Connecting you to the topical tax issues

Tax Alert

July 2017

Making tax simpler for individuals

By Emma Marr and April Wong

Following on from extensive proposed changes to the information disclosure requirements of employers and payers of investment income (see our April Tax Alert and May Tax Alert for more details on the draft legislation), the Government has revealed the next step in their master plan – how they will use all that extra information. The release of the discussion document, *Making Tax Simpler, Better administration of individuals' income tax*, outlines the Government's plans on modernising the tax system for individuals.

As foreshadowed in the Government's comments when the draft legislation was tabled in April, the objective of the new rules is to be able to pro-actively manage the tax rates that are being applied to individual's income during an income year.

In this issue:

This will reduce or eliminate the need for tax payments or refunds to be made after year end, and will also allow Inland Revenue ("IR") to adjust tax payments for individuals who currently have no obligation to file a tax return, and so who might currently be either under - or over - paying tax, without any idea that is happening. In addition, the Government will have the information it needs to adjust social policy payments during the year using up to date information.

Although there are two alternative options proposed in the discussion document, the document appears to focus on and perhaps prefer the so-called "alternative approach" that will enable individuals who derive only certain types of "reportable income" (i.e., salary, wages, and investment income), to no longer have to file returns to qualify for a tax refund, and instead, have refunds automatically calculated by IR and deposited into their bank accounts. On the flip-side, taxpayers who end the year owing tax due to under-deductions during the year will no longer get away with not paying it just because they are non-filing taxpayers.

It is envisaged that the number of individuals who end up with large tax bills at the end of the year will reduce as tax payments will become more accurate throughout the year. It is estimated that an additional 1.1 million people will not have to provide any information about their income to IR, bringing the total number of people who do not need to file any returns up to 3 million.

With over 2 million customers active on myIR as at 1 December 2016, we commend IR for further developing its online platform to give individuals the opportunity to better engage and work together with IR.

The current filing rules

Currently, individuals have to work out whether they need to file a return, request or amend a personal tax summary, provide further information, or whether they do not need to take any action to finalise their tax position.

The rules surrounding whether taxpayers have to file a return are not always easy to understand or follow. Further, individuals who are required to file an income tax return must pay any tax that has been underpaid during the year, whereas a person who is not required to file a return does not. For some time now, tension has been bubbling within the tax administration system over the unequal treatment between filing and non-filing taxpayers. Although the current rules were intended to reduce the number of individuals filing returns or receiving a personal tax summary, in the 2015 tax year approximately 1.1 million people submitted a personal tax summary and an additional 1.1 million people filed an IR3 tax return form. The current rules are more complicated and burdensome for individuals than they are intended to be.

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Individuals are currently required to consider whether tax has been correctly deducted from their income, but once third parties are supplying this information, if the individual receives only "reportable income" the process will become much simpler

The proposals in a nutshell

The discussion document sets out two options for which individuals should have to provide information to IR; the "improved status quo" and "alternative approach".

Improved status quo

Under the "improved status quo" approach, IR would continue to issue personal tax summaries when appropriate, and the individuals who receive them would have to either confirm or complete them. If a personal tax summary is not issued, individuals will still need to determine whether they need to request a personal tax summary. This approach builds on from the earlier legislative changes noted in our April Tax Alert, which requires the payers of salary and wages, and of investment income, to provide more extensive and more frequent information to IR during the year. The only real difference in this approach is that IR would have more information available, so would be likely to issue more personal tax summaries as it identifies taxpayers with more tax to pay.

Alternative approach

The alternative approach separates the rules around providing information to IR from the rules around filing a return. The starting point under the new proposals is that individuals who only earn "reportable income" will not have to provide information to IR. Reportable income will be income for which IR receives third party reporting during or shortly after the end of the year, such as employment income, the taxable value of employee share scheme income, and investment income.

Individuals are currently required to consider whether tax has been correctly deducted from their income, but once third parties are supplying this information, if the individual receives only "reportable income" the process will become much simpler. IR will calculate any difference between the amount of tax remitted through withholding tax, and an individual's tax liability on this income. If there is no further tax to pay or refund, no further action would be taken. If there is tax to pay or a refund, or if IR consider they need further information, IR would then follow up with the individual.

Individuals will have a prescribed period to respond to IR's calculation (to make any necessary changes, i.e., to add any non-reportable income or claim a tax deductible expense), but if they do not respond in time, then they will be deemed to have accepted the information as displayed on myIR. IR also reserves the right to examine whether a particular individual has received non-reportable income (for example, an individual may derive rental income). An electronic default assessment (EDA) could be issued based on the amount of income previously returned by the taxpayer. A person who files a return following the issue of an EDA will be treated as filing a request to the Commissioner to amend the assessment. A "notice of proposed adjustment" is also able to be issued in response to the EDA.

If individuals receive non-reportable income (eg from partnerships and look-through company interests, trust income, and overseas investment income), they will have to provide information to IR. In addition, if a taxpayer is required to make provisional tax payments, is not a domestic tax resident, has tax credits to carry forward, has a tax loss/tax balance component in their accounts, and/or is not cash basis person under financial arrangement rules, they will also be required to provide information to IR.

For the majority of people who are required to provide information, they must do so by 7 July every year, subject to extension of time arrangements. If the individual interacts before 7 July and confirms their statement, it will become an assessment on the day they confirm their statement. The effect of the amount calculated crystallising onto an assessment is that the taxpayer is liable to pay the amount to IR, is entitled to receive the amount as a refund, or is entitled to carry the amount forward as a net loss.

Other things to note

Donations to charity

Currently, individuals can claim tax credits for gifts of $5 or more made to donee organisations such as charities by filing a claim form and submitting this to IR with receipts as proof of claim. The discussion document proposes that individuals scan their receipts directly onto myIR during the year or at the end of the year. We welcome this proposal as it digitally streamlines the process and makes it easier and more accessible for individuals to claim tax credits.

Special tax codes

The Government proposes making special tax code certificates easier to get and maintain. Special tax codes are particularly useful for individuals who are receiving more than one type of income, for example a benefit and employment income, or working two jobs, which results in an income tax threshold being crossed. IR proposes that it could access the information it collects proactively and, if appropriate, suggest that an individual apply for a special tax code from the

information held about the individual's income, and subsequently inform their employer about the change in tax code if the individual wishes to switch tax codes.

Individuals would also be allowed to apply for a special tax code online and would not need to re-apply for a special tax code every year, which is a welcome change from the current tedious process whereby individuals have to fill out a special tax code application, post it to IR, and inform their employer of their tax code change. This resulted in a very low number of individuals opting to use a special tax code (in the 2015 tax year, only 7,975 individuals used a special tax code). We welcome this change as it empowers certain individuals with the ability to control their tax liabilities and ensure that they are not being over-taxed during the year.

The Government does not propose mandating the use of a special tax code given that it can still result in a refund or tax to pay if income is variable or does not remain at the level the individual predicted.

Refunds and payments of tax

Individuals can choose to receive refunds via direct credit or a posted cheque. IR is proposing to eliminate the posted cheque option, with limited exceptions. We support this proposal insofar as it reduces compliance on IR's part, but express concern about the larger percentage of non-individuals who receive their income tax refunds through cheques. In the 2014/15 year alone, it is reported that 56% of taxpayers opted to receive their refunds via cheques.

IR proposes that individuals will be able to pay tax directly from myIR, in addition to the current options of paying via bank transfer or by debit/credit card on IR's website. Existing ways to recover tax, including issuing a "notice to deduct" to a third party payer, setting up an instalment arrangement, or writing off amounts under the $20 threshold, or if the individual is experiencing serious financial hardship, will continue to be available.

IR can refrain from collecting tax owed if it is below $20, and can choose not to issue refunds if they are less than $5. Given that refunds will be made electronically, IR suggests that there is no longer a need to retain the $5 threshold as there would be no compliance cost on IR's part. As an additional 456,000 people will be entitled to a refund (if the $5 threshold was repealed) according to the 2015 tax year statistics, we support the repeal of this threshold.

Deloitte comment

We generally commend the Government's efforts to simplify tax for individuals. It is especially notable that refunds and payments of tax may crystallise in future without any tax return being filed. This should make it easier for individuals to comply with their tax obligations, and to remove the sometimes arbitrary distinction between non-filing and filing taxpayers.

It is interesting to note that although the Government acknowledges that one reason for these reforms is the ability to amend social policy payments, such as child support and Working For Families tax credits, none of the examples in the discussion document illustrate how these payments could be reduced during the income year, based on other information that will be available to IR. The examples in the discussion document focus more on situations in which taxpayers could receive a refund at the end of the income year or reduced tax payments during the income year. Given that IR have identified that in the 2015 tax year, 617,000 people with tax to pay did not file or request a personal tax summary, we suspect there will be a significant number of taxpayers who will be surprised by an assessment of tax if the new rules go ahead. Nevertheless, the 778,000 people entitled to a refund in that same year who did not file or request a personal tax summary will be more pleasantly surprised under the new rules.

Individuals would also be allowed to apply for a special tax code online and would not need to re-apply for a special tax code every year, which is a welcome change from the current tedious process whereby individuals have to fill out a special tax code application, post it to IR, and inform their employer of their tax code change

CRS goes live

Troy Andrews and Vinay Mahant

The Common Reporting Standard (CRS) which forms part of the OECD's automatic exchange of information (AEOI) initiative commenced for New Zealand Financial Institutions on 1 July 2017. Entities that fall under the scope of CRS are required to identify and report certain financial account information held by non-New Zealand residents.

CRS builds on US Foreign Account Tax Compliance Act (FATCA). Though it is built on similar principles, it is not the same, as it is based on OECD principles and is not US centric. Where FATCA requires Financial Institutions to report on US account holders only, CRS requires Financial Institutions to report on all other non-New Zealand resident account holders. CRS also provides fewer exemptions than FATCA. Similar to FATCA, CRS breaks down pre-existing due diligence requirements by low value individual accounts, high value individual accounts and entity accounts. There are different timeframes by which Financial Institutions are required to complete due diligence on these existing account holder types.

CRS generally will apply to Financial Institutions that fall within the ambit of FATCA. There are essentially four types of Financial Institutions (similar to FATCA):

- Depository institution;
- Custodial institution;
- Specified insurance company; and
- Investment entity.

Many entities that would not normally be considered to be in the financial services industry may be caught within the above. The definition of entity is broad for both FATCA and CRS and covers legal persons and legal arrangements including partnerships, limited partnerships and trusts.

A particular focus will be applying CRS to various New Zealand trusts. For example, a family trust may be regarded as an Investment entity (and therefore a Financial Institution that may have due diligence or reporting obligations) if the trust is managed by another Financial Institution. This may simply be by using a share broker under discretionary investment management services (DIMS).

Most individuals and entities will need to know their CRS status as part of the account opening process with a Financial Institution. It is not always a straightforward exercise to determine what the CRS status should be and specialist tax advice should be sought where it is unclear (noting that an entity's status under CRS may not necessarily be the same as its FATCA status).

An area of focus in implementing CRS is that the list of reportable jurisdictions committed to entering into agreements to promote the AEOI is expected to evolve over time. Inland Revenue has recently published a list of the current reportable jurisdictions and also intends on publishing a list of participating jurisdictions shortly. New Zealand has adopted the wider approach to due diligence and reporting in an effort to minimise compliance costs. This means it is mandatory for Financial Institutions to identify all non-resident account holders irrespective of whether the account is from a reportable jurisdiction.

To promote compliance, the penalties for non-compliance with CRS are extended beyond reporting Financial Institutions and include account holders and controlling persons. For trusts this could include the settlor, trustees and beneficiaries. This includes where an account holder fails to provide a Financial Institution with information required for due diligence or fails to provide an update if there has

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been a material change in circumstances effecting a previous certification. The penalty for non-compliance by account holders and controlling persons includes civil penalties of $1,000 per offence. This is potentially very wide ranging and Inland Revenue is currently running a targeted public awareness campaign to highlight the impact of CRS.

Inland Revenue is currently working through submissions received on excluded entities and accounts for CRS and has issued determinations which state that Kiwisaver schemes should be non-reporting Financial Institutions for CRS purposes and that a Kiwisaver member's account in a Kiwisaver scheme should be an excluded account. Further determinations may be published following Inland Revenue's review process.

Inland Revenue has published Automatic exchange of information (AEOI) guidance material to assist New Zealand Financial Institutions comply with CRS from 1 July 2017. This includes useful guidance on the impact of CRS to New Zealand trusts, partnerships and collective investment vehicles. Inland Revenue has also recently published a memo on the impact of CRS on residual superannuation and workplace saving schemes to provide guidance on where such entities may be exempt or otherwise have excluded accounts under CRS.

The first CRS reporting period covers 1 July 2017 to 31 March 2018 (annually to 31 March for subsequent years) and information should be exchanged with Inland Revenue by 30 June 2018. The New Zealand CRS legislation provides an option for a 3 month grace period for the first two reporting periods to allow additional time to conduct due diligence procedures. However, any reportable information gathered during the grace period will need to be reported in the relevant AEOI report. The mechanism for reporting information to Inland Revenue is expected to be in XML format (similar to FATCA) in line with the OECD prescribed schema.

Please contact us if you believe you may be within the scope of CRS and we can further discuss the implications.

New MLI and what it means for NZ businesses

Melanie Meyer and Evan Tuck

Introduction

On 7 June 2017, the New Zealand Minister of Revenue signed the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI") alongside ministers and high level officials from over 60 other countries and jurisdictions.

The MLI is an international tax treaty designed to offer signatory governments an efficient and swift means of implementing the tax treaty related measures arising from the OECD's base erosion and profit shifting ("BEPS") project, which was undertaken to close the gaps in existing international tax rules. The MLI operates by giving signatories the ability to update a worldwide network of several thousand existing bilateral tax treaties to adopt the recommendations, without the need to re-open and negotiate each tax treaty on a treaty by treaty basis.

The MLI itself contains 39 provisions relating to BEPS actions on treaty abuse, permanent establishment avoidance and dispute resolution. To offer signatories a level of flexibility, the MLI provisions are characterised as either minimum standards or optional provisions. The minimum standards are those articles that are agreed as part of the BEPS actions relating to treaty abuse and dispute resolution that are required to be adopted (in the absence of similar provisions in existing treaties). Optional provisions are not obligatory for signatories but instead are intended to represent OECD best practice and offer a more substantive approach to implementing BEPS related actions on treaty abuse, permanent establishment avoidance and dispute resolution. Further, to assist in the practical application of the MLI, signatories are required to expressly provide any conflicts or overlaps that may exist between MLI existing tax treaties, and where applicable, notify any reservations against the optional MLI provisions. Any comparability comments or reservations must be notified to OECD to ensure that the MLI is modified and provide transparency for Government and businesses.

While signatories are given various choices on whether provisions are adopted, exactly what provisions are included in each treaty, and to what extent, will ultimately depend upon the position taken by each signatory. Between considering minimum standards, comparability issues, and reservations, we expect that the MLI will add another layer of complexity to treaty analysis and application.

New Zealand implementation

The extent to which the MLI articles are to be incorporated in New Zealand will turn on the final position of both the New Zealand Government and its treaty partners. We note that with the exception of Malaysia, Papua New Guinea, Philippines, Samoa, Taiwan, Thailand, United Arab Emirates, United States of America and Vietnam, all countries that New Zealand have treaties with (or are negotiating treaties with) have signed up to the MLI. It is likely that New Zealand will look to negotiate separate side agreements with some of these jurisdictions. We understand for example that a bi-lateral agreement has been signed with the US.

New Zealand's current positon, as indicated in the Officials' issues paper released in March this year (which is still under public consultation), provides details on the affected treaties and proposes MLI adoptions (see our March Tax Alert). In addition to the issues paper, the New Zealand Government has also released a

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provisional list of expected reservations and notifications as at the time of signing the MLI, including the tax treaties it wishes to be covered by the MLI.

Our expectation is that once public consultation on the Officials' issues paper has closed, the New Zealand Government will begin the formal treaty ratification process, which is required before the MLI will have legal effect in New Zealand. Once ratified the MLI will have the effect of modifying each bilateral treaty on a phased in basis, as both parties sign and ratify the MLI locally. It is likely that New Zealand's tax treaties will begin to be modified from 2019 onwards.

Potential considerations for New Zealand businesses

While the effect of the MLI on New Zealand business cannot be confirmed until the MLI is formally ratified and the New Zealand Government publish further guidance, it is certain that New Zealand based businesses can expect increased uncertainty and additional complexities, at least in the short term. Businesses with international operations that may be affected by the MLI provisions should begin to appreciate how these changes may impact their international tax obligations within the wider context of BEPS. Specifically, New Zealand based businesses may be impacted by the following:

- Businesses that are considered dual tax residents (i.e. treated as resident for tax under domestic law in two countries) will be affected by the change in the tax residence tie-breaker test under the MLI. Existing tax treaties generally seek to decide tax residence and allocate respective taxing rights using the "effective management" test. The MLI intends to remove this test and instead proposes that tax residency is determined by the Competent Authorities of the treaty parties, meaning that dual tax residents will have to apply to Competent Authority to have residence determined. This may cause particular issues in relation to New Zealand and Australian entities operating in both counties, as under domestic legislation in both jurisdictions the tax residency rules are drafted broadly with wide capture. Those affected may face uncertainty as to the application of the treaty for double taxation relief. We also expect that use of a Competent Authority may result in a long wait time (current average time frame for mutual agreement procedure is approximately 20 months), prove costly and burdensome and may lead to denial of treaty relief in instances where residency is not determined. Reflecting these concerns, we understand that the Australian Taxation Office and IRD are intending to work together on guidance on this issue.

- Treaty analysis will become more complex for businesses that utilise tax treaties in determining their tax affairs. The MLI does not operate in the same way as amending protocol to an existing bilateral treaty because the MLI does not directly change the underlying text of the treaty, instead it is read alongside the existing treaty to modify its application. In the absence of a publically consolidated version of a tax treaty, treaty analysis will be more difficult as taxpayers will be required to read the MLI alongside the treaty to determine its application. At this stage there is no proposed requirement for New Zealand to amend the publically available treaties, however, it is hoped that Inland Revenue will produce some form of consolidated treaty once the final positions are finalised to assist in understanding where treaties have been modified.

- Businesses with international operations should be aware of the updated definition of permanent establishments ("PE") contained in the MLI. The MLI proposes to broaden the tax treaty definition of a PE to implement BEPS Action 7 on Preventing the Artificial Avoidance of Permanent Establishment Status. Specifically, the MLI proposes to broaden the definition to capture commissionaire type arrangements, narrow the specific activity exemptions (i.e. only exclude activities considered to be "preparatory or auxiliary") and counter contractual splits. This may result in existing structures and supply chains previously not considered to fall within the PE definition, to now be characterised as one by virtue of the updated definition. In addition to updates to PE rules via the MLI, there is also proposed domestic legislation on PEs in New Zealand, which is currently also under public consultation.

Conclusion

The MLI is a powerful tool for BEPS implementation, both globally and in New Zealand, and will have a far reaching impact New Zealand businesses that utilise the tax treaty network. However, we envisage the practical application for taxpayers trying to reconcile the MLI with existing tax treaties during the early stages to be a road of complexity and uncertainty. Between considering minimum standards, comparability issues, and reservations, businesses impacted by changes to the tax treaty network should evaluate their positions in light of MLI and the wider BEPS framework to identify any potential implications and mitigate any risks for their global businesses going forward.

Binding rulings regime – proposed changes

Campbell Rose and Virag Singh

The Binding Rulings regime under the Tax Administration Act 1994 ("the TAA") came into effect from 1 April 1995. Since then the regime has undergone a number of changes, the most material of which have sought to clarify the instances in which the Commissioner of Inland Revenue ("CIR") can or cannot provide a ruling.

In its discussion document issued in December 2016, *Making Tax Simpler - Proposals For Modernising The Tax Administration Act – A Government Discussion Document* ("the Discussion Document"), the Government has proposed further changes to the binding rulings regime. Specifically, the Discussion Document notes that:

"As a first step towards Inland Revenue rationalising its advice products, the Government proposes to widen the scope of the rulings regime to make it more flexible, and to make it more affordable for small and medium-sized enterprises."

The proposals in the Discussion Document relating to binding rulings are discussed below. On balance these are helpful, and particularly so in an environment where there is significant value in obtaining certainty in respect of a tax position.

Reduce the cost

The first proposal is to reduce the fees charged by Inland Revenue for providing binding rulings, with the goal of making rulings more accessible for small and medium-sized enterprises. Two options have been put forward to achieve fee reductions:

1. A single flat application fee for all ruling applications.
2. A graduated schedule of application fees depending on the size or type of entity applying for the ruling.

Any changes to that would allow the binding rulings regime to be accessible to more taxpayers are welcome. We agree with the Government's understanding in the Discussion Document that the fees currently charged are a significant barrier to smaller business and individuals accessing the regime

Under the proposed changes, the current hourly rate fee structure would be removed.

Any changes that would allow the binding rulings regime to be accessible to more taxpayers are welcome. We agree with the Government's understanding in the Discussion Document that the fees currently charged are a significant barrier to smaller business and individuals accessing the regime. There is at least a perception amongst some SME taxpayers that the binding rulings regime is a luxury that can only be afforded by larger corporate taxpayers. In our experience, cost is one of the primary reasons why SME taxpayers do not proceed with making binding ruling applications to obtain certainty on their tax positions.

An alternative option that could be considered from a cost perspective is basing a fee structure on a combination of the size of the taxpayer and the potential amount of tax in respect of which certainty is being obtained.

Post assessment rulings

Currently, a ruling application cannot be made following an assessment. The Discussion Document notes that the reason for this prohibition is that assessment issues were seen to be in the domain of the disputes regime.

The proposal seeks to allow post-assessment binding rulings and notes that the practical effect of this would be to deliberately blur the boundary between a ruling and a dispute.

This proposal is a positive move away from taxpayers becoming unnecessarily trapped within Inland Revenue's friendly disputes process. There are good policy reasons to allow post assessment binding rulings. One obvious benefit of this change is that, upon making a self-assessment, taxpayers can have a tax position on a discrete issue confirmed through a ruling. This would immunise that tax position from later audit activity. Secondly, where taxpayers do not agree with Inland Revenue's view or interpretation of a tax law, they can take a filing position in accordance with that view or interpretation and then upon file a notice of proposed adjustment requesting Inland Revenue to amend their self-assessment. While this provides the taxpayer with protection from shortfall penalties, it does trigger the expensive disputes resolution process which is not a productive use of time for either the taxpayer or the CIR. A post assessment binding ruling would eliminate this cumbersome and expensive process in those circumstances. Another point to consider will be whether a post assessment binding ruling potentially could also be

treated as a voluntary disclosure which would entitle the taxpayer to a reduction in shortfall penalties in certain circumstances.

The post assessment proposal also appears to extend to the disputes resolution stage. This would cover any reviews, investigations, audits and the disputes resolution process itself. In a separate section of the Discussion Document, Inland Revenue has acknowledged that allowing binding rulings following assessment, "including during the formal disputes process", would be one measure to reduce taxpayer burn-off. This would be a very welcome change. Taxpayers have been encountering aggressive audit activity which often ultimately leads to a protracted, disruptive and expensive disputes process resulting in taxpayer burn-off. Allowing an independent set of legal minds within Inland Revenue to rule on issues post assessment should allow swift conclusion to the review, investigation, audit or the disputes process

Extending the scope of rulings – other proposals

1. Purpose of taxpayer

Currently, a ruling cannot be provided to clarify "the purpose" of a taxpayer. It is proposed to remove this prohibition in relation to certain provisions of the Income Tax Act 2007.

While no further information is provided on this, it is again a move in the right direction. The purpose of the rulings regime is to provide certainty for taxpayers on the application of tax law. Tax laws are in some cases dependent on the purpose of the taxpayer – such as the land taxing provision under section CB 6 of the Income Tax Act 2007. Ultimately it is incumbent on the taxpayer to provide the CIR with all relevant information to consider and issue a binding ruling. This should be no different when determining the purpose of a taxpayer. This has the potential to make for a more interactive two-way process, with an even greater focus on the collection of relevant facts and meetings/interviews with taxpayers, in order to ensure that the CIR can comfortably conclude and therefore rule on purpose issues.

2. Arrangement

The Discussion Document proposes relaxing the requirement that a ruling can only be issued on an "arrangement" - but only to the extent of allowing the CIR to give certainty on some specific quasi-factual matters. This would include matters such as whether a person is resident in New Zealand. Again, this is a sensible step given that the application of tax laws to a taxpayer does not always involve an "arrangement".

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3. Rulings and the financial arrangements rules

Without providing any further guidance, the proposals seek to clarify the connection between rulings and determinations issued in respect of the financial arrangement rules.

The Discussion Document notes that this may lead to the CIR ruling on certain matters rather than issuing determinations, and may possibly lead to replacing financial arrangement determinations with private or product rulings.

4. Assumptions and conditions

Rulings are often based on certain assumptions and conditions when issued. The Discussion Document proposes clarifying the role of assumptions and conditions in rulings, their differences, when they should be used as well as when a ruling does not apply because a condition or assumption is breached. Again, given the significant value that rulings provide for taxpayers, this clarification will be welcome, and should ensure that taxpayers even more critically appreciate the dimensions of the ruling that it is essential to verify (and in some cases continue to verify/confirm) in order for the ruling to apply or remain applicable.

Final comment

In the current climate of uncertainty around how tax laws are being interpreted and applied by Inland Revenue investigators, any changes to the binding rulings regime that can make the process flexible in application and accessible from a cost perspective will be beneficial for taxpayers. These proposals are therefore a move in the right direction.

The proposals are (not entirely unexpectedly) light on the finer details and the devil will be in the detail of any changes introduced in a tax bill. There would be a number of other consequential changes required to the TAA as a result of these changes to realise their full potential.

We strongly recommend that our clients obtain binding rulings in appropriate circumstances, to secure certainty for their tax positions. The **Deloitte Tax Disputes and Rulings** team has extensive experience working closely and successfully with clients and Inland Revenue to obtain binding rulings.

If you require further information on making a binding ruling application or would like to discuss further, please feel to contact your Deloitte client service team in the first instance. Alternatively, please feel free to contact the Tax Disputes and Rulings team directly:

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High Court rules on tax sparing provision in treaty with China

By Emma Marr and April Wong

In a recently released decision, *Lin v CIR*, the High Court found that tax relief under the New Zealand/China Double Tax Agreement (China DTA) is available for tax payable under the controlled foreign company (CFC) regime, and that New Zealand tax credits are available for tax paid by a CFC in China and also for tax spared in China.

Although the scope of the CFC rules is narrower than it was at the time the income was earned in this case, the decision is still a helpful guide to the interaction between the CFC rules and our double tax treaties. It also clarifies the ambit of the tax sparing articles in double tax agreements, and in this case a New Zealand taxpayer was allowed a tax credit in New Zealand for tax paid by her CFC's in China, and for tax those companies had been spared under Chinese exemptions.

As New Zealand has tax sparing arrangements with China, Fiji, India, Korea, Malaysia, Papua New Guinea, Singapore and Vietnam, this decision is of wider interest to investors in those countries, as it provides guidance on how New Zealand resident taxpayers could qualify for foreign tax credits for tax spared in those countries.

Lin v CIR is an interesting case both in its analysis of how the DTA applies to CFC income and tax sparing, but also more generally for its consideration of the interface of domestic laws and DTAs, the negotiation process of DTAs, and the different aids for interpreting DTAs.

The facts

Ms Lin is a New Zealand tax resident who from 2005 – 2009 indirectly held controlling interests in five Chinese companies. Under the CFC rules, income earned by the Chinese companies was attributed to Ms Lin, so she was liable for New Zealand tax on this income, even though she never actually received any cash income. The income amounted to $4.605 million, for which the Commissioner allowed tax credits of $926,968 for tax paid in China by the companies.

Under Chinese tax law, the companies were also relieved of tax totalling $588,135 (tax spared). If this amount was credited against her New Zealand tax liability, Ms Lin's tax liability would have been reduced to approximately $281,000. However, the Commissioner refused to allow Ms Lin to claim any tax credits for the tax spared. The dispute between Ms Lin and the Commissioner came before the High Court.

The judgment

Thomas J in the High Court held that the China DTA allows a credit against New Zealand tax payable by Ms Lin on her CFC income, for Chinese tax paid by a CFC, and that tax payable in China includes any tax spared amount.

While this was certainly good news for Ms Lin, who escaped an otherwise hefty shortfall penalty and increased income tax liability, what does this mean for future taxpayers who hold attributable CFC income overseas? Further, do tax sparing provisions always give rise to a claimable foreign tax credit in New Zealand?

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What is tax sparing?

Tax sparing is a way of ensuring that a tax incentive granted to an entity in (usually) a developing country is not simply transferred to the revenue authority in a developed country. A tax incentive is designed to fuel growth in the developing country. If the non-resident shareholder of the entity doesn't get a tax credit for that amount, and has to pay tax in their own jurisdiction, the tax incentive has turned into tax revenue for the home country of the shareholder. The overall rationale of enabling foreign investors to get the benefit of tax incentives is to create an increase of inbound capital flows to the developing country, which may contribute towards economic development.

Whether or not the tax sparing provision in the China DTA applied to allow Ms Lin a tax credit for tax spared in China was the key question for the High Court. If the Chinese tax concessions would reduce the Chinese companies' tax liability in China, but Ms Lin couldn't get any New Zealand tax credits for them, the tax concessions would transfer tax revenue from China to New Zealand. If the tax sparing provision applied to the tax spared in China, Ms Lin, rather than the New Zealand Government, would get the benefit of the Chinese tax concessions and the investment incentives behind tax sparing would remain intact.

The China DTA – interpretation and application

Counsel for the Commissioner and Ms Lin engaged in thorough debate on the correct interpretation of Article 23 of the China DTA, namely whether Article 23 relieved attributed CFC income from double taxation, and if so, whether Ms Lin qualified for a foreign tax credit for the Chinese tax spared. The Court had the benefit of two well qualified experts, Professor Craig Ellife (expert witness for Ms Lin) and Robin Oliver (expert witness for the Commissioner) in interpreting the China DTA. The Court considered and answered two questions, outlined below.

1. **Does Article 23 relieve attributed CFC income from double taxation?**

The China DTA allows a tax credit to a New Zealand resident for "Chinese tax paid … in respect of [CFC] income derived by a resident of New Zealand" (Article 23(2)(a) of the China DTA). There was significant dispute between the parties as to the meaning of the phrase "in respect of". The Commissioner took the position that Article 23(2)(a), which provides relief against double taxation, could never apply to CFC attributed income because the tax was paid by the CFC, not by the New Zealand taxpayer. Counsel for Ms Lin submitted that the proper construction of Article 23(2)(a) is to focus on the tax and not the payer, therefore tax paid by a CFC should give rise to a tax credit to Ms Lin.

Thomas J concluded in favour of Ms Lin, after considering the background to the negotiation of the China DTA, the OECD and the UN Model Conventions, and the commentaries to those Conventions, which assist in interpreting DTAs. He also considered the principles governing the interpretation of international treaties, as set out in the Vienna Convention on the Law of Treaties 1969. This background information persuaded him that the Court should adopt an expansive interpretation of the words "in respect of", also finding support in the domestic tax legislation. Thomas J noted that the position taken by the Commissioner would mean that Article 23 could never apply to attributed CFC income.

Thomas J found that if the Inland Revenue was content to ignore the statutory form of the CFC in taxing Ms Lin – ie, even though the relevant income was derived by the CFC and not Ms Lin she was still taxable on that income – then it should also disregard the statutory form in allowing a tax credit. Therefore, the tax paid by the CFC should give rise to a tax credit for Ms Lin.

2. **If the answer to (1) is yes, is a tax credit for allowed for tax spared for the CFCs in China?**

The tax sparing rule in Article 23(3) of the China DTA refers specifically to "tax payable… by a resident of New Zealand". As tax spared to the Chinese Companies is tax payable by the CFCs, rather than Ms Lin, the Commissioner argued that Article 23(3) precluded Ms Lin from obtaining any tax credit in respect of tax spared to a CFC. On the other hand, counsel for Ms Lin argued that the provision includes tax which is deemed to have been paid by a New Zealand resident under Article 23(2)(a), even though that tax in reality has been paid by the CFC.

Thomas J again preferred the case brought by Ms Lin, finding that as the CFC rules deem the income of the CFC to have been earned by the shareholder, the tax paid by the CFC is deemed to have been paid by the owner, i.e., Ms Lin. When this analysis is extended to Article 23(3), the only logical conclusion is that tax paid or payable by a New Zealand resident includes tax which is deemed to have been paid or to be payable by Ms Lin for the purposes of Article 23(2)(a).

The outcome of *Lin v CIR* would suggest that the courts take a broad pragmatic approach in interpreting tax sparing provisions to give taxpayers the opportunity to utilize foreign tax credits and reduce their income tax liability accordingly.

As New Zealand has tax sparing arrangements with China, Fiji, India, Korea, Malaysia, Papua New Guinea, Singapore and Vietnam, the decision is of wider interest to investors in those countries, as it provides guidance on how New Zealand resident taxpayers could qualify for foreign tax credits for tax spared in those countries

A snapshot of recent tax developments

US to share more tax information about multinationals with New Zealand

On 7 June 2017, the Minister of Revenue Judith Collins announced that Inland Revenue will receive more information about US multinationals operating in New Zealand following the signing of a new bilateral arrangement with the US Internal Revenue Service (IRS) to share country-by-country (CbC) reports. Ms Collins notes that "this will further enhance Inland Revenue's risk assessment processes to make sure that the right amount of tax is being paid" and ensure that Inland Revenue is receiving better information about how multinationals allocate profits from their operations within New Zealand. The bilateral agreement enforces an annual exchange of information between the IRS and Inland Revenue starting from 2018.

Reportable jurisdictions for application of CRS standard

On 8 June 2017, the Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Regulations 2017 (Regulations) was notified in the New Zealand Gazette. The Regulations provide for 58 territories to be reportable jurisdictions for the purpose of the CRS applied standard. Reportable jurisdictions are territories to which Inland Revenue will provide certain information on non-residents that is reported to Inland Revenue by financial institutions in accordance with the CRS applied standard. Under section 91AAV of the Tax Administration Act 1994 however, the Commissioner may, at her discretion, determine a territory to be a reportable jurisdiction.

The Regulations form part of the OECD's "Standard for Automatic Exchange of Financial Account Information in Tax Matters" (commonly known as AEOI) and comes into force on 1 July 2017.

Inland Revenue finalises IS 17/05: Income tax – treatment of New Zealand patents

On 8 June 2017, Inland Revenue finalised Interpretation Statement IS 17/05: Income tax – treatment of New Zealand patents (final IS), which updates legislative references to reflect changes to income tax and patents legislation since 2006, and replaces the 2006 Interpretation Statement reported in the August 2006 edition of *Tax Information Bulletin*. The item also discusses legislative changes addressing blackhole expenditure in the Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Act 2016. The Commissioner's view in the final IS reflects the following changes:

- Renewal/maintenance fees are now considered revenue and deductible expenditure in the year incurred; and
- Expenditure for underlying intangible items after asset recognition will be considered depreciable.

While the final IS does not substantially differ from the content in the draft IS, it is noted that the final IS clarifies that a deduction may be allowed where a patent application is refused or withdrawn or not lodged in terms of section DB 37 of the Income Tax Act 2007.

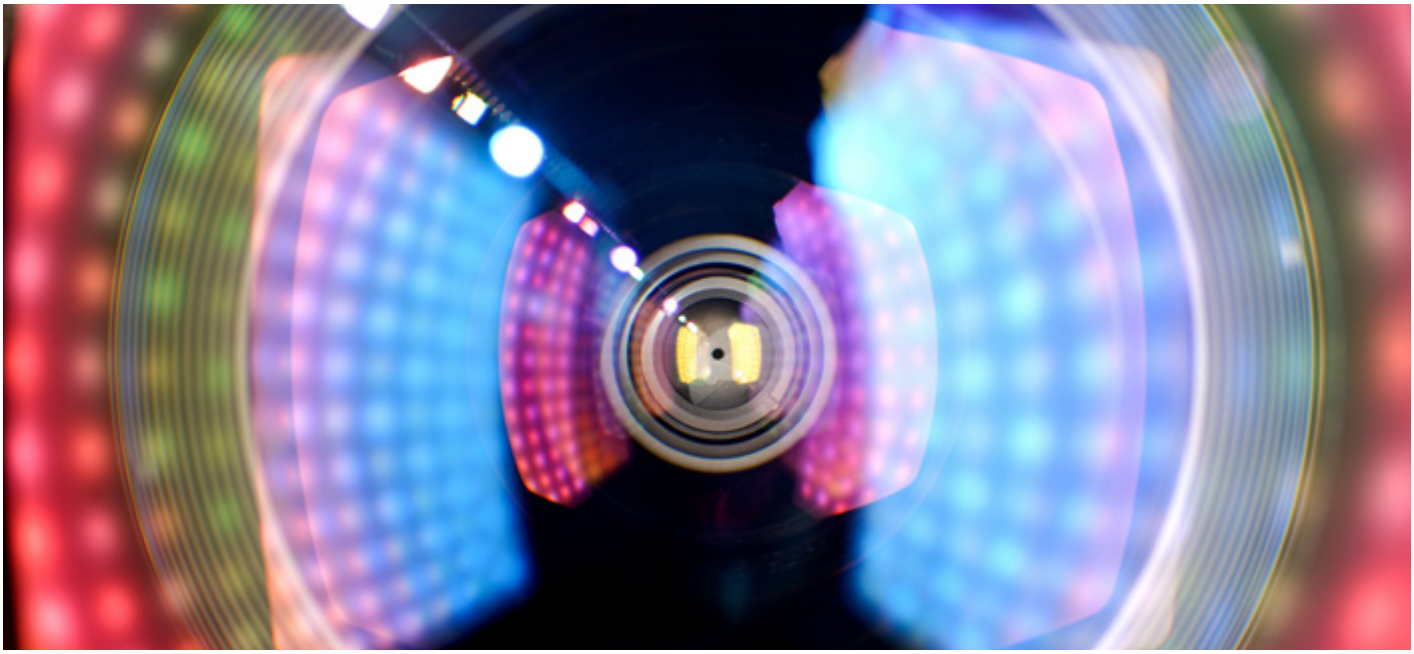
Draft Standard Practice Statement: Income equalisation deposits and refunds

This draft Standard Practice Statement (SPS) ED0196: Income equalisation deposits and refunds sets out the Commissioner's statutory discretionary powers to accept income equalisation deposits for a tax year outside the specified period, and to accept refund applications for a tax year outside the specified period. The item applies to income equalisation deposits and refunds made under the main income equalisation scheme and the thinning operations income equalisation scheme. However, it does not apply to the other income equalisation deposits made under the adverse event income equalisation scheme, or certain types of refunds. Once finalised, this SPS will replace SPS 05/09 Income deposits and refunds issued in September 2005.

The deadline for comment is 14 July 2017.

New Deputy Commissioner role appointed

On 7 June 2017, Commissioner of Inland Revenue Naomi Ferguson announced that Gaye Searancke has accepted the role of Deputy Commissioner for the Customer and Compliance Services – Business group



at Inland Revenue. This new group will be focused on streamlining and targeting Inland Revenue's technical services to small, medium, and large businesses.

General Determination DEP99: Campervans and Motorhomes

On 7 June 2017, Inland Revenue finalised General Determination DEP99: Campervans and Motorhomes. This Determination corrects the applicable depreciation rate for campervans and motorhomes for the 2010/11 and subsequent tax years.

The Note to Determination DEP99 clarifies that campervans and motorhomes are considered to have a high residual value (20%), and assets acquired during or after the 2010/11 income year have an estimated useful life of 8 years. Any assets acquired prior to this time have an estimated useful life of 10 years. It is also noted that taxpayers impacted by the retrospective depreciation rate change can seek relief under section 113 of the Tax Administration Act 1994 (to request for an adjustment to assessments for past years), to the extent that legislation permits a refund to be made under subpart RM of the Income Tax Act 2007. Alternatively, taxpayers may choose to use the new depreciation rate prospectively and make the appropriate depreciation recovery adjustment upon disposal of a campervan or motorhome.

GST on low value imported goods delayed until 1 July 2018

The Australian proposal for offshore businesses to register and remit GST on offshore supplies of low value goods sold to consumers in Australia will now take effect from 1 July 2018, instead of the initial 1 July 2017 start date. The House of Representatives recently adopted the recommendations made by the Senate Economics Committee on 21 June 2017, with royal assent of the Treasury Laws Amendment (GST Low Value Goods) Bill 2017 to follow. This delayed start date is welcomed as it gives affected foreign vendors, online market place operators, shopping/mailbox service suppliers redelivering goods to consumers in Australia, as well as international courier/logistics providers, further time to prepare.

The delayed start date does not affect the previously enacted measure requiring overseas-based suppliers to register and remit GST on services, digital products or rights supplied to Australian consumers, which takes effect from 1 July 2017.

For more information and commentary, please refer to Deloitte Australia's tax@hand article.

Tax debt threshold set for information sharing with credit reporting agencies

Changes to the law earlier this year gave Inland Revenue the authority to disclose information about companies with significant tax debt to certain approved credit reporting agencies. A recent Order in Council has now set the tax debt threshold at $150,000, which means that a company's tax debt over this threshold may be disclosed to certain credit reporting agencies. In her media statement, the Minister of Revenue Judith Collins noted that the threshold will give smaller creditors greater protection from businesses owing significant tax debts and allow them to make more informed decisions about credit risks.

This $150,000 threshold will come into force on 29 June 2017 and is limited to companies.

IRRUIP10: Income tax treatment of software development expenditure – update

Inland Revenue (IR) have informed us that the issues paper, IRRUIP10: Income tax treatment of software development expenditure will not be published, because the issues in the paper have been referred to IR's Policy and Strategy group for consideration. As such, there is no change in the interim regarding

Inland Revenue's current practice concerning the income tax treatment of software development expenditure.

Submissions on this item closed on 25 August 2016.

QB 17/06 Income Tax: Insurance – key-person insurance policies

On 22 June 2017, Inland Revenue finalised QB 17/06 Income Tax: Insurance – key-person insurance policies, which considers the income tax treatment of key-person insurance policies that replace lost business profits as a result of the death or disablement of a key employee. The Commissioner's view is that a lump sum or periodic sum paid under such policies will be taxable income of the employer under section CB 1 of the Income Tax Act 2007, and any premium amounts paid are also deductible under section DA 1.

QB 17/07 Resident and non-resident withholding taxes: Non-cash dividends

On 22 June 2017, Inland Revenue finalised QB 17/07 Resident and non-resident withholding taxes: Non-cash dividends, which concludes that income of a person who receives a non-cash dividend includes not only the dividend, but any withholding taxes paid for the dividend, i.e., resident withholding tax, or non-resident withholding tax. Recipients of equivalent non-cash dividends will have different amounts of income for tax purposes, depending on whether withholding taxes apply to the dividend.

General Determination DEP100: Depreciation rate for rapid DC car charging stations

Inland Revenue has finalised General Determination DEP100: Depreciation rate for rapid DC car charging stations. The Commissioner has set a general depreciation rate for a new asset class, "rapid DC car charging stations", which have an estimated useful life of 10 years, and will be depreciated at the diminishing value rate of 20% or the straight line rate of 13.5%.

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