which is a further base maintenance measure affecting multinationals.
- And, the Government no doubt will also reference the announcement of the recent foreign trust review in Budget 2016.

Suffice to say – these measures plus the international changes resulting from the OECD BEPS project alone are already significantly changing the landscape for multinationals operating in New Zealand. Based on this and comments to date we can't see that the New Zealand Government will introduce a diverted profits tax. Of course the tougher multinational rules in Australia could in fact dissuade multinational companies and / or even Kiwi businesses from setting up businesses in Australia. It's a balancing act between attracting investment and making sure the rules are fair for all.

And last but not least, Australia will be imposing GST on imported goods from 1 July 2017. Overseas suppliers will need to register for Australian GST if their supplies to Australian exceed A$75,000. Interestingly New Zealand Customs had been scheduled to release its own proposals on GST on imported goods by April 2016, but this is still awaited.   Perhaps this will be announced as part of Budget 2016?

For further information about the Australian Federal Budget 2016, please read this report.

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