Connecting you to the topical tax issues

Tax Alert

December 2017

BEPS proposals now before New Zealand Parliament

by Robyn Walker

On 6 December 2017 the New Zealand Government introduced a taxation bill into Parliament addressing Base Erosion and Profit Shifting (BEPS) concerns.

Once enacted, the Taxation (Neutralising Base Erosion and Profit Shifting) Bill will generally apply to income years starting on or after 1 July 2018.

We outline the key proposals below, noting there is a lot of detail and complexity in the proposed rules which we don't fully explain here and in some instances there are conflicts between the words of the legislation and the proposal articulated in the Bill Commentary.

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Interest Limitation Rules

Historically New Zealand has used its thin capitalisation rules to limit the amount of debt that can be held in New Zealand, with transfer pricing rules applying to ensure the rate of interest on debt is appropriate. There has been a concern expressed by Officials that the transfer pricing rules are too fact dependent and subjective, too hard to police, and overall not wholly effective at keeping interest deductions in New Zealand to an appropriate level.

The new rules were perhaps the most controversial proposals when consultation occurred earlier this year, however some refinement of the original proposals has taken place. At a high level, the new rules are as follows:

- Introducing a "restricted transfer pricing" approach to pricing related-party loans between a non-resident lender and a New Zealand-resident borrower. Under this approach, there are a series of real or assumed credit ratings that can be applied to determine the appropriate interest rate in certain circumstances. In limited circumstances it could be the borrower's own credit rating for long-term unsecured debt; in others it will be higher of BBB- and the rating that would be given if the borrower had a debt ratio of less than 40%; in other circumstances it will be the higher of the borrower's credit rating and the highest credit rating in the borrower's worldwide group minus one notch (this option is referred to as the "safe harbour" option). The option a taxpayer uses will be influenced by whether the taxpayer is considered to be at a high risk of BEPS behaviour. A taxpayer is categorised as a high risk of BEPS if they fail one or more of the following tests:
  - The borrower has a greater than 40% debt to asset ratio, or they exceed the 110% worldwide debt test; or
  - Borrowing comes from a jurisdiction where the lender is subject to a lower than 15% tax rate; or
  - The borrower has an income-interest ratio of less than 3.3 (this is referred to as an EBITDA test).

A de minimis rule applies to exempt taxpayers from these rules if related-party cross-border loans are less than $10million.

- Once a credit rating is established, further features of the debt need to considered and/or disregarded when pricing the debt. These features include the term of the loan and whether the debt is subordinated.
- Specific rules apply to taxpayers who are insurers or in the business of lending.
- Amendments are being made to the existing thin capitalisation rules, including:
  - Changing the way debts and assets are measured by subtracting non-debt liabilities from the value of assets for the purposes of the thin capitalisation calculation;
  - Introducing a de minimis rule to reduce compliance costs for smaller businesses;
  - Amending the rules for taxpayers caught under the "acting together" tests to ensure the rules work as originally intended;
  - Clarifying the circumstances in which a taxpayer can use an alternative asset valuation from that used in the financial statements;
  - Introducing a further avoidance rule to prevent manipulation of debt and asset values at balance date;
  - Extending owner-linked debt provisions to trusts;
  - Providing a limited exemption from the thin capitalisation rules for certain government infrastructure projects.

Permanent Establishment Rules

New rules will target large multinationals (at least €750million consolidated global turnover) that structure arrangements to avoid having a permanent establishment (PE) in New Zealand. The new rules will deem a non-resident entity to have a PE in New Zealand if a related party is conducting sales activity in New Zealand in a manner designed to avoid tax.

These rules attribute activities for the related party to the PE. Of some concern is that these rules have been explicitly designed to apply regardless of any contrary positions under New Zealand's Double Tax Agreements (DTAs), unless that DTA incorporates the OECD's latest PE article (Article 12(1) of the Multilateral Convention).

Transfer Pricing Rules

A raft of changes are being made to the transfer pricing rules to make them more robust and to achieve greater alignment with Australian transfer pricing rules. Changes include:

- Including a reference to the OECD transfer pricing guidelines in the Income Tax Act 2007;
- Giving priority to the economic substance and conduct of parties over the terms of a legal contract;
- Providing Inland Revenue with the ability to disregard or replace transfer pricing arrangements which are not commercially rational;
- Extending the application of the transfer pricing rules to transactions where non-resident investors are "acting in concert" to effectively control a New Zealand entity;
- Shifting the onus of proof from the Commissioner to the taxpayer (consistent with the approach for other tax matters);
- Extending the time bar that limits Inland Revenue's ability to reassess transfer pricing positions from four years to seven years.

Country-by-Country Reporting

The requirement for New Zealand headquartered multinational groups with annual consolidated group revenue of €750million or more to prepare and file a country-by-country report will be codified in legislation.

Hybrid and Branch Mismatch Rules

The Bill includes a comprehensive adoption of the OECD hybrid recommendations with modification for the New Zealand context. The proposed rules are designed to address the following hybrid and branch mismatches:

- Hybrid financial instruments;
- Disregarded hybrid payments;
- Structures producing double deductions;
- Reverse hybrids;
- Dual resident entities;
- Imported mismatches; and
- Deemed branch payment and payee mismatches.

Other policy matters

A number of other policy matters are included in the Bill:

- The Bill proposes amendments to allow the Commissioner to request offshore information held by large multinational groups and introduces a new civil penalty imposing fines of up to $100,000 on a large multinational group member who has failed to comply with a request for information. This rule will apply from the date of enactment.
- A new rule is proposed to allow Inland Revenue to collect tax owed by a member of a large multinational group from any wholly-owned (local) group member.
- A new deemed source rule is proposed which will deem an item of income to have a New Zealand source if New Zealand has a right to tax that item of income under a DTA.
- An amendment is proposed to ensure that no deductions for the reinsurance of life insurance policies are available if the premium income on that policy is not taxable in New Zealand.

Deloitte Comment

This Tax Bill contains some of the most complex legislation produced in recent memory. It will take considerable time and effort to come to grips with all the proposals contained within the Bill and what they mean for taxpayers. Of most concern is the manner in which the rules propose to override existing OECD arm's length concepts for the pricing of debt and existing DTAs. The concern is that such proposals have New Zealand going against existing international norms as well as effectively seeking to legislate itself out of previously agreed DTA positions.

With most proposals coming into effect from income years beginning on or after 1 July 2018, this doesn't leave much time for taxpayers to prepare.

The next steps are for the Bill to be read in Parliament for a first time, after which it will be referred to the Finance and Expenditure Committee who should then call for public submissions on the Bill.

Keep an eye on www.taxathand.com or our Tax@Hand mobile app for more detailed commentary on these proposals.

For more information please contact your usual Deloitte advisor.

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Terms of reference announced for Tax Working Group

by Veronica Harley

The 100 day plan of the new coalition Government includes the establishment of a Tax Working Group (the Group) to consider changes that would improve the structure, fairness and balance of the tax system. In November 2017, the Ministers of Finance and Revenue announced the terms of reference for the Group. It was also announced that the Group would be chaired by Sir Michael Cullen who was a former minister of finance and revenue in the previous Labour Government, with the rest of the members to be announced prior to Christmas 2017. The membership will be diverse and will include representatives from all sectors of the New Zealand economy. It will not only include tax and finance experts, but also representatives from the business and community sectors plus Māori representation. The Group will be supported by a secretariat of officials from Treasury and Inland Revenue and will have an independent advisor to analyse the various sources of advice received.

The Group will have a wide mandate to look at New Zealand's tax system and this has been broadly framed as follows:

- Whether the tax system operates fairly in relation to taxpayers, income, assets and wealth,
- Whether the tax system promotes the right balance between supporting the productive economy and the speculative economy,

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- Whether there are changes to the tax system which would make it more fair, balanced and efficient, and

- Whether there are other changes which would support the integrity of the income tax system, having regard to the interaction of the systems for taxing companies, trusts, and individuals.

In examining the points above, the Working Group has been tasked to consider in particular the following:

- The economic environment that will apply over the next 5-10 years, taking into account demographic change, and the impact of changes in technology and employment practices, and how these are driving different business models,

- Whether a system of taxing capital gains or land (not applying to the family home or the land under it), or other housing tax measures, would improve the tax system,

- Whether a progressive company tax (with a lower rate for small companies) would improve the tax system and the business environment, and

- What role the taxation system can play in delivering positive environmental and ecological outcomes, especially over the longer term.

However, the Government has specifically ruled out any increase in income tax or GST tax rate, the introduction of an inheritance tax, any other changes that would apply taxation to the family home or the land thereunder and the adequacy of the personal tax system. Further, the Group will not focus on the technical matters already under review as part of the Tax Policy Work program including international tax under the Base Erosion and Profit Shifting agenda and policy changes as part of Inland Revenue's Business Transformation programme.

With regard to the issue of GST on low value purchases, the Government has stated the following: "The Group will have the opportunity to look at that issue, but it does not have a mandate to consider the GST rate. As the Working Group is mandated to consider fairness in the tax system, it will be able to review fairness across what GST is collected on. Due to this work already being started by the previous government, the Working Group will be given the ability to report back early on this issue, as appropriate".

Final recommendations to Ministers are expected by February 2019. In terms of implementation, no significant changes will be implemented until the 2021 tax year, however the statement notes that where work was already underway, such as GST on online-purchases, it may be possible to make progress ahead of that timeframe.

R&D Tax Credits: Reflections from New Zealand and Australia

By Aaron Thorn & Greg Pratt

New Zealand has historically underperformed its OECD counterparts in the investment of its businesses in Research and Development (R&D). Whilst the broader benefits of R&D in growing an economy are accepted, the debate has continued as to the best way to encourage and incentivise a higher level of business R&D investment.

For the 2008/09 income year, New Zealand arguably had one of the world's best R&D Tax Credit regimes which gave innovative businesses a potential 15% tax credit for R&D. Alas, for political reasons that regime only lasted one year, but with the formation of the 52nd Government of New Zealand we now have the prospect of a revived R&D Tax Credit Regime back on the table. Not only that, but the Minister of Research, Science and Innovation, Hon Dr Megan Woods, has set an ambitious timetable of having a 12.5% R&D tax credit regime in place for the 2018/19 income year (this timeline is subject to receiving and considering official advice, which we would expect to recommend a later application date). With such an ambitious timeline, the most efficient approach for everyone would be to re-enact the rules which applied in 2008/09.

Given this initiative is being driven by the Minister of Research, Science and Innovation rather than the Minister of Revenue, it has so far avoided being included in the range of tax topics to be analysed by the Tax Working Group.

So what does an R&D tax credit regime mean for taxpayers? Well it is one more avenue for taxpayers being encouraged and supported to invest in innovation, delivered in a way which doesn't require applying for grant funding. Our expectation is the new R&D tax credit regime will sit alongside grant based funding, and the existing R&D tax loss cash back regime (refer to our December 2016 Tax Alert for more information about this regime).

As we wait for more details on how the new regime will work, we thought it was worth

reflecting on how the R&D tax credit regime operated in 2008/09 and what Australia has done in this area in recent years.

The New Zealand Experience

In the 2008/09 income year claims were made for R&D Tax Credits which totalled $154 million (source: IRD Annual Report 2010), this was roughly in line with the forecast cost of the regime of $630 million over four years when the regime was first introduced.

The purpose of the R&D tax credit regime was to encourage greater innovation and dynamism in New Zealand businesses and to make New Zealand a more attractive location for innovative businesses. Because of the political issues surrounding the R&D Tax Credit regime, with taxpayers knowing that the regime only had a single year of life, in our experience fewer taxpayers made the effort to understand the regime and make claims that might have otherwise been the case. It was too soon to be able to comment on whether the previous regime was successful in encouraging innovation.

The Inland Revenue invested heavily in preparing guidance on the operation of the regime. In our experience Inland Revenue robustly tested a number of claims made by taxpayers, but on the whole was accepting of credits that taxpayers thought they were eligible for.

The Australian Experience

The Australian R&D Tax Incentive regime operates in a slightly different fashion to the old New Zealand R&D Tax Credit regime, whereby rather than receiving a tax credit, tax offsets are available. There are two rates:

- a 43.5% refundable tax offset which is available to companies with a turnover under $20m. If companies have sufficient tax losses, this entire amount can be refunded; if the company is tax paying, the benefit equates to a 16% tax credit (given the small business tax rate of 27.5%).

- a 38.5% non-refundable tax offset which is available to companies with a turnover of $20m or greater. If a company is in tax losses, this benefit is carried forward (similar to tax losses); if the company is tax paying, the benefit generally equates to a 8.5% tax credit (given the standard corporate tax rate of 30%).

In recent years we have seen a continual tightening of the R&D rules in order to restrict the ability of businesses to claim the tax offsets and to place limits on the level of R&D tax incentives available. The objective of these recent changes is to constrain fiscal costs.

In addition, a review of the R&D Tax Incentive was requested by the Australian Government as part of the National Innovation and Science Agenda announcements back in 2015. The aim of this review was to identify opportunities to improve the effectiveness and integrity of the program. Six recommendations to improve the program were made in the review. Key recommendations included retaining the current definitions of R&D activities, the introduction of a collaboration premium for certain R&D expenditure incurred with publicly funded research organisations and the capping of cash refunds available to companies. There have been significant delays in the Australian Government announcing which, if any, of the review recommendations will be adopted, with latest thinking suggesting there will be announcements made before the end of 2017.

Despite the continual tightening of the rules, the Australian Government has continued to invest significantly in the R&D Tax Incentive regime, which continues to be the Federal Government's primary mechanism to support innovation in Australia.

Conclusion

The commitment of the Government to do something to encourage R&D is pleasing. While we are still to find out the finer details of what the tax rules will be and when they will apply, businesses may now wish to consider whether the future existence of an R&D tax credit may improve the viability of innovative projects which may otherwise be high risk marginal investments.

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Is AIM the right provisional tax method for you?

By Veronica Harley

An additional option for calculating provisional tax known as AIM (Accounting Income Method) will become available for small businesses that use approved accounting software to prepare their accounts with effect from 1 April 2018. If you are a medium or large business reading this, take note that Inland Revenue very much see this roll out to small business as a pilot, with the intention that a form of it will be offered to larger businesses down the track. They are already exploring ideas for how to do this.

Essentially from 1 April 2018, taxpayers will be able to elect to pay two-monthly instalments of provisional tax which will be based on the current tax adjusted income to be calculated automatically by the software. The use of money interest regime will not apply to payments made under this method. The reasoning behind introducing this method was the concern that small businesses were stressed about managing provisional tax because of the uncertainty or unpredictability of income and the existing assumption that income is earned evenly throughout the year was often incorrect and unfair.

The theory is that if businesses make more regular payments which are more closely aligned to income as they earn it, this will assist taxpayers who find it difficult to budget for tax payments. Hence, AIM was born and the software providers have been working behind the scenes with Inland Revenue to make this a reality. This is despite the poor adoption of the GST ratio method of calculating provisional tax which already exists for small businesses. The GST ratio method, introduced in 2006, was also designed for small businesses to make regular provisional tax payments which are based on a percentage of GST supplies so that tax payments align more to income as it is earned.

It would be fair to say some of the "gloss has worn off" since AIM was first promulgated in April 2016. This is mainly because that at the same time this method was introduced, the Government also made significant changes to how use of money interest applies on provisional tax with effect for the 2018 income year. These changes include raising and extending the safe harbour rule before use of money interest will apply and removing use of money interest from the first two payments of provisional tax where the standard up lift method is used. These two changes alone have been very beneficial for most taxpayers such that smaller businesses may now fall outside the rules completely or at least can better manage their obligations and cash flow as a result.

The second reason enthusiasm is waning is that now the finer details have been released of how this new method will work, it's becoming clear that this method won't necessarily suit all the small businesses it's aimed at (excuse the pun). We have set out below the key questions to help you determine if this method is right for you. There are some attractive features of this method, but whether they are enough to tempt taxpayers into this method is a big question.

Who is eligible to use this method?

Taxpayers who have annual gross income of less than $5 million and who use an AIM capable system that has been approved, are able to elect to use this method.

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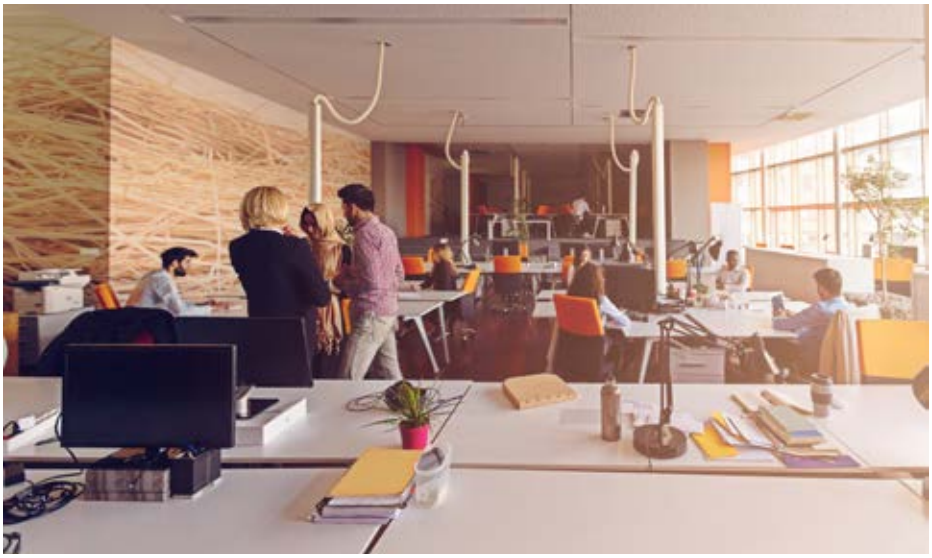

There is also the ability for taxpayers with gross income greater than this threshold to apply for the Commissioner's approval to use this method. That said, trustees and beneficiaries of trusts, partnerships, taxpayers with investments in foreign investment funds (FIFs) or controlled foreign companies (CFCs), Māori authorities, portfolio investment entities and superannuation funds are precluded from using this method.

Software providers must have their system approved by the Commissioner before they can offer this method within their software. This is so the Commissioner can check to see if the software can make the minimum necessary tax adjustments as required. Software companies that will have been approved will likely advertise this capability directly to their clients that use this software. From the taxpayer's view point, the taxpayer will see the option to access this functionality within their software once it's available. However taxpayers may need to seek professional advice from their accountant before electing this method. There is an important set up process to work through to ensure the method calculates the tax payments with the minimum of manual intervention, otherwise there is great potential for compliance costs to outweigh any benefits.

How does it work?

Most taxpayers will make six instalments of provisional tax under this method; although those GST registered taxpayers who pay GST on a 1-monthly cycle will make 12 monthly instalments. The instalment date is dependent on whether they are GST registered and the cycle of their taxable period. Taxpayers must opt into this method at the beginning of the tax year before the first payment would be due. Taxpayers with a March balance date will be liable to make their first instalment on 28 June 2018.

Provided the initial set up is completed correctly and the taxpayers maintain accurate real time accounting records, then the AIM capable software should automatically calculate a provisional tax instalment that is reflective of the tax payable, broadly based on tax adjusted income earned at that point in time.

Certain tax adjustments are mandatory under this method. The Commissioner has recently released a number of technical determinations which cover the various tax adjustments to be taken into account when an instalment is calculated. Tax adjustments may be required for tax depreciation and depreciation recovery income, trading stock, livestock, private expenditure, debtors and creditors (if they are registered for GST on an accruals basis) and non-deductible provisions. There is also a determination covering the use of tax losses.

On set up, taxpayers will be required to make various decisions on how AIM will calculate provisional tax and whether or not to make tax adjustments for certain items. Taxpayers should discuss this step with their tax advisors to ensure the method suits their business and that they are able to comply with the rules specified in the technical determinations that accompany this method.

In theory, if set up is completed correctly, these should just happen automatically within the software. The tax adjustments do not impact the underlying accounting system – they are merely taken into account for the calculation of provisional tax. A pre-enrolment alert will be sent to the tax agent to let them know of a taxpayer's election into this method.

Before each due instalment date, the AIM capable software will automatically calculate the payment due and map the relevant ledger accounts into a "statement of activity", which is then submitted directly via the software to Inland Revenue. The statement of activity's purpose is to demonstrate the robustness of the accounting system behind the amount paid as provisional tax. Taxpayers will be able to see it before it is sent to Inland Revenue. It is similar to the Summary of financial statements (IR10) form with some additional AIM information added, e.g. refund instructions in the case of an overpayment. The summary isn't classified as an income tax return and isn't processed as one which means mistakes can be fixed in the next statement. It appears that manual tax adjustments can also be made at this point if the system has not been set up to make tax adjustments automatically.

What are the advantages of this method and why would I opt for it?

- Tax payments made throughout the year should broadly align to the actual tax liability meaning tax payments and cash flow can be better managed.

- The use of money interest regime will not apply to provisional tax payments made under this method if the year-end residual income tax liability is different. However note that use of money interest will still apply from terminal tax date. Use of money interest and late payment penalties would also still apply should the taxpayer pay less provisional tax than the amount the AIM capable system calculates.

- If income drops to the point that provisional tax payments already made under the AIM method to date have been overpaid, a real benefit is that refunds can be refunded or transferred before the year end.

- This method would particularly suit those businesses with lumpy or seasonal income because tax is paid at the same time the income is earned. However, if a taxpayer earns all income at the beginning of the year, this may not be seen by all as an advantage! Likewise start-up companies may be better served by the GST ratio method that already exists and doesn't require payment for the use of accounting software if they are not already using it.

What are the pitfalls and things to look out for?

- If the initial set up is not completed properly, there is the potential for significant additional compliance if manual adjustments need to be made for each instalment. We think it is essential that taxpayers involve their accountant in first deciding whether the method is for them and, if so, helping to set the method up so it produces the right tax payments each time with as little manual intervention as possible. This may mean some initial compliance costs will be incurred by the taxpayer.

- In some instances the requirements imposed by the tax adjustment determinations may be too prohibitive to be worth the trouble. For example, while tax losses can be brought forward, grouping of tax losses from other companies is not permitted. Therefore, company taxpayers in a group of companies with losses available to offset are unlikely to want to elect this method. Another consideration will be whether a tax depreciation schedule is maintained within the software or not, how frequently this is updated and whether manual adjustments will be required. Similarly for taxpayers with trading stock or livestock, there are particular issues to consider before electing into AIM. There are definitely a few other fishhooks to be aware of depending on a taxpayer's circumstances and type of business. One size does certainly not fit all in this regard.

- The success of this method will hinge on the extent to which the underlying accounting information is correctly coded at the outset so there is no need to make manual adjustments at each instalment. For example, to minimise manual adjustments, private expenditure will need to be coded by the taxpayer correctly to the shareholder's current account. The system should ideally be set up to automatically make private use adjustments for business assets such as vehicles when related expenditure is incurred. Otherwise there is a mandatory requirement for a manual adjustment to be made. Any errors or omissions made are expected to be fixed in the next period. Despite the fact that "close enough may be good enough", the bottom line is that taxpayers must still take reasonable care when calculating tax liabilities under this method and could still be exposed to penalties for not doing so.

- Not all tax adjustments that you will ultimately make in a tax return are mandatory when calculating the provisional tax instalment (e.g. entertainment). This means there is potential for the actual residual tax liability to be different, unless these additional entries can be set up to occur automatically by the AIM capable software. It is expected that taxpayers can choose to make these additional adjustments manually or automatically if the particular software will allow this.

- While it is believed that AIM will be able to get taxpayers to a position of having less terminal tax to pay, once the AIM instalments are made the taxpayer still has to complete a tax return as usual.

- Taxpayers who choose the AIM method are prevented from using tax pooling to manage provisional tax payments and cash flow, although tax pooling can still be used for terminal tax and reassessments of tax.

- There is also the question of whether taxpayers would want to simply rely on the activity statement that is produced by the system or whether the statement of activity should be reviewed by a tax agent each time or at least initially, until there is confidence about what is being produced. Although, we think initially Inland Revenue is likely to be fairly hands off until the method is bedded down and it can review how the method is working in practice.

- While Inland Revenue downplay this aspect, a taxpayer is in effect supplying Inland Revenue with a mini set of financial statements every two months and therefore far more information about their business and activity than is currently the situation. Some taxpayers may not be comfortable about this. We think it is possible that Inland Revenue could run data analytics on such data submitted down the track if it wished to.

Conclusion

Inland Revenue is currently actively marketing this method to taxpayers through the various channels it has. This is only likely to ramp up the closer we get to 1 April 2018 as the software providers are ready to go live with this product. With Christmas looming, April 2018 is not that far away and so the key message is to do your homework and talk with your advisor before electing in.

GST on online shopping – the holiday is coming to an end

By Robyn Walker

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Currently in New Zealand, goods can be purchased from overseas with a value of up to $400 before GST will be added to the cost at the New Zealand border. Conversely New Zealand retailers can sell their products outside of New Zealand and not charge New Zealand GST. With Christmas looming and many taking to the internet (or the phone, or mail order) to buy and sell products it's timely to consider how the GST implications of online shopping will soon be changing.

Australian GST deadline looming

If you're a business selling goods to consumers in Australia then 1 July 2018 is an important date. This is when it may be necessary to register for and start charging Australian GST on your sales.

These rules have been in the works for a number of years now, but it is only now that all the obstacles to Australia implementing them have been removed. Equivalent rules for applying GST on online services took effect from 1 July 2017.

Some key requirements to be aware of:

Who: Non-Australian businesses who are making (or projected to make) supplies to Australian consumers of AU$75,000 or more per annum may be required to register and charge Australian GST on sales to these customers. In some instances the GST obligations may fall to another party, such as an online marketplace operator or redelivery service provider.

The rules will apply from 1 July 2018. Businesses subject to the rules will need to start thinking now about how they will comply with the new rules and get themselves ready to register for Australian GST (with a full registration for GST or under a new simplified registration process)

These rules have been in the works for a number of years now, but it is only now that all the obstacles to Australia implementing them have been removed. Equivalent rules for applying GST on online services took effect from 1 July 2017

What: Under the new Vendor Registration Model suppliers will need to add Australian GST of 10% to any supplies of "low value goods" to Australian consumers (i.e. not GST registered businesses). The "low value good" threshold in Australia is AU$1,000. Generally sales of goods costing over AU$1,000 do not require GST to be charged (GST will continue be collected at the border instead). If multiple products are sold at the same time, exceeding the AU$1,000 threshold it is necessary to determine whether the goods will be consigned together or separately to determine if GST should apply.

When: The rules will apply from 1 July 2018. Businesses subject to the rules will need to start thinking now about how they will comply with the new rules and get themselves ready to register for Australian GST (with a full registration for GST or under a new simplified registration process). It's our understanding that a full registration for GST can take some time to be processed by the Australian Tax Office (ATO), so this shouldn't be left to the last minute.

How: There are a number of complicated design features associated with these rules. Businesses selling over the internet will need to consider upgrading ecommerce software to deal with complications from these rules. Some of the issues which will need to be grappled with include determining where customers are based, converting NZD currency amounts to AUD to determine whether a customer is buying low value goods, determining whether customers are end-consumers or GST registered businesses, determining whether goods will be consigned together or separately, ensuring New Zealand GST is not also charged, and determining how returned or replacement goods will be dealt with. These questions may lead businesses to consider how they transact with customers, and in particular whether enough profit is derived from Australia to justify these new compliance costs, or whether another avenue of selling (such as through an online marketplace, or not shipping direct to Australia and allowing redelivery services to be used by customers) is worth considering.

New Revenue Minister says collecting GST on overseas online purchases is the 'right thing to do'

On the back of Australia moving ahead with its new GST rules, it has been confirmed that New Zealand is considering collecting GST on online purchases of "low value goods" by New Zealand consumers. However the implementation of such a tax might still be some time off.

It has been confirmed by the Minister of Revenue Hon Stuart Nash that the issue of collecting GST on low value goods will be considered by the Tax Working Group. This provides further time for full consideration of the pros and cons of levying such a tax and what the most appropriate mechanism would be. The Minister is quoted as saying collecting GST on overseas online purchases is the "right thing to do", and therefore it still seems likely that we will eventually see GST being applied to goods being sold to New Zealanders from offshore.

For more details about the Tax Working Group, please refer to our earlier article.

Currently a "low value good" is one where the combined GST and duty owing is NZ$60 or less (this roughly equates to a purchase worth NZ$400, subject to the application of duties).

The options available for the Tax Working Group to consider include lowering the collection threshold to have the tax collected at the border. An alternative is to follow the lead of Australia and have non-resident suppliers register for GST and levy GST on transactions (discussed above).

From October 2016 Inland Revenue has required non-resident suppliers of online services to register and start charging GST, with the number of registrations and GST collected far exceeding expectations. The success of that system, combined with monitoring the success of the Australian regime may help with the decision making.

New Zealand is committed to following the Generic Tax Policy Process when implementing tax changes, therefore if a recommendation is made by the Tax Working Group we would expect to see consultation on any proposals before they are legislated for. It is therefore difficult to see any changes to the current rules having effect before 2020.

Proving arm's length pricing is set to become a taxpayer's burden

By Bart de Gouw & Julian Bryant

Included in the Government's recent announcements in relation to Base Erosion and Profit Shifting ("BEPS") (for further details see our March 2017 Tax Alert article) is a proposal to shift the burden of proof for transfer pricing matters from the Commissioner of Inland Revenue to the taxpayer.

This is part of a wide package of measures including an extension of the time bar for transfer pricing matters from four years to seven years, and the granting of greater power to Inland Revenue to collect information from multinational enterprises ("MNE"). The shifting of the burden of proof is likely to require taxpayers to put a greater focus on ensuring that transfer pricing positions are documented appropriately.

Current position

Under New Zealand's current rules, taxpayers determine the arm's length amount for their cross-border dealings with related parties. If the Commissioner disagrees with this assessment, she generally has the burden of proof in demonstrating that the related party dealings are not consistent with those that would be agreed by third parties operating at arm's length.

Shifting the burden of proof

In the discussion documents released in March 2017 and subsequent Cabinet Papers released in August 2017, the Government has confirmed its intention to shift the burden of proof for transfer pricing matters to the taxpayer. This change is expected to be enacted early next year and would apply from income years commencing on or after 1 July 2018. Under the revised position, taxpayers will have the primary obligation of proving that their related party dealings are consistent with those that would be agreed by third parties operating at arm's length. Inland Revenue considers this change to be consistent with both international practice and other taxation matters under New Zealand's tax legislation. Further, Inland Revenue considers that given the increasing complexity of multinational structures and transactions, MNEs hold the relevant information and are in a better position to justify the nature of their own transfer pricing practices.

What this means for you

We anticipate that Inland Revenue may be more aggressive in transfer pricing disputes once it is unshackled from its burden to prove an alternative position to be more reliable. Taxpayers will likely be faced with the prospect of being told that they have not adequately proven their positions, especially if facts are disputed and external benchmarking is not directly on point. Taxpayers will also continue to be exposed to "lack of reasonable care" penalties for incorrect transfer pricing positions taken where there has been a failure to adequately document transfer pricing positions at the time the tax positions are taken.

Transfer pricing documentation will become ever more important in supporting a taxpayer's position. In that regard, New Zealand has endorsed the OECD's recommendations for transfer pricing documentation, which requires documentation to be in the form of a master file and a local file. The master file should provide a high level overview of the MNE's global operations and

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transfer pricing policies and will typically be prepared in the jurisdiction in which the MNE is headquartered. Conversely, the local file should provide specific detail on the material related party transactions in the specific jurisdiction that a taxpayer is operating in.

While taxpayers should be able to leverage a global master file that has been prepared in another jurisdiction according to the OECD guidelines, local files prepared in other jurisdictions would almost certainly be insufficient to document the particular features and transactions of the New Zealand entity. A New Zealand local file that explains the New Zealand operations and transfer pricing methodologies would need to be prepared.

Next steps

A Bill in relation to the BEPS measures including the shifting of the burden of proof was introduced in Parliament on 6 December 2017, for enactment by July 2018.

Now is a good time to review your current transfer pricing documentation and supporting evidence to ensure your cross-border related party transactions are accurately and appropriately documented in accordance with OECD guidelines and to a level of detail that would enable the burden of proof to be discharged.

Please contact your usual Deloitte advisor if you would like to discuss these requirements further including the steps you can take to mitigate any potential risks.

Transfer pricing documentation will become ever more important in supporting a taxpayer's position. In that regard, New Zealand has endorsed the OECD's recommendations for transfer pricing documentation, which requires documentation to be in the form of a master file and a local file

Impact of changes to the look-through company rules

By Emma Faulknor & Susan Wynne

Eight months have passed since the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 was enacted at the end of March 2017. The effect of this legislation was to make a number of changes to the specific tax rules that apply to closely held companies, in particular the look-through company (LTC) rules.

Overview of the changes

The LTC regime recognises that companies are taxed differently to individuals and is intended to be concessionary by extending the tax treatment of an individual to a company that has elected to be a LTC. This is achieved through the look-through nature of a LTC for income tax purposes.

The intention behind the recent amendments to the LTC regime was to strengthen the rules so that they better aligned with the original policy intent – a regime targeted to entities with a small number of owners with direct ownership interests.

The main changes to the LTC regime were to limit who could own an interest in an LTC to only individuals or trusts where certain conditions are met. This was to match the policy intent that LTCs are not widely held entities. These changes included:

- The method for counting look-through counted owners where a trust is a shareholder was expanded to include all beneficiaries who have received a distribution from the trust, including amounts received from trust capital and corpus.
- The definition of 'look-through company' was amended to exclude Maori Authorities and Charities from being LTC owners. Fortunately, the restrictions do not apply to Maori Authorities or Charities with an existing interest in an LTC by grandparenting existing structures that were in place prior to 3 May 2016, when the Bill was introduced.
- Trusts that own LTCs have been prohibited from distributing to corporate beneficiaries to ensure that the restriction on corporate owners is not circumvented. Trust owners are also restricted from making distributions to Maori Authorities unless the LTC qualifies as grandparented.
- A company is unable to be an LTC if it has more than 50% foreign ownership and foreign sourced income of more than both $10,000 and 20% of the company's gross income for the year.
- The loss limitation rule that restricted the amount of deductions an LTC owner could claim for a tax year no longer applies to LTC interests. The exception is where a LTC is in a partnership or joint venture. The calculation has not changed.
- The LTC entry tax that applies when an existing company elects to become an LTC is now payable at the shareholders' marginal tax rates rather than a flat 28%.
- A 'self-remission' concept was introduced so that a debt written off in an LTC owed to an owner is not taxable to that owner.

Most of the changes came into effect on 1 April 2017. More detail

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on the changes is discussed in our previous Tax Alert article here.

Impact of the changes

The amendments have seen LTCs being used less where an LTC may have historically been used. The revised LTC eligibility tests are also being considered more carefully where an LTC is either already in place or being considered. In contrast, the use of limited partnerships has been increasing. A limited partnership provides a similar transparent or look-through tax effect to owners as an LTC.

Tax transparent entities such as LTCs and limited partnerships are useful from a tax perspective. With the amendments to the LTC rules we have seen an increase in limited partnerships being utilised in the following situations:

- Where a separate legal entity is required;
- Where entities are able to benefit from a lower tax rate, e.g. Maori Authorities;
- Where entities want to offset losses against a profit-making owner;
- To access tax credits.

While similar in some respects, there are differences between the LTC and limited partnership regimes:

- Ease of establishment: Setting up an LTC is easier and less costly than setting up a limited partnership. An LTC is a New Zealand incorporated company that has made a tax election into the LTC regime where it meets the eligibility criteria. A limited partnership requires a formal partnership agreement to be written up by lawyers as part of the establishment process.
- Limitation of tax deductions: As discussed above, the cumbersome loss limitation rule, which can restrict tax deductions to owners, will no longer apply for most LTCs. The loss limitation rule continues to apply to limited partnerships, which will require this annual calculation to still be performed and could limit tax deductions to limited partners.
- Structure: An LTC must have five or fewer look-through counted owners. A limited partnership is not restricted in the number of owners but has two types of partner, a general partner and a limited partner, and must have at least one of each. A limited partner is restricted in their involvement in the management of the limited partnership. The general partner must undertake day-to-day management and they do not have limited liability.

Remaining issues

There are still practical issues that arise when using a tax transparent entity, for example when interests are sold and purchased in either LTCs or limited partnerships. Essentially, when a person disposes of their interest in either an LTC or limited partnership, the person is treated as disposing of their interest in the underlying property, with the associated tax consequences. A concession applies when the gain on sale of the owner's share of property is less than $50,000 so that tax consequences are deferred and the new owner effectively steps into the exiting owner's shoes. There are also other concessions subject to relatively low thresholds for depreciable property or trading stock owned by the LTC or limited partnership.

This can require complicated calculations for the exiting owner to determine what tax liability may arise. The difficulty for a new owner and the remaining owners can be how to manage underlying assets with different cost bases for different ownership portions following ownership changes. For example, where an LTC or limited partnership holds depreciable assets, the portion of the asset equivalent to the interest a new entering owner has in the LTC should be revalued to the amount the entering owner paid, or was deemed to pay for the asset.

Maintaining a tax fixed asset register can become complex in these circumstances or the issue may simply be ignored. The Inland Revenue commentary QB 14/02: Income tax - Entry of a new partner into a partnership - effect on continuing partners considered the income tax effects of a new partner entering an existing partnership and highlights the complexities of accounting for such changes.

Deloitte comment

Overall, the changes to the LTC regime are positive and the tax regime remains useful for closely held businesses. However, there continues to be more Inland Revenue can do to address all practical issues associated with the LTC and limited partnership regimes to ensure these operate effectively. Issues continue to arise when owners enter and exit look-through entities or contribute additional capital. In addition, look-through entities are not consistently treated as transparent within the tax rules, resulting in issues such as the application of the associated persons rules. As a result, the application of these regimes will continue to have some practical difficulties.

Contact your Deloitte usual tax advisor if you would like to discuss any issues raise in this article.

Are your GST processes and controls up to scratch?

By Sam Hornbrook and April Wong

With the launch of GST online administration via "MyIR", Inland Revenue's Business Transformation program has certainly kept its promise of reducing paper-based compliance for its customers and tax agents alike. Since MyIR went live earlier this year in February, more than a million GST returns have been filed online and around 163,000 direct debit payments worth $1.6 billion have also flowed through MyIR.

This shift towards administering GST online via MyIR has also enhanced Inland Revenue's visibility into taxpayer activity using data analytics. Inland Revenue has advised they are paying close attention to taxpayers' wider GST processes and systems as part of its routine risk reviews. Inland Revenue expects taxpayers to be:

1. Ensuring that at least one person is preparing the GST return and another in charge of reviewing;

2. Performing trend analyses (at the minimum, taxpayers should be tracking any unusual trends between their GST returns filed);

3. Creating or maintaining a GST controls / processes manual, and following the manual in its GST compliance practices. This manual should also be regularly updated for any business changes that impact GST; and

4. Undertaking full GST reconciliations monthly, or at the very least, annually.

Number 4 on that list in particular should not be overlooked as we are aware that many clients do not presently perform a full GST reconciliation. Data analytics has given Inland Revenue the ability to perform their own sophisticated GST reconciliations using a taxpayer's GST return information and financial statements. Inland Revenue will be able to look at 12-months' worth of GST returns filed and compare this to the information in the taxpayer's financial accounts. Generally, a GST reconciliation requires comparing your GST output tax to the level of income earned in the period, plus asset sales. You should compare your input tax amount to expenses incurred, excluding expenses with no GST (e.g. interest, depreciation, salary and wages) and add asset purchases.

A few different forms of GST sense checks exist across the taxpayer base. For example, one may look at the GST General Ledger (GL) and check that the GST balance matches what goes in the GST return.

This shift towards administering GST online via MyIR has also enhanced Inland Revenue's visibility into taxpayer activity using data analytics. Inland Revenue has advised they are paying close attention to taxpayers' wider GST processes and systems as part of its routine risk reviews

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However, this process assumes accuracy of the GST treatment in the GL. There are often GST coding issues with sundry income, insurance pay-outs and barter transactions. Fully reconciling the GST return and the financials can be challenging for larger organisations that deal with more complex transactions. Nevertheless, Inland Revenue expect businesses to be performing these GST reconciliations and this will be an area of focus now that they are becoming more sophisticated at using taxpayer data. *While Inland Revenue accepts a certain level of variance between the two sets of data in the wider context of the organisation's materiality thresholds, the extent to which Inland Revenue will accept this variance will be re-examined and likely narrowed in light of Business Transformation practices.*

Given the potential complexity involved with GST reconciliations and Inland Revenue's recent focus on ensuring that all taxpayers are returning and claiming back the right amount of GST, we recommend involving an Indirect tax advisor at Deloitte. We have our own GST reconciliation tool that will help ensure that your GST processes and controls are up to Inland Revenue's standards.

Are you issuing correct invoices?

Inland Revenue has released a draft QWBA (PUB00306) which considers whether a GST registered person can issue a tax invoice and a credit note in a single combined document. The item notes that a GST registered person may do so if the tax invoice and credit note each relate to a different supply of goods and services. However, a tax invoice and credit note may not be combined into a single document if they both relate to the same supply. There are also differences between a prompt payment discount and a credit note. If the terms of a prompt payment discount are clearly shown on the face of the tax invoice, then the supplier need not issue a credit note.

Submissions on the item close on 8 December 2017. Please contact your Deloitte Indirect Tax Advisor if you wish to clarify anything in relation to your invoicing practices.

A snapshot of recent developments

The Minister of Revenue's speech at the 2017 CAANZ Tax Conference

The Minister of Revenue Stuart Nash delivered the opening address to the 2017 CAANZ tax conference, held in Auckland on Thursday 16th and Friday 17th November. The Minister's speech included comments regarding the Coalition Government's 100-day plan, future challenges that New Zealand faces, BEPS, and an update on Inland Revenue's Business Transformation program. For further information, refer to our Tax Working Group – Terms of Reference article in this edition of *Tax Alert*.

Reinstatement of Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill

On 8 November 2017, Parliament reinstated the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill. The Finance and Expenditure Committee will now continue its consideration of the Bill. The Bill, introduced on 6 April 2017, contains measures relating to collecting employment and investment income information, reforms to the taxation of employee share schemes and sets the annual tax rates for 2017–18. Parliament did not re-instate the Income-Sharing Tax Credit Bill, introduced in August 2010.

Speech from the Throne

On 8 November 2017, Her Excellency The Rt Hon Dame Patsy Reddy delivered the "Speech from the Throne". Her Excellency noted that the Government will "review the tax system, looking at all options to improve its structure, fairness and balance, including better supporting regions and exporters, addressing the capital gain associated with property speculation and ensuring that multinationals contribute their share. Penalties for corporate fraud and tax evasion will increase. Personal income taxes, taxes on the family home and GST will remain at the same rates as they are today."

Research & Development Tax Credits – proposed timeline in the works

Minister of Research, Science and Innovation, Megan Woods, says that the new Coalition Government is "hopeful" to reintroduce the 12.5% tax credit for R&D for the 2018-19 tax year. The exact timeline will be finalised once the Minister has received more advice from Officials. The Minister also hinted that a major restructure could be on the way for Callaghan Innovation Grants, the Crown agency, and that the key is "getting the balance between the grants and the tax credit" right.

The Coalition Government's goal is to lift R&D expenditure from its current level of 1.3% of the GDP to the OECD average of 2.4%. The policy is expected to cost $100 million in the first year, increasing to $300 million by its fourth year.

OECD Council approves the 2017 update to the OECD Model Tax Convention

On 21 November 2017, the OECD Council approved the contents of the 2017 Update to the OECD Model Tax Convention (the OECD Model). The 2017 Update, which was previously approved by the Committee on Fiscal Affairs on 28 September 2017, will be incorporated in a revised version of the OECD Model that will be published in the next few months. Refer to the OECD's full press release here.

Government notifies third protocol to Convention between India and New Zealand

The New Delhi Government recently notified the New Zealand Government that it has completed domestic procedures required to bring the third protocol for amendment of the Double Tax Agreement between India and New Zealand into force. The Protocol updates the existing framework of exchange of tax related information to the latest international standard, which would help curb tax evasion and tax avoidance between the two countries and enable mutual assistance in the collection of taxes. Read more here, and for the text of the protocol, click here.

Binding Rulings – Effect of the Commissioner changing her mind in relation to the application of section BG 1

Inland Revenue has released a draft Question We've Been Asked (PUB00318) considering what would happen if the Commissioner issues a binding ruling for an ongoing arrangement, but later changes her mind as to how the general anti-avoidance rules apply to that arrangement. The item concludes that the Commissioner is entitled to apply a new interpretation of the law following the expiry of the ruling, as long as this does not have the effect of reversing the tax outcomes in the period covered by the ruling.

The deadline for comment on this item closes on 20 December 2017.

When is income from a cash dividend paid on ordinary shares derived?

This draft Question We've Been Asked (PUB00296) considers the timing differences between cash basis and accrual basis taxpayers (other than when a specific timing regime applies). It also considers the tax treatment of dividends derived from closely held companies where more diverse practices concerning dividends can arise. Once finalised, the draft QWBA is intended to apply from the income year commencing 1 April 2018, or the first day of any income year starting after 1 April 2018 where a non-standard balance date applies.

The deadline for comment closes on 22 December 2017.

CAANZ and TMNZ Annual IR Satisfaction Survey

Chartered Accountants Australia and New Zealand (CAANZ) and Tax Management NZ (TMNZ) have commissioned their annual survey of the views of members in public practice (i.e. tax agents, tax professionals) and businesses on Business Transformation, the new provisional tax rules and AIM.

Some highlights from survey's results include:

- In relation to the administration of GST online via myIR, 60% of respondents believe that filing GST returns online was working well.
- Three quarters of respondents in public practice believe that their clients will be better off due to the new provisional tax changes. In contrast, only 36% of respondents from the business sector believe that the new provisional tax changes are positive.
- Most respondents in the business sector agree that the new provisional tax calculation method, AIM, will provide more certainty around provisional tax. However, only 24% of those in public practice believe that their clients would use AIM, decreasing from the 38% recorded last year.
- Other unsatisfactory areas included lengthy phone calls and wait times for phone calls with Inland Revenue.

Read the press release and download the results from the full survey here.

When is an arrangement considered to be "materially different" from the arrangement identified in a private or product ruling?

On 27 November 2017, Inland Revenue released a draft Questions We've Been Asked (PUB00319) considering when a revised arrangement is considered to be "materially different" from the arrangement identified in a private or product ruling.

The draft item concludes that if the revised arrangement is revised to the extent that it is capable of affecting the tax outcome referred to in the ruling, the revised arrangement will be considered as "materially different" from the ruling identified in a private or product ruling.

Deadline for comment on this item closes 31 January 2018.

2017 Deloitte Top 200 Awards

Deloitte New Zealand held its annual Top 200 awards on 23 November 2017. The awards evening acknowledged business excellence and noteworthy leadership across 10 award categories. The finalists and winners of the 2017 Deloitte Top 200 Awards are listed here.

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