Tax Alert

A focus on topical tax issues

April 2017

Business Transformation steamrolls on

The Government's business transformation program to modernise New Zealand's tax administration system continues to roll on, with changes to the disclosure of investment income information and the PAYE rules in the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters Bill) (Bill), introduced on 6 April 2017.

The Bill will greatly extend the pool of data available to Inland Revenue in relation to investment income (mostly interest and dividends). This will place a significant and costly burden on many financial institutions and other companies. The Bill also changes the administration of PAYE and the taxation of employee share schemes, as well as other minor policy and remedial changes.

In this issue:

Inland Revenue will gather the data to compile a complete picture, along with employment and other income information, of each taxpayer's total income, and use this information to determine whether taxpayers are on the correct tax rate, to proactively adjust a tax rate if necessary, and to pre-populate income tax returns

Inland Revenue will release the submission date in due course.

Investment income information ramps up

From 1 April 2020 interest and dividend payers will have to disclose to Inland Revenue regular and comprehensive information on interest and dividend payments, including details of the recipients of those payments. Inland Revenue considers it does not receive sufficient information on investment income at the moment, and cites evidence suggesting that some taxpayers are under-declaring interest income in particular and receiving higher social policy entitlements than they should be.

The response is to require such a significant volume of data that one wonders whether Inland Revenue's (admittedly re-vamped) computer systems will be able to process it accurately and on a timely basis. The aim of the reforms is to reduce costs for recipients of investment income and for the Government - what the Commentary on the Bill fails to acknowledge is that the cost will be borne by investment income payers. As the Government receives information on withholding taxes already on an annual basis, we wonder why the estimated $21m - $27m of income tax is foregone every year due to income not being disclosed. We also wonder whether this figure will be greater or lesser than the cost to investment income payers of complying with the new rules.

Payers of interest on domestically issued debt will have to provide investment income information electronically to Inland Revenue every month that interest payments are made, by the 20th of the following month. The information required is extensive, including the investor's tax file number, contact details, date of birth, amount and type of income and tax withheld, information about any joint owners, and the investor's tax rate.

Similar information must be disclosed by the payers of dividends, Maori Authority distributions, and royalties paid to non-residents.

The intention is that Inland Revenue will gather the data to compile a complete picture, along with employment and other income information, of each taxpayer's total income, and use this information to determine whether taxpayers are on the correct tax rate, to proactively adjust a tax rate if necessary, and to pre-populate income tax returns.

Other measures to support this objective include:

- **IRD Numbers**: Strengthening rules requiring provision of IRD numbers to payers of investment income. The non-declaration rate will increase from 33% to 45% and investors in multi-rate PIEs will be deemed to have exited unless an IRD number is provided within six weeks of opening their account.

- **E-filing**: Investment income payers will have to file investment income information electronically unless it would subject the payer to unreasonable compliance costs or hardship as a result of having to file electronically (from 1 April 2020).

- **RWT exempt-status**: The terminology for those with a certificate of exemption from RWT will change to describe them as having RWT exempt-status. An electronic database will be created so that any investment income payer can verify whether an investor has current RWT-exempt status.

- **Year-end withholding tax certificate**: This will no longer be required unless recipients of investment income payments have not provided their IRD number to the investment income payer.

- **Correcting errors**: Errors in the amount of withholding tax deducted will be able to be corrected in the year following payment of the investment income without the imposition of penalties or interest, up to specified thresholds – the greater of $2,000 or 5% of the payer's total withholding tax liability. Taxpayers have an option to opt in earlier than 1 April 2020 if they so wish.

Changing the taxation of employee share schemes

The Bill introduces reforms to the taxation of employee share schemes (ESS), both for "option-like" schemes and for widely-offered employee share schemes. Although there has been consultation on these proposals in a 2016 Officials' issues paper Taxation of employee share schemes (refer to our October 2016 Tax Alert for more background on these proposals), it is only now that the detail of the reforms is available that affected employers and employees will be able to properly identify the impact of the new rules. The stated objective of the proposals is to achieve a neutral tax treatment of ESS benefits, i.e., the tax position of the employer and employee will be the same, regardless of whether remuneration for labour is paid in cash or in shares.

"*Option-like*" share schemes

There have been concerns for some time that some share schemes have been structured in a manner to bring forward the taxing point for employees in order to have no tax payable by employees. This has been achieved by having employees (or a trustee on their behalf) acquire shares on Day 1, with title passing at some point in the future once conditions have been satisfied. Provided the shares are acquired for the market value on Day 1 there would be no tax payable if there is any movement in the value of shares to the date when they vest with the employees.

New rules will ensure that employees are taxed as there will be a new "share scheme taxing date", being the date the employee holds the shares like any other shareholder (i.e. they have vested with the employee).

Employers who are incurring costs on these employee share schemes will effectively be entitled to claim a deduction for the cost of shares (noting many employers are already able to do this), however the timing of the deduction will be aligned with when employees are returning taxable income (i.e. at vesting point).

The Bill includes some complicated proposals dealing with the Available Subscribed Capital consequences of employee share schemes.

In effect the rules will tax employees on capital gains made on the value of the shares they receive. This will have a disproportionate effect on start-up companies, who may not even be able to utilise the deduction they receive if they are generating losses initially and have a change in shareholder continuity, as is common for start-ups.

The new rules will generally apply six months after the Bill has received Royal Assent.

Widely-offered share schemes

There are currently tax concessions for certain widely-offered share schemes (often referred to as Section DC 12 Schemes). The Bill proposes to modernise these schemes to make them more flexible and easier to apply. Existing DC 12 Schemes should automatically fall within the new rules (i.e. it will not be necessary to change these schemes as a consequence of these changes).

These schemes currently exempt the income received by employees from tax. This treatment will continue, however on the flipside in order to have symmetry the Bill proposes to deny employers from claiming a deduction for the cost of the shares provided to employees (even when the employer is purchasing shares on-market rather than undertaking a fresh issue of shares). Given the cost of shares is a true cost to employers, it is disappointing that this approach has been taken in the Bill. Of even greater concern is it is proposed that deductions are to be denied from the date of introduction of the Bill, i.e. from 6 April 2017.

In effect the rules will tax employees on capital gains made on the value of the shares they receive. This will have a disproportionate effect on start-up companies, who may not even be able to utilise the deduction they receive if they are generating losses initially and have a change in shareholder continuity, as is common for start-ups

More detail on these proposals will be provided in our next Tax Alert.

Improving the administration of PAYE

The administration of PAYE will be improved by integrating information provision obligations with payroll software and aligning timing with payday cycles. Employers will be able to report information directly to Inland Revenue from compliant payroll software systems, or to continue to provide information on paper if their systems do not allow electronic filing. Information will be required shortly after each payday, with timeframes varying depending on the size of the employer and their access to suitable digital services. This replaces the current two weekly and monthly filing timeframes. It is intended to reduce compliance costs by integrating tax obligations with existing pay cycles. Payday information will have to be provided from 1 April 2019 but can be provided from 1 April 2018 by employers who wish to make the change earlier. These information requirements will replace the current PAYE returns, however employers will still have to make PAYE payments on the dates they do currently – either fortnightly or monthly. Both aligning information provision with payday cycles, and integrating this with payroll software should streamline the way in which employers comply with their

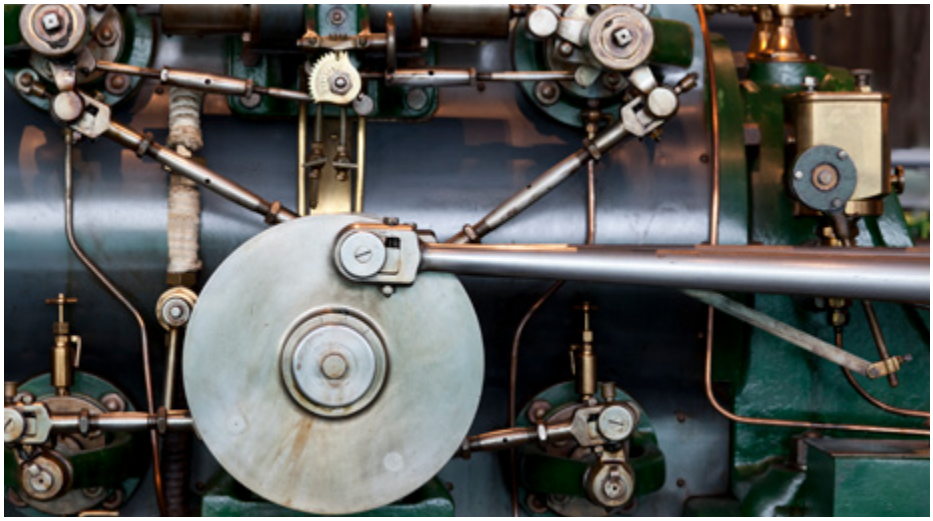
tax obligations. Additional reforms to the administration of PAYE include:

- Lowering the threshold for mandatory electronic filing of PAYE information from $100,000 of PAYE and ESCT in the preceding tax year to $50,000 from 1 April 2019;
- Requiring employers to provide Inland Revenue with information about new and departing employees no later than the next return of payday information;
- Requiring employers to disclose the value of share benefits employees received under employee share schemes effective from 1 April 2017;
- Giving employers the option to tax holiday pay paid in advance as if the lump sum payment was paid over the pay periods to which it relates; and
- Abolishing the existing payroll subsidy for PAYE intermediaries from 1 April 2018.

Other remedial and policy matters

There are a number of other remedial and minor proposals in the Bill, and we highlight some below.

- **Bank account requirement for IRD numbers**: The vexed requirement for an offshore person to have a New Zealand bank account before they can have an IRD number has finally been resolved by a sensible amendment – the Commissioner will have discretion to issue IRD numbers if she is satisfied as to the identity of the offshore person. This amendment is welcomed.
- **Trustee capacity**: The Bill proposes to distinguish between a trustee's personal or body corporate capacity, and their separate trustee capacity. This is intended to address the uncertainty that arose from two recent High Court decisions, Concepts 124 Ltd v Commissioner of Inland Revenue [2014] NZHC 2140 and Staithes Drive Development Ltd v Commissioner of Inland Revenue [2015] NZHC 2593. In those cases it was held that voting rights attached to shares owned by a corporate trustee were attributed to the corporate trustee's natural person shareholders in their personal capacity. This resulted in the unfavourable situation where a shareholder in a trustee company (such as a solicitor's trustee company), which in turn holds shares in a number of unrelated client companies on trust for unrelated beneficiaries, would result in otherwise unrelated client companies being associated for tax purposes. The proposed change will ensure this is not the case as, in effect, the corporate trustee will be treated as the ultimate shareholder and not looked-through and will be acting in a different capacity for each trust.



- **Demergers**: Transfers of shares of a subsidiary of an ASX listed company received by a New Zealand shareholders as a result of a demerger will not be treated as a dividend. We support this amendment which recognises the fact that there is no change in the shareholder's economic ownership of the shares.
- **E-filing GST returns**: This will be compulsory when taxable supplies exceed a prescribed threshold set by Order in Council following consultation. Exemptions will be available for those without access to suitable digital services. As long as the threshold is sensible and consultation is proper and genuine, we agree that this is a useful amendment recognising the efficiency of electronic filing.
- **GST treatment of Pharmac rebates**: Confusion regarding the GST treatment of community and hospital rebates paid to Pharmac will be removed by ensuring the treatment for both types of rebates is the same.
- **Petroleum mining decommissioning**: The existing "spread-back" mechanism for petroleum mining decommissioning expenditure will be replaced with a refundable tax credit.
- **Lloyd's of London tax simplification**: The tax treatment of payments made to Lloyd's of London (an insurance market rather than an insurance company) will be aligned with the tax treatment of premiums paid to overseas insurers.

For more in-depth information on the Bill's proposals, please refer to the following:

- Minister of Revenue Hon Judith Collins' media statement;
- Bill commentary;
- Summary of submissions from the investment income information consultation in July 2016; and
- Cabinet papers (relating to the Making Tax Simpler consultation, feedback and decisions).

Beware the hidden traps in the new foreign trust disclosure rules

By Joanne McCrae and Emma Marr

A trust that is subject to New Zealand income tax is subject, among other things, to the foreign investment fund rules, the financial arrangement rules, and taxable distribution rules. These all add a layer of complexity which is out of step with the fact that many if not all of the assets and most of the beneficiaries may be non-resident.

New Zealand resident trustees of foreign trusts have a very short period of time to get familiar with the new foreign trust disclosure rules, enacted on 21 February 2017. A wide-ranging overhaul of the rules, as recommended by the Government's 2016 Inquiry into Foreign Trust Disclosure Rules (the Shewan Report), will require much greater information be provided both on registration and annually. Failure to comply exposes the trust to New Zealand income tax, and as we discuss below, the ambit of the rules is broad enough that some trustees may be subject to the rules without having any awareness that they even exist, while some trusts will not be able to comply with the rules at all. We consider the rules as currently enacted will result in unintended and unworkable outcomes, and should be amended to remove non-professional trustees from their ambit.

Existing foreign trusts have until 30 June 2017 to comply, whereas any trust formed after 21 February 2017 must comply with the rules within 30 days. A concession for trustees who are non-professional individuals allows four years and 30 days to comply with the rules.

The Shewan Report concluded that foreign trusts had very limited disclosure requirements and further, the requirements were not effectively policed. The Government, concerned to protect New Zealand's reputation, has greatly enhanced those disclosure requirements. There are three main parts to the new rules: registration, annual returns, and ongoing compliance. Failure to comply with any of those three parts will result in loss of the exemption from New Zealand income tax for that trust.

Inland Revenue have launched a new foreign trusts website with an overview of the information requirements and links to the forms that must be filed. These requirements and forms are discussed below later, but first we have highlighted some serious concerns with the new rules.

Issues with the new disclosure rules

We think it is very likely that some trusts will be caught unaware by the rules, and that some trusts will have difficulty complying with the rules at all.

Joanne McCrae
Partner
Tel: +64 9 303 0939
Email: jmccrae@deloitte.co.nz

Emma Marr
Associate Director
Tel: +64 4 470 3786
Email: emarr@deloitte.co.nz

It is of serious concern that trusts without a trust deed cannot register at all under the rules, and therefore cannot ever access the tax exemption. This compromises New Zealand taxing trusts based on the residence of the settlor vs the trustee. For example, the Special Report released by Inland Revenue to further explain the rules confirms that a testamentary trust is a trust for the purposes of the rules, but the will under which it is established is not considered a trust deed. It would appear therefore impossible for such trusts to ever register under the foreign trust rules, meaning that if a New Zealand resident is appointed trustee, executor or administrator of the testamentary trust or estate, that foreign trust will be subject to New Zealand income tax.

As the rule applies to all trusts, including bare trusts (which can arise inadvertently), it is inevitable that trusts will become liable to New Zealand income tax without any person associated with that trust being aware of the liability, or there being any way of removing that liability.

This is a very unfortunate outcome and one that certainly doesn't appear to be contemplated by the Shewan Report. The Shewan Report strongly advocated for preventing foreign trusts exploiting our rules to avoid tax or conceal assets. Extending the scope of the new trust disclosure rules to tax testamentary trusts with extremely limited connections to New Zealand is far beyond the intention of the Shewan Report recommendations.

New Zealand's broad residence rules are also likely to mean that a New Zealand resident trustee (which includes executor or administrator) may be a New Zealand resident despite having only a tenuous connection with New Zealand, and may not even currently be in New Zealand. For example:

- A person could be a New Zealand resident by reason of having a permanent place of abode or breaching the day-count rule but not actually be in NZ currently or for the foreseeable future.
- A trustee company may be New Zealand resident because a director exercises control of the company from New Zealand.

If these trusts do not comply with the disclosure requirements, they will be subject to New Zealand income tax from the 2017/18 income year. This includes full compliance with initial registration, annual returns, and ongoing disclosure requirements. This would apply whether a Double Tax Agreement would treat the individual as a non-resident for tax purposes.

There is a grace period for individuals (not entities) who are not in the business of providing trustee services. They will have four years and 30 days to register the trust.

A further condition of maintaining the tax exemption is disclosure of any additional settlements. Settlements can take different forms, including low interest loans to a trust or services performed for the trust for no payment. It is very likely that such settlements on foreign trusts could take place without anyone being aware that this simple act, if not disclosed, will create a New Zealand income tax liability. Again, this seems beyond the original intention of the rules.

A trust that is subject to New Zealand income tax is subject, among other things, to the foreign investment fund rules, the financial arrangement rules, and taxable distribution rules. These all add a layer of complexity which is out of step with the fact that many if not all of the assets and most of the beneficiaries may be non-resident. Considered in the context of the intention of the Shewan Report, we consider this an unintended and unworkable outcome. In our view the foreign trust disclosure rules should only apply to professional trustees and structures that have been put in place to take advantage of our rules.

Existing foreign trusts have until 30 June 2017 to comply, whereas any trust formed after 21 February 2017 must comply with the rules within 30 days. A concession for trustees who are non-professional individuals allows four years and 30 days to comply with the rules

Requirements

A foreign trust is one which has a foreign settlor and no New Zealand resident settlor. A trust may have trustees and beneficiaries in New Zealand but will not be resident in New Zealand unless the settlor is New Zealand resident. Foreign trusts have been exempt from New Zealand income tax, but in the future will only be so if they comply with the registration requirements.

The first requirement is registration, which is required within 30 days from the date that the foreign trust is subject to the rules – eg, it is settled or the trustee moves to New Zealand. Trusts already in existence when the law was passed have until 30 June to ensure they comply with the new registration requirements.

It is important to note that all the information outlined below can be disclosed by Inland Revenue to the Department of Internal Affairs, New Zealand Police and, the tax authorities of other countries with whom New Zealand has a tax treaty.

Registration must be completed using three separate forms:

1. **IR607**: This is the foreign trust registration form.
   - This form will include the basic identifying information about the trust, trustees, payment of the registration fee, a copy of the trust deed, and a declaration that the information provided is true and correct.
2. **IR607A**: Foreign trust connection person schedule.
   - This must be attached to the IR607 and includes information about any person connected with the trust, including settlors, trustees, parents or guardians and beneficiaries. Detailed information must be disclosed, including name, address, jurisdiction, email address and taxpayer identification number. The form also includes a declaration that the person completing the form and all people named on it are aware of their obligations under, and have complied with tax and anti-money laundering legislation.
3. **IR900A**: Foreign trust settlements & distribution schedule.
   - This is also attached to the IR607 and includes details of all settlements and distributions made to or by the trust, including the name of the settlor or beneficiary, the amount, the currency and the date on which it was made. Upon the initial registration of the trust under the new rules, this will include all settlements dating back to the formation of the trust or, where all the trustees are individuals who are not in the business of providing trustee services, to the later of the trusts formation and four years prior to the date on which the trustee becomes required to register the trust.

Annual returns must be completed within six months of balance date or, if the trust has no balance date, by 30 September. An IR900 must be filed, including a copy of the trusts financial statements and an IR900A detailing all settlements and distributions during the year. An Order in Council will be made at some point to specify minimum standards for foreign trust financial statements.

Ongoing disclosure of changes to any information supplied during the initial registration must be provided to Inland Revenue within 30 days of the trustee becoming aware of the change.

Although new foreign trust disclosure rules were an appropriate response to the Shewan Report, we are concerned that there will be widespread inadvertent non-compliance with the rules, as well as a total inability of some trusts to comply with the rules at all. We would like to see the rules amended to allow registration without a trust deed, to remove non-professional trustees from the rules, and to allow some lenience by Inland Revenue in enforcing the rules when trustees are not aware of their obligations.

When did I buy my land? Inland Revenue explains

By Emma Marr and April Wong

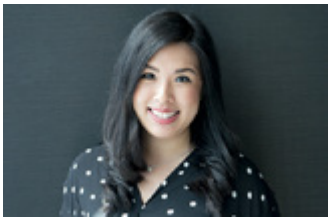
A recently finalised Inland Revenue statement (in the form of a "Questions We've Been Asked" or QWBA) provides guidance on the time that land is considered to be acquired for tax purposes. It is important for all property owners to be aware of when Inland Revenue considers land to have been acquired, and in particular that the test is different if the 2-year bright-line rule applies to the property sale.

QB 17/02 Income Tax – Date of acquisition of land, and start date for 2-year bright line test (QWBA) updates the Commissioner's previously published view in the February 2016 Tax Information Bulletin, which clarifies the date on which a person is treated as acquiring land under the general land taxing provisions in the Income Tax Act 2007 (ITA), and the different rule that applies under the 2-year bright-line test.

Broadly, a person may be taxed on a profit made from the sale of land for a range of reasons including that they acquired it with the intention of disposing of it, as part of a business in dealing in land, or if the land was disposed of within 10 years of acquisition in various circumstances. Those circumstances include that they or an associate dealt in land, was in the business of developing or subdividing land, carried on a building business, or carried out some kind of development or subdivision scheme at the time the land was acquired. A new rule that applied from 1 October 2015 also taxes gains made from the disposal of residential land if it is acquired and sold within two years (otherwise known as the "bright-line" test). The bright-line test does not apply to the landowner's main home. For the purposes of the land taxing provisions, including the 2-year bright-line rule, it is necessary to identify when the land was acquired in order to determine if a gain arising from the disposal of the land is taxable.

The QWBA includes a useful table summarising the date on which land is acquired for both the general land taxing rules and the 2-year bright-line rule. For the purposes of the general land taxing rules , the date of acquisition will be the date that a person first has an interest in the land. This may be on the date that a binding sale and purchase agreement is entered into (even if the agreement is conditional), the date that an option to acquire land is exercised, or, when land is acquired from an associated person,

Emma Marr
Associate Director
Tel: +64 4 470 3786
Email: emarr@deloitte.co.nz



April Wong
Consultant
Tel: +64 9 303 0986
Email: apwong@deloitte.co.nz

the date the associated person acquired the land. Different starting dates may also apply for specific transactions such as transfers of relationship property, distributions on death, distributions from a trust, transfers of value from a company and gifts of property.

It is important to recognise that the 2-year bright-line test operates differently from the other land provisions. In most cases, the 2-year period for the bright-line test starts on the date that the land transfer is registered and the purchaser gets legal title. Where land is subdivided, the start date is the date that title for the undivided land is transferred. Variations on the rule apply when the transfer is a result of a relationship property settlement, the land is acquired subject to the completion of a development or subdivision, the interest is a lease converted into freehold title, or if no title is registered before it is disposed of.

In addition, Inland Revenue has changed their view on when someone is deemed to have their first interest in land in certain kinds of nominations. A nomination can take various forms. If the original purchaser is acting on behalf of the nominee (the person who subsequently purchases the property) then the nominee is treated as acquiring the land at the same time as the original purchaser. However, if prior to settlement, a person nominates another person to complete the purchase (often an associated person) and is not acting on their behalf, the original purchaser is not treated, for the purposes of the 2-year bright-line rule, as having acquired the land at all. Previously, Inland Revenue was of the view that any capital gain arising from such a nomination would be taxable under the bright-line rule. However, Inland Revenue have revised that view and now acknowledge that the nominator does not transfer their interest in the land; rather they create a new right for the nominee. Therefore on-selling the right to acquire the land does not give rise to a liability under the bright-line test. Another scenario is when a person assigns their contractual rights to purchase land, for example a person buys a property off the plans, and on-sells the property before it is completed. The 2-year period for the assignor will start on the date that that they entered into the sale and purchase agreement. For the assignee, the date of acquisition under the general land taxing provisions will be the date that they enter into a binding agreement to purchase the property, whereas for the purposes of the bright-line test the 2-year period will start on the date the transfer of title is registered to them.

It is important to recognise that the 2-year bright-line test operates differently from the other land provisions. In most cases, the 2-year period for the bright-line test starts on the date that the land transfer is registered and the purchaser gets legal title

Withholding tax reforms for branches

By Emma Marr

New rules recently enacted in New Zealand impose withholding tax on interest payments that have previously been paid free of any withholding tax, in particular where lending has been via an offshore or onshore branch of a New Zealand company. Interest payments that have previously been exempt will now in some circumstances be subject to either non-resident withholding tax (NRWT, generally at the rate of 10%) or approved issuer levy (AIL, at the rate of 2%). Some of the changes are deferred for existing arrangements for a period of up to 5 years, with other changes applying when the legislation received Royal Assent on 30 March 2017. As part of the same package of reforms, the Government has strengthened the rules to match timing of the liability to deduct withholding tax with the deduction taken for the payment of the interest. These rules were covered in the February 2017 Tax Alert.

Offshore branch exemption

The first change removes the offshore branch exemption that allows funds lent to New Zealand entities via an offshore branch of a New Zealand entity to escape any withholding tax on interest payments. As an example, a New Zealand resident bank with an offshore branch may borrow funds on the wholesale market, via the offshore branch, with the funds on-lent to non-resident or resident borrowers. Interest payments to the wholesale lender did not attract any New Zealand withholding tax under the previous rules as the interest payments related to a business carried on outside New Zealand.

Changes to the rules now treat any interest payment by the offshore branch to a foreign lender as having a New Zealand source, to the extent that the funds are lent to New Zealand residents. For example, if the offshore branch borrows $100 from a non-resident lender and on-lends $50 to New Zealand residents, 50% of the interest paid to the foreign lender is treated as New Zealand source income. It will be subject to either NRWT (generally paid on associated lending) or AIL (only available for non-associated party lending or lending to a New Zealand registered bank).

The rules apply immediately to new arrangements entered into after 30 March 2017, and after a period of five years for arrangements existing on that date.

Onshore branch exemption

Changes are also afoot for non-resident lenders operating in New Zealand via a branch. Currently, interest paid on a loan from a non-resident lender to a New Zealand resident is exempt from NRWT or AIL if the non-resident lender operates in New Zealand via a branch. This applies whether or not the interest is paid to the branch. The offshore branch exemption will be removed so that NRWT or AIL is payable on interest payments, unless the interest is derived by the New Zealand branch. The onshore branch exemption will remain available for banks (ie, if the lender's New Zealand branch has a banking licence), if the lender is not associated with the borrower. If the lender is associated with the borrower, the interest payer would be able to pay AIL.

The rules will apply from 30 March 2017 for loans between associated parties, other than banks, and to all new arrangements entered into after 30 March 2017. There are some transitional periods for existing arrangements where either:

- A New Zealand resident borrower is borrowing from an unassociated non-resident with a New Zealand branch; or
- The borrower is a bank.

In these cases, the rules will apply after five years, recognising that existing arrangements will generally be at arms-length terms.

Onshore notional loans

To equalise the treatment of advances of funds from foreign banks to their New Zealand subsidiaries with advances to New Zealand branches, the new rules will treat amounts made available from a non-resident head office to its New Zealand branch as a notional loan. This means that the branch which is entitled to a deduction for any interest on that notional loan will also have to pay AIL on the loan. This puts them in the same position as subsidiaries. This new rule will apply immediately to new amounts made available after enactment date. A two year transitional rule applies to amounts that were made available up to enactment date.

Emma Marr
Associate Director
Tel: +64 4 470 3786
Email: emarr@deloitte.co.nz

Are you ready for the new withholding tax rules?

By Emma Marr and Liv Thomson

New withholding tax rules apply from 1 April 2017 that will allow contractors to elect their own withholding rate. Further, the withholding tax rules are extended to labour-hire firms. There is a fish-hook in the rules for some contractors who operate via a company and are working for a labour-hire firm, so some quick action will be needed to get the right tax outcome.

The rules apply to payments made to such contractors from 1 April 2017, regardless of when the services relating to the payment were performed. Although in the case of expansion of the rules to labour-hire firms, up to a 3-month extension may apply in order to get compliance systems in place.

The standard withholding rate is 20%, if the contractor is working through a labour-hire firm, or if there is a particular schedular rate set out in legislation, then this rate will apply (these are the old rates that apply to contractors such as entertainers, labourers, farm workers and so on). Contractors have the option to elect their own rate by completing an IR330C. The minimum withholding rate that can be elected is 10%, or 15% for non-residents or contractors with a temporary work visa. However, some resident contractors may be able to obtain a lower withholding rate – as low as 0% – by applying for a special tax rate certificate from the Commissioner of Inland Revenue. This will be particularly important for contractors operating through a company where they are subject to the income attribution rules or who have a look-through company, and this is covered in more detail below.

If the contractor fails to provide their name and IRD number to the payer a non-declaration withholding rate of 45% will apply (20% for a non-resident company). Contractors can't regularly change their withholding rate – more than two changes in a 12-month period will require the consent of the payer. In addition, the Commissioner has the ability to prescribe a withholding rate (no higher than 60%) where the contractor has a tax debt.

The contractor withholding rules will now also apply to payments made by labour-hire firms. A labour-hire firm is one for which labour-hire arrangements are one of the main activities of the firm. These types of arrangements involve a client hiring a firm to provide a contractor to perform work or services for that client. The client then pays the firm, who in turn pays the contractor. Such firms must, if their systems are capable, start deducting withholding tax from payments made to contractors from 1 April 2017, but have until 1 July 2017 to get their systems in order if necessary. These rules will apply whether the contractor works through a company or on their own account.

Potential issues for contractors

Credit transfer issues may arise for contractors operating through a company. If the personal attribution rules apply (meaning the income is attributed to the shareholder of the company) or the company is a look-through company, withholding tax credits deducted by the labour-hire firm are useable by the company rather than the individual contractor. The tax credits could be refundable once the company files

Emma Marr
Associate Director
Tel: +64 4 470 3786
Email: emarr@deloitte.co.nz

Liv Thomson
Senior Consultant
Tel: +64 4 470 3545
Email: othomson@deloitte.co.nz

its annual income tax return, but this obviously creates a timing issue as the individual contractor will not be able to access the tax credits to cover their personal income tax liability (including provisional tax obligations) until the company's return is lodged and assessed (after the end of the income tax year).

As a result, the individual contractor will still have to pay provisional tax, even where withholding tax is deducted from the payments made to their company. The contractor can estimate their provisional tax to take the withholding tax into account, but this means they miss out on the new use of money interest concession rules now available under the simplified provisional tax rules, because this concession is only available if the standard uplift method is used for at least the first and second provisional tax instalments.

There are two options currently available to contractors who are subject to the personal attribution rules or have a look-through company when receiving payments from labour-hire firms with withholding tax deducted:

- *Apply for a special tax rate certificate of 0% for the company by filing an IR23BS with Inland Revenue*

  If a special tax rate certificate of 0% is issued by Inland Revenue and is presented to a labour-hire firm, the labour-hire firm will not be required to withhold tax from payments made to a company. The contractor may still have to pay provisional tax, and has increased administrative requirements as a special tax code application must be lodged annually to renew the 0% rate.

  While it may have been difficult to obtain 0% special tax rates in the past, Inland Revenue has advised us that it is happy to issue 0% tax rate to a company subject to withholding under a labour-hire arrangement, provided the taxpayer has a good record of filing returns and making payments on time.

  This is because Inland Revenue will still be receiving details of the gross payments made to the company by the labour-hire firm and will be able to check gross income recorded against the company's income tax return if desired.

- *Transfer the credit after year end*

  The current rules allow a transfer of credits between associated taxpayers for tax withheld or deducted on the taxpayer's behalf. The transfer is deemed to take place on the day after the end of the accounting year for standard or late balance dates or 1 April following the balance date for early balance dates.

  This means that for contractors with a 31 March balance date the effective transfer date will be 1 April of the following income tax year, which falls after the first and second provisional tax dates (28 August and 15 January, respectively).

  Any refund of the company transferred to the contractor on 1 April could be applied against the third instalment of the individual's provisional tax due on 7 May, but this doesn't solve the problem of the first two provisional tax instalments.

A change to the credit transfer rules would be a useful solution, perhaps by allowing for transfers of withholding tax credits from a company to individual contractors who are subject to the personal attribution or look-through company rules effective on the date of withholding. Contractors operating via a company are advised to consider whether they should apply for a special rate certificate and, if so, to apply sooner rather than later.

A snapshot of recent developments

Closely Held Companies Bill receives royal assent

On 30 March 2017, the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 (CHC Act) received royal assent. Significantly, the CHC Act aims to give taxpayers more certainty over their tax affairs by dealing with inefficiencies and complexities that have occurred over time. It also aims to reduce compliance costs by simplifying certain tax rules. The CHC Act:

- Changes the eligibility criteria in relation to look-through companies, and simplifies the dividend rules as they apply to closely held companies to ensure that the decision to convert a small business to a company is not driven by tax considerations;
- Tightens the NRWT and AIL rules around taxing New Zealand interest earned by non-residents;
- Addresses various GST issues including allowing businesses to deduct GST associated with the costs of raising capital;
- Provides depreciation rollover relief for businesses in last year's earthquake-affected areas (upper South Island and Greater Wellington);
- Clarifies time bar rules and application to ancillary tax returns;
- Changes the treatment of related party debt that is remitted;
- Changes the deductibility and timing treatment of aircraft overhaul expenditure; and
- Adds 14 new charities to the list of donee organisations in schedule 32 of the Income Tax Act 2007.

Look out for an article in this issue on the NRWT and AIL reforms as they apply to branches.

Inland Revenue releases 2017 International Tax Disclosure Exemption

Inland Revenue has released the 2017 International tax disclosure exemption ITR28 (Disclosure Exemption), which is released annually to remove the requirement for a resident to disclose various interests of less than 10% in a foreign company or foreign interest funds. The Disclosure Exemption is unchanged from the prior year and applies for the 2016/17 income year.

Inland Revenue increases the threshold for minor errors

Inland Revenue has increased the monetary threshold for taxpayers to self-correct minor errors from $500 to $1000 following the enactment of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017. This change is now reflected in Inland Revenue's Standard practice statement SPS 16/01: Requests to amend assessments.

Tax relief for flood damaged farms

On 16 March 2017, the Minister of Revenue Judith Collins welcomed Inland Revenue's decision to exercise its discretion on income equalisation for farmers around the Franklin Ward, Hauraki District and Thames-Coromandel District. Farmers who are significantly affected by floods will be allowed late deposits from the 2016 income tax year to be made up to 30 April 2017, regardless of when the 2016 tax return is filed or the due date for filing that return. Early tax refunds will also be allowed.

Honk Land Trustees Ltd v Commissioner of Inland Revenue

On 10 March 2017, the New Zealand Court of Appeal delivered a judgment on the deductibility of management fees, finding for the Commissioner that management fees were not deductible as there wasn't a nexus between the payments and the taxpayer's income earning and/or business activities. The Court found that the management fee served the sole purpose of eliminating the taxpayer's income tax liability by transferring it to a company that itself had losses, therefore totally eliminating any tax. The Court also confirmed that the Commissioner had correctly imposed a shortfall penalty on the taxpayer for taking an abusive tax position.

Inland Revenue releases draft Question We've Been Asked – Income tax: Whether YouTube receipts are taxable

Inland Revenue has released a draft Question We've Been Asked (QWBA) for consultation. The draft QWBA considers whether YouTube receipts are subject to income tax and concludes that in many cases YouTube receipts are taxable income because they are derived from a business. A YouTuber may also find that they may deduct some of the expenses related to producing or creating content for the website.

Inland Revenue finalises Interpretation Statement 17/02 – Income tax: deductibility of farmhouse expenses

Inland Revenue has finalised interpretation statement, IS 17/02: Income tax – deductibility of farmhouse expenses, which considers the deductibility of expenditure relating to a farmhouse that forms part of a farming business. The Commissioner distinguishes between two types of farms; Type 1 farms, where the value of the farmhouse is 20% or less of the total value of the farm, and Type 2 farms, where the value of the farmhouse is 20% or more of the total value of the farm.

Farmers can continue to claim a deduction of 100% for interest and rates relating to the farmhouse if they have a Type 1 farm. However, Type 2 farmers must undertake a "home office" calculation like any other taxpayer who carries on business from their home to determine the proportion between business and private use. This apportionment calculation can be based on time or space. This percentage can also be applied to all general farmhouse expenses that cannot be dissected. In addition, farmers are only allowed to deduct 50% of their home telephone rental (previously, farmers could deduct 100% of these costs) unless they can show that actual business use is higher.

IS 17/02 applies from the start of the 2018 income year.

Special report released on GST and services connected with land

On 31 March 2017, Inland Revenue released a special report which provides early information on the change to the Goods and Services Tax Act 1985, recently enacted in the CHC Act, relating to GST zero-rating of services connected with land.

From 1 April 2017, the ability to zero-rate services relating to land in New Zealand, where these services are provided by New Zealand suppliers to non-resident customers who are not in New Zealand, has been reduced. The previous GST legislation excluded from zero-rating services which are "directly in connection with" land in New Zealand, and a physical change of the land by the services provided was necessary to disallow zero-rating. Now, zero-rating will be disallowed for services, which are in connection with land, or an improvement to land, located in New Zealand, where those services are "intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement". This will require a significant range of service providers (including lawyers, valuers, advertisers) to charge GST at 15% on their services.

While the principle itself is clear, its application to some services is somewhat questionable as to what will be the critical point in evaluating how close or removed these services are to/from the particular land in relation to this GST taxation scope extension. The special report provides some guidance including examples, but does not provide clarity for all situations.

Inland Revenue has a new foreign trust webpage

Inland Revenue has created a webpage for foreign trusts. The webpage provides a broad overview on the new disclosure requirements for foreign trusts, the registration process, annual return process, and what happens if the contact trustee for the foreign trust changes. Trust registration forms are available for download.

Use of money interest rates decrease

Effective 8 May 2017, use of money interest rates will **decrease**. The taxpayer's paying rate of interest on unpaid tax will move from 8.27% to **8.22%** per annum, and the Commissioner's paying rate of interest on overpaid tax decreases from 1.62% to **1.02%** per annum.

Third party providers approved to store taxpayer electronic records offshore

Inland Revenue has updated the list of approved certain organisations that are permitted to store taxpayers' electronic records outside of New Zealand. You can view the approved organisations on Inland Revenue's website.

Taxpayers who store their business records with these approved organisations do not need to obtain approval under s 22(2BA) of the Tax Administration Act 1994 to store their business records outside of New Zealand. Although a third party provider may be used to store business records, taxpayers remain responsible for their tax obligations including retaining business records for the retention period (usually seven years) required under the Tax Administration Act.

New corporate tax residency test proposed in Australia may result in dual residency implications

The Australian Tax Office (ATO) has proposed a new corporate tax residency test which has the potential ability to capture more companies as tax resident. Previously, the ATO deemed a company

to be an Australian resident if it carries on business in Australia and has its centre of management (CMC) in Australia. The proposed new test as set out in draft Taxation Ruling TR 2017/D2 significantly broadens the net for Australian residency by determining Australian residency simply on the basis of a company's CMC. Effectively, it will no longer matter whether a company carries on business in Australia.

For example, a New Zealand subsidiary that is incorporated in New Zealand and carries on its business on New Zealand shores, could be deemed to be Australian tax resident if it has a parent company who exercises "centre management and control" in Australia. This dual residency outcome is unfavourable and will likely attract considerable debate.

Submissions on the draft ruling are due 12 May 2017 and, once finalised, this ruling will apply from 15 March 2017.

Follow us on Twitter
@DeloitteNZTax

Queries or comments regarding Alert can be directed to the editor, Emma Marr, ph +64 (4) 470 3786, email address: emarr@deloitte.co.nz.

This publication is intended for the use of clients and personnel of Deloitte. It is also made available to other selected recipients. Those wishing to receive this publication regularly are asked to communicate with:

The Editor, Private Bag 115033, Shortland Street, Auckland, 1140. Ph +64 (0) 9 303 0700. Fax +64 (0) 9 303 0701.

New Zealand Directory

Auckland Private Bag 115033, Shortland Street, Ph +64 (0) 9 303 0700, Fax +64 (0) 9 303 0701
Hamilton PO Box 17, Ph +64 (0) 7 838 4800, Fax +64 (0) 7 838 4810
Rotorua PO Box 12003, Rotorua, 3045, Ph +64 (0) 7 343 1050, Fax +64 (0) 7 343 1051
Wellington PO Box 1990, Ph +64 (0) 4 472 1677, Fax +64 (0) 4 472 8023
Christchurch PO Box 248, Ph +64 (0) 3 379 7010, Fax +64 (0) 3 366 6539
Dunedin PO Box 1245, Ph +64 (0) 3 474 8630, Fax +64 (0) 3 474 8650
Internet address http://www.deloitte.co.nz