Connecting you to the topical tax issues

Tax Alert

August 2018

In this issue:

Modernising tax administration

Statement on reimbursement of mileage costs finalised

Inland Revenue released guidance on tax treatment of resource consents

Inland Revenue focusing on purchase price allocations

Is remuneration paid in cryptocurrency subject to PAYE and FBT?

A snapshot of recent developments

Modernising tax administration – rulings, anomalies and taxpayer information

By Virag Singh

As we briefly highlighted in the July 2018 Tax Alert the Government has introduced a new tax bill with some important changes to certain aspects of tax administration. The Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill (the Bill) proposes changes to some core aspects of the Tax Administration Act 1994 (the Act). These proposals have their origins in the discussion document issued in December 2016, Making Tax Simpler – Proposal

for modernising the Tax Administration Act (the Discussion Document). You can read our July 2017 Tax Alert for more detail on the changes as originally proposed in the Discussion Document.

The key changes/proposals are discussed below.

The changes are proposed to come into effect from the date of enactment of the Bill.

Binding rulings

The Commentary to the Bill (the **Commentary**) notes the adoption of the OECD's "right from the start" framework, which suggests a proactive approach to tax administration. This framework is stated as the basis to make tax compliance simpler, particularly for the small business sector. The essence of the framework is that the tax administration system should actively facilitate accurate upfront compliance on the part of taxpayers, so as to reduce the need to make subsequent reassessments and the resulting burden that this imposes on both taxpayers and Inland Revenue.

Short-process rulings

The Bill introduces changes to allow the Commissioner of Inland Revenue (the **CIR**) to make short-process rulings. The key features of this proposal are:

- A person with annual gross income of $5m or less and a question involving tax below $1m can apply for a short-process ruling;
- Removal of the usual requirements when applying for a binding ruling to state the taxation laws and propositions of law for which the ruling is sought; and
- Application and hourly rates (as determined and published by the CIR) will be lower for short-process rulings compared to the current rates, which are $280 (plus GST) for the initial application fee and $140 per hour (plus GST) for further fees.

The application for a short-process ruling will have to be in a prescribed form. The other requirements for obtaining a ruling or obligations on Inland Revenue when considering a ruling application would largely mirror the current rules for private rulings.

Extending the scope of binding rulings

Changes are being proposed to extend the scope of the binding rulings regime (which will include the new short-process rulings regime).

The Commentary acknowledges that the current rulings regime was designed with complex transactions in mind, which is why it was restricted to "arrangements" and largely legal rather than fact-based questions.

The proposals will:

- Allow rulings to be made on a taxpayer's purpose, for example, whether the taxpayer had the purpose of selling a property at the time the property was acquired;
- Allow for rulings to be made on factual matters rather than just arrangements. This includes, for example, rulings on whether a person is tax resident in New Zealand or has a permanent establishment in New Zealand, whether an item or property is trading stock or revenue account property etc.;
- Allow for rulings to be made on matters relating to financial arrangements for which the CIR can currently only issue a determination. These matters are:
  - Whether an amount is solely attributable to an excepted financial arrangement;
  - The use of certain spreading methods;
  - The value of certain property or services; and
- Clarify the difference between an assumption and a condition, and when a ruling ceases to apply because a condition or assumption is breached. In particular, the Commentary notes that the term "assumption" is replaced with the term "condition", as this is more reflective of market practice.

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The essence of this framework is that the tax administration system should actively facilitate accurate upfront compliance on the part of taxpayers.

Deloitte comment

These are welcome changes to the binding rulings regime. In the current climate of uncertainty in terms of how Inland Revenue investigators interpret tax laws, frequent legislative change and fewer substantive tax cases progressing through the courts, these changes should (at least in theory) make the binding ruling process more flexible and accessible.

However, in their current form, there is a risk that the proposals may not achieve their intended outcome.

The Commentary notes that the main problem the Bill seeks to address is that in practice rulings are only available to large taxpayers and that SME taxpayers are priced-out because of advisor costs and Inland Revenue fees. However, the short-process rulings regime is targeted at taxpayers with an annual turnover of less than $5m and a tax question involving tax of less than $1m. At a practical level, these changes would only be applicable to mostly the "small" component of New Zealand's SME sector. The new regime therefore would not be accessible to a significant number of mid-market businesses. Unfortunately, unless there are material changes to the thresholds proposed as part of the consultation process, the changes would not address the main problem identified in the Commentary.

The CIR has not yet prescribed fee levels for short-process rulings. However, given that a complete legal analysis would be included in preparation of the ruling application by the relevant tax advisor, and based on the proposed truncated form of ruling application, taxpayers should expect substantial reductions in time and fees charged by the CIR for the applications.

Disappointingly, post-assessment binding ruling applications are not proposed in the Bill. We strongly recommend that this is considered by the Officials as part of the consultation process. Admittedly, this would not be a simple issue given that careful consideration would need to be given to interaction with, for example, the disputes resolution process. Nevertheless, in light of the cumbersome and expensive disputes process and the significant taxpayer burn-off that comes with it, we recommend that consideration should be given to introducing this change.

A final observation is that, assuming the $5m / $1m thresholds are increased as noted above - which should make the regime available to a bigger range of SME taxpayers - the key challenge for Inland Revenue would be having adequate resourcing to meet the demand for more rulings and the ability to turn around these rulings in a timely fashion.

Amending assessments

The changes propose to repeal section 113A of the Act and enact a replacement that will allow taxpayers to:

- Automatically include an error in a subsequent return if total errors for the return (for income tax, GST or FBT) are equal to or less than the current threshold of $1,000; and
- Make an adjustment in a subsequent return for income tax or GST (but not FBT) if the total errors in the original return are equal to or less than $10,000 and 2% of the taxpayer's taxable income or GST output tax liability.

Care and management

The Bill proposes changes to extend the CIR's care and management powers by providing tools to address "legislative anomalies". Legislative anomalies will be a defined term, but broadly will mean an unintended outcome caused by gaps or inconsistencies in the legislation that do not reflect the clear policy intent of a provision. In cases of legislative anomalies, the tools would provide an interim/temporary solution to allow taxpayers to adopt an approach that is consistent with the intended policy outcome until a legislative fix is enacted.

The proposed tools to deal with legislative anomalies are:

- An Order in Council as recommended by the Minister of Revenue;
- A binding determination by the CIR; and
- An administrative action by the CIR.

The application of these tools to modify the application of the law will be limited to groups or classes of taxpayers (rather than for a particular taxpayer). The modifications would apply for a period of not more than three years during which the CIR must determine if legislative change is required.

Deloitte comment

In recent times there has been a significant volume of new and complex tax bills introduced and enacted. While these tax bills have gone through a consultation process, this process has arguably been relatively short given the complexity of the relevant subject matter. This has resulted in heightened risk that that the drafting of the legislation has not produced the intended policy outcome. In this respect, the above changes to address such legislative anomalies are helpful.

However, there are important matters that will need to be addressed as part of the consultation process:

- Whether the administrative action by the CIR will be binding on her. Currently administrative policies published in the CIR's statements, guidelines etc. are not binding on her. Given the significance of the tax administration issue that the CIR is seeking to address, it is important that the administrative action is binding on the CIR.
- Following on from the above point, taxpayers should have protection from penalties and use of money interest to the extent they apply the measure implemented by the CIR.
- It is quite restrictive to limit the ability to modify the application of a tax law to groups or classes of taxpayers. If there is a legislative anomaly, the CIR must be able to fix the anomaly regardless of whether it affects one taxpayer or a group or class of taxpayer. Knowingly not fixing a legislative anomaly just because it affects only one taxpayer would not be consistent with the CIR's care and management function (and of course it is possible that more than one taxpayer may be actually affected).

Information collection, use and disclosure

Changes are proposed to the information collection, use and disclosure rules under the Act. The changes mostly rewrite the existing rules to make them clearer and more navigable. There are however, some substantive changes proposed which we have briefly referred to below.

Information collection

Other than reordering of the current information gathering powers under section 16-19 and 21 of the Act, the Bill introduces a new regulation-making provision for collection of bulk data on a regular basis where that collection is necessary or relevant for revenue purposes. This provision will be the subject of a number of safeguards.

Information use

This proposed amendment provides an express clarification that information gathered for one revenue purpose can be used for any other revenue purpose. The Commentary reasons that, if enacted, this would assist the CIR in exercising her care and management responsibility, which requires her to make the most efficient use of the information at her disposal in order to fulfil her various functions and responsibilities.

In cases of legislative anomalies, the tools would provide an interim/temporary solution to allow the taxpayers to adopt an approach that is consistent with the intended policy outcome until a legislative fix is enacted.

Confidentiality and exceptions

Inland Revenue is currently required to maintain the secrecy of "all matters relating" to the Inland Revenue Acts. Under the proposal, the confidentiality rule would be amended to focus on information about, or relating to, taxpayers. In particular, the new rule would cover "sensitive revenue information" which is defined as information that:

- identifies or could identify a taxpayer, directly or indirectly;
- might reasonably be regarded as private, commercially sensitive, or otherwise confidential; or
- the release of which could result in loss, harm or prejudice to a person to whom it relates.

The exceptions to the confidentiality rule are being reordered into new sections which will contain the overarching framework for the exceptions, now called "permitted disclosures". Further details of each broad category of exception will be contained under the new schedule 7 of the Act.

Information sharing

Changes are proposed to enable the sharing of information for the provision of public services. The Commentary notes that while a considerable amount of cross-agency sharing is allowed, there is no readily apparent consistent principle governing the sharing of confidential information for the provision of public service. The amendments are aimed to make such information sharing more flexible, principled and transparent. The information sharing arrangements would be entered into in three alternative ways:

- An approved agreement under Part 9A of the Privacy Act 1993;
- An agreement between agencies where consent will be obtained from the taxpayer; and
- Regulation, made by Order in Council.

Deloitte comment

The changes to the information use, collection and sharing provisions are mostly for the purposes of clarity, with no intended substantive change.

Under the proposal, the confidentiality rule would be amended to focus on information about, or relating to, taxpayers.

The changes to the tax secrecy rules to cover "sensitive revenue information" rather than "all matters relating to" the Inland Revenue Acts is interesting. An issue that has frustrated tax advisors is the refusal of the CIR to release decisions of the Disputes Review Unit (**DRU**) on a redacted basis with the CIR relying on the secrecy provisions as the reason not to do so. Given the proposed definition of "sensitive revenue information", it is arguable that the CIR should have the flexibility under the proposed changes to issue decisions of the DRU on a redacted basis. This remains to be seen.

Please contact Virag Singh or your usual Deloitte advisor if you have any questions or would like to discuss this issue.

Statement on reimbursement of mileage costs finalised

By Andrea Scatchard and Veronica Harley

On 4 July 2018 Inland Revenue released its finalised Operational Statement 18/01 - Commissioner's statement on using a kilometre rate for work related running of a motor vehicle. Readers may recall our earlier article on the draft statement which highlighted real practical issues with the proposals for employers who had historically been using the IR mileage rate to reimburse employees. The earlier draft statement proposed that there be a wide range of rates at which an employer could reimburse employees at for work-related use of a private vehicle. Rates would vary based on engine size, fuel type and annual kilometres travelled. Deloitte strongly submitted against this on the grounds of unreasonable compliance costs being placed on employers.

While the finalised statement is much improved, aspects of it still seem unnecessarily complicated in our view and will require some employers to give some thought to their reimbursement policies over the next year.

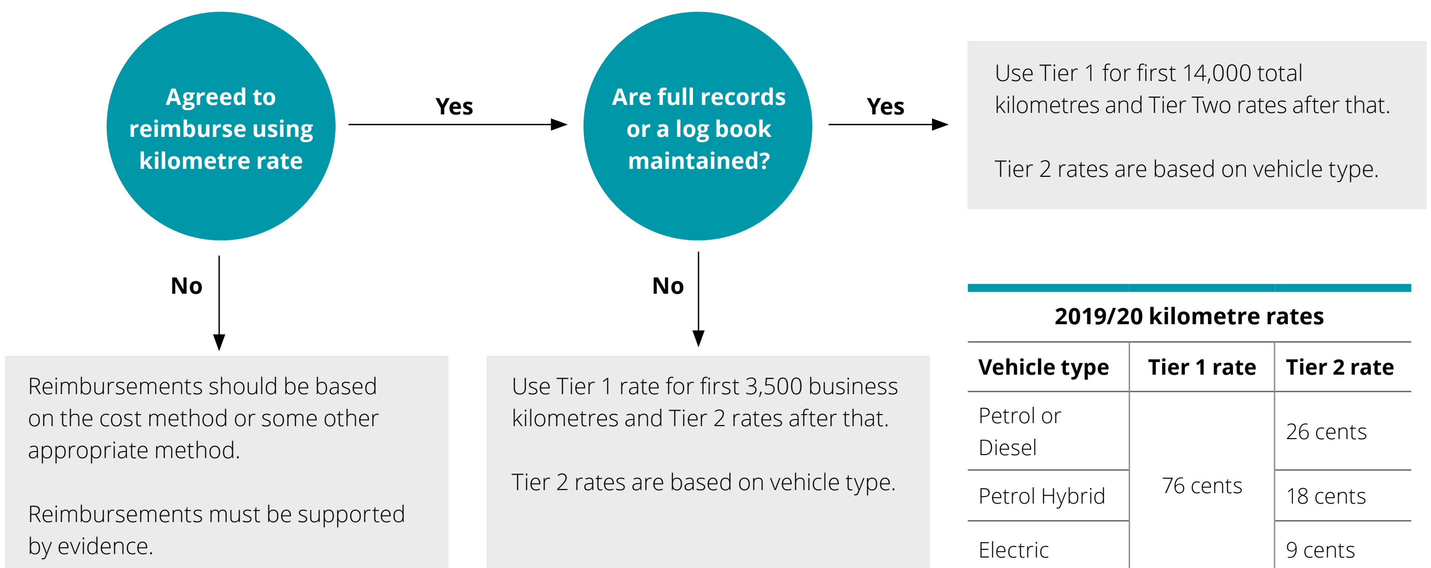
What's changed?

The good news is that for the reminder of the 2019 income year, i.e. from the date of the release of the statement on 4 July 2018, employers are able to reimburse employees at a flat rate of 76c/km regardless of distance travelled. This rate is up from the existing 73c mileage rate.

However, for the 2020 income year and onwards it will be necessary to use a two-tiered reimbursement rate. The tier one rate of 76c/km applies to the work related portion of the first 14,000km of combined business and private travel per annum, provided a log book or similar records are maintained by the employee.

Our expectation is that records of individual journeys taken, including expense claim systems which link into online mapping systems to calculate distances travelled, will be sufficient to satisfy the requirement of a "log book or similar records".

The tier two rates apply to travel that exceeds this limit. Practically the 14,000km combined travel limit means most employees will fall within the tier one rate threshold. If the employee does not maintain a logbook or other records, the tier one rate can be used to reimburse a maximum of 3,500km per annum of work related mileage. Many employees will comfortably fall under the 3,500km threshold.



2019/20 kilometre rates

Vehicle type	Tier 1 rate	Tier 2 rate
Petrol or Diesel		26 cents
Petrol Hybrid	76 cents	18 cents
Electric		9 cents

Practical implications

For employers who have employees with typical business mileage over the 3,500KM threshold, it gets more complicated. The statement has simplistic examples which consider the claim from a whole year perspective which is fine in theory. The reality is that employers reimburse employees regularly for mileage claims (e.g. monthly) and so will need to track and determine at what point the tier one threshold is exceeded and the tier 2 rate kicks in. If this is not monitored and the mileage rate paid is above the Tier 2 rate, the additional amount paid to the employee may be taxable with a PAYE obligation for the employer.

Employers will need to think about their reimbursement policies, what records will be required from employees, and how this threshold will need to be monitored. For example, employers could request employees take an odometer reading at the start of each tax year so there is at least some measure of total kilometres travelled in a year and that monthly mileage claims can be assessed against this starting number. This will become more tricky when employees start part way through the year or change vehicles during the year.

The level of mileage reimbursements to employees is usually governed by employment contracts and/or HR policies. These may dictate a level of reimbursement that is linked to IR rates. Where this is the case, employers may be able to update the reimbursement rate to reflect these changes.

Alternatively, the employment contracts or HR policies may prescribe a specific rate for reimbursement. If this is the case, and this rate is higher than the IR rate or rates applying, some part of the reimbursement may be taxable and subject to PAYE.

It may now be time to consider other options. For example, employers could consider using AA rates as an alternative. The law permits the tax free reimbursement of a "reasonable estimate" of actual expenditure and the AA rates are perfectly acceptable as an alternative – it is not compulsory to follow OS 18/01.

Of course if employers have employees travelling great distances and this all gets too hard, perhaps it's time to weigh up the option of purchasing a company vehicle for employees' use which is ideally a work-related vehicle which is then exempt from FBT.

For more information about applying new mileage rules or other options, please contact your usual Deloitte advisor.

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Inland Revenue released guidance on tax treatment of resource consents

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As noted in our July Tax Alert, Inland Revenue have released a draft interpretation statement: Income Tax – treatment of costs of resource consents, outlining Inland Revenue's view on when taxpayers can deduct expenditure incurred in obtaining resource consents, and on what basis.

This is welcomed guidance on an issue for which many taxpayers have sought input from Inland Revenue. It helpfully continues the recent trend of providing a number of examples and two flow charts (at pages 24 and 25), which summarise the analysis that Inland Revenue considers should be undertaken to determine the tax treatment of resource consent expenditure. You can read the full statement here.

Overview of tax treatment

When a taxpayer incurs capital expenditure the Income Tax Act 2007 (Act) generally allows a depreciation deduction for costs incurred in obtaining a resource consent where either:

1. it is a consent granted under the Resource Management Act 1991 (RMA) to do something that would contravene sections 12 – 15B of the RMA; or
2. the consent comprises "a right to use land".

The interpretation statement discusses these two consents within the broad framework of the following categories:

1. "environmental" consents (being consents granted under sections 12 – 15 of the RMA, ie item 1 above); and
2. "land" consents (consents granted under sections 9 and 11 of the RMA – a subset of which may be a right to use land as discussed further below).

Inland Revenue acknowledges that environmental consents should be items of depreciable intangible property (as they meet the above requirements), so that expenditure which forms part of the 'cost' of the consent can be depreciated over its fixed term.

However, in respect of land consents, Inland Revenue's view is that as these are generally of unlimited duration, they will not usually be depreciable property. Therefore, to extent that they do not comprise a "right to use land" (discussed below), Inland Revenue's view is that expenditure on land consents can only be depreciated to the extent that the expenditure can be capitalised into the cost of another item of depreciable property. No depreciation deduction is available for any expenditure capitalised into the cost of non-depreciable property, ie:

- Land; or
- Buildings (with a useful life of more than 50 years).

The issue of what constitutes a "right to use land" has not always been clear. The statement does explain Inland Revenue's view – but unfortunately their definition is very narrow. The Commissioner considers a right to use land will only arise in exceptional circumstances because the consent will have to be time limited and be a right to use land within schedule 14 of the Act.

The statement refers to a number of cases that support Inland Revenue's view that a right to use land:

- Must be a right to use exercised independently from the rights of ownership. Inland Revenue's view is that fee simple owners will not usually have a separate right to use; and
- In the case of a resource consent, must create a right to use land rather than merely removing a statutory fetter.

What type of expenditure is included in the 'cost' of a resource consent?

Inland Revenue acknowledges in the statement that whether particular expenditure is part of the cost of a resource consent depends on the relevant facts for each taxpayer, and the nature of the consent which is being sought.

Key takeaways on Inland Revenue's view of the cost of a resource consent are:

1. For expenditure to be part of the cost, it must be directly attributable to bringing the asset to the location and the condition necessary for it to be capable of operating. Therefore, Inland Revenue's view is that the cost is effectively restricted to the initial cost of an item of depreciable property.
2. Not all expenditure associated with a resource consent will form part of its cost base. For example, expenditure incurred on meeting conditions of the consent after the cost of the consent has been fixed, is not a cost of the consent.
3. Expenditure incurred on an application (including administrative fees under section 36 of the RMA) to obtain the resource consent will be part of the cost of a consent. Expenditure on legal and hearing costs is also likely to be a cost of the consent.
4. Expenditure incurred in compiling information, reports and strategies for the purposes of the application will also generally be part of the cost of the resource consent. This could include expenditure on resource monitoring, environmental investigations, engineering reports and the development of mitigation strategies for adverse environmental effects.

Inland Revenue acknowledges that whether particular expenditure is part of the cost of a resource consent depends on the relevant facts for each taxpayer, and the nature of the consent which is being sought.

5. On larger projects, consultation will often be a necessary step in the process of applying for resource consent. Expenditure on public awareness campaigns, public meetings, mail drops, media releases and consultation with affected persons including iwi, may all be part of the cost of the resource consent.
6. If a resource consent is subject to a condition that must be fulfilled before the consent commences then this expenditure, although incurred after the consent has been granted, may be a cost of getting the resource consent ready to use. In these circumstances, the expenditure should be added to the cost base of the resource consent.

The statement helpfully includes a list of expenditure which the Commissioner considers to be examples of expenditure that may be incurred in the resource consent process.

The statement also makes reference to accounting standards (NZ IAS 16 and NZ IAS 38) and suggests that they have relevance where 'cost' is unclear as they support the proposition that the cost must be directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating.

What type of expenditure is excluded from 'cost' (and which may be immediately deductible…or not)?

There are some types of expenditure which Inland Revenue doesn't think is part of the a cost of a resource consent, namely:

- Expenditure that is revenue in nature: This is unlikely to have material benefit as the guidance states that applying the principles in the Supreme Court decision in Trustpower Limited v CIR [2016] NZSC 91, the Commissioner considers that resource consents will generally be capital in nature because resource consents will usually relate to the business structure and provide an enduring advantage.

- Expenditure that constitutes "feasibility expenditure" under the principles in Inland Revenue's interpretation statement IS 17/01: "Income tax – deductibility of feasibility expenditure": The guidance states that based on the principles established in Trustpower there is limited scope for feasibility expenditure in the context of applying for a resource consent, on the basis that the expenditure will often be directed to a specific capital asset or towards making tangible progress on a specific capital asset – so again, unlikely to be of any practical benefit under Inland Revenue's interpretation of that case.

- Expenditure otherwise deductible under a specific provision: The guidance refers to section DB 19 of the Act which relates to certain resource consents that are not obtained or used, and section DB 46 which relates to pollution control.

That old chestnut…

Those familiar with the Trustpower case (in particular the Court of Appeal judgement) will recall the (unusual) proposition put forward by the Court that the nexus between incurring expenditure and deriving income was not established.

That principle then weaved its way into IS 17/01: "Income tax – deductibility of feasibility expenditure" and has, unhelpfully, found its way into this statement.

Inland Revenue states that for resource consent expenditure to be either deductible or depreciable, a sufficient relationship or nexus must exist between the expenditure and the taxpayer's business, or income-earning activity - and that for some taxpayers, resource consent expenditure will not be deductible or depreciable because it will have been incurred preliminary to, or preparatory to, the commencement of a business or income-earning activity.

Taxpayers will therefore need to tread very carefully to ensure the general permission is satisfied prior to incurring expenditure to ensure 'black hole' expenditure does not arise.

Next steps

Comments on the draft statement closed on 3 August 2018. It will be interesting to see what changes (if any) are made a result of submissions. Please contact your usual Deloitte advisor if you have any questions.

Inland Revenue focusing on purchase price allocations

By Virag Singh and Vyshi Hariharan

We are aware of an increasing trend for Inland Revenue (IR) to challenge taxpayers' allocations of purchase price when they enter into business asset sale transactions. IR's chief concern appears to be that the values used by either the vendor or the purchaser do not reflect market values. This is something that everyone either buying or selling a business needs to be aware of, as it can have a material impact on the expected tax outcome of a business sale. The situations that IR are focussing on include:

- **Scenario 1** - parties have agreed to a purchase price allocation in the sale documentation and adhere to this allocation for the purposes of preparing their respective tax returns;
- **Scenario 2** - parties have agreed to a global price for the business / assets, no allocation is agreed to in the sale documentation, and the vendor and purchaser use different allocations for the purposes of preparing their respective tax returns; and
- **Scenario 3** - despite the parties agreeing to an allocation in the sale documentation, either the vendor, purchaser or both do not adhere to this allocation for the purposes of preparing their respective tax return(s) and instead obtain different allocations and prepare their tax returns based on this. We expect this situation to be quite rare, in the absence of other information.

We understand that IR's key concern is that tax positions taken are not based on market values of the assets sold. In particular, they appear focussed on situations where there is asymmetry in the tax treatment between the respective parties; or where IR believes that the purchase price allocation has been struck to take into account specific tax attributes of the vendor / purchaser (eg where the price allocated to fixed assets is in excess of tax book value and the depreciation recovery is offset by existing tax losses of the vendor or the vendor is exempt from tax). IR have included a project on the tax policy work programme to consider these issues further.

Business asset sales can involve the sale of a range of items (including trading stock, depreciable tangible assets, buildings, land, intangible property, goodwill etc.). For tax purposes, there is a requirement that certain items (such as depreciable property, trading stock, revenue account property) are disposed (or deemed to be disposed) at their market values.

Market value is not a defined term under the Income Tax Act 2007 (the Act) for the above purposes. One view is that market value is not one number but rather a range and there are of course a number of valuation methodologies that can be applied. Under this approach, despite the existence of a market valuation for the asset, there are a number of other factors that could affect the final price at which an item is sold e.g. the nature of the asset and the circumstances of the buyer/seller.

Scenario 1

Where independent parties, operating on an arm's length basis, agree on an allocation in the sale documentation and adhere to that allocation in their respective tax returns, then our view is that those allocations should be respected as market value allocations. There is a natural tension when parties in this situation negotiate and agree on an allocation of the overall sale price. There should be no room for interference by IR to disturb this allocation unless the arrangement is a sham.

Scenario 2

Where there is a global purchase price agreed for the sale of the assets of a business and no allocation has been agreed, either party can end up allocating in an inconsistent manner. This inconsistency could be tax driven. For example, sellers could be motivated to allocate to depreciable assets amounts that are equal to or less than the tax written down values of those assets, while purchasers may be motivated to allocate to depreciable assets as much as possible to enhance future depreciation deductions. The irony of this inconsistency is that both allocations could potentially be supported by two market valuations (undertaken by each party). Once IR intervenes to review the inconsistency, there could well be a third market valuation (being the one obtained by IR itself). This is clearly an undesirable and potentially quite expensive outcome for the taxpayers.

Scenario 3

Our understanding is that only in very rare circumstances are parties proceeding to obtain their own valuations and adopt tax positions in accordance with those valuations, despite agreeing to different allocations in the sale documentation. In this case, IR has tools to address this inconsistency (both within the specific provisions, and by virtue of the specific and general anti-avoidance rules). Once parties have agreed to a price and allocation of that price, then we expect that they should be bound by that price and allocations both for tax and non-tax purposes as that is ultimately the cost of that item in its truest sense. Given that parties have agreed allocations, then the presumption should be that this should reflect the market values of the items being sold.

Summary & Recommendation

To mitigate risks in the current environment we recommend that taxpayers:

- ensure that, where possible, the sale documentation includes an allocation of purchase price across the classes of assets being sold, and they agree in writing to file their income tax returns in accordance with the documented allocation (if required due to the transaction timeline the parties could document in the agreement that they will seek to agree the allocation post-signing).
- consider obtaining an independent valuation of material assets being bought/sold and subject to commercial negotiations to support the allocation agreed.
- consider what contractual protection may be available for an increased tax liability arising from the other party and / or IR adopting a different allocation to what is documented eg through the sale and purchase agreement or W&I insurance.

Please contact your usual Deloitte advisor if you have any questions or would like to discuss this issue.

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One view is that market value is not one number but rather a range and there are of course a number of valuation methodologies that can be applied.

Is remuneration paid in cryptocurrency subject to PAYE or FBT?

By Oscar Jones and Ian Fay

Industry 4.0 is rapidly redefining how we do business. One of the key ways we are seeing this play out currently is the use of Blockchain technology to securely remunerate employees – i.e. paying employees via transfers of cryptocurrency. As the use of cryptocurrency in business starts to gain momentum, new questions are emerging as people turn their mind to the tax treatment of such transactions and whether the existing tax rules are sufficient to tax transactions arising using Blockchain technology.

Recently, Inland Revenue released an issues paper on whether remuneration paid to an employee in cryptocurrency is subject to PAYE or FBT because the answer is not clear in certain situations, particularly where the arrangement is structured as a salary sacrifice.

Where the employee's after-tax remuneration is in effect being traded for a payment of cryptocurrency, then because the employee has derived the full amount of salary or wage before the agreed deduction, Inland Revenue consider this is clearly subject to PAYE. In contrast, the main issue of the paper concerns whether arrangements are valid salary sacrifice arrangements and, if so, whether the payment in cryptocurrency is subject to PAYE or FBT.

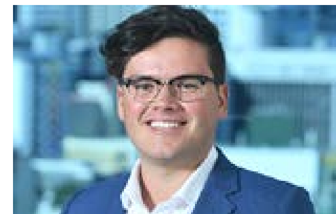
Inland Revenue consider a valid salary sacrifice will only arise where the employee has no right under the employment contract to receive the relevant part of their salary in money instead of cryptocurrency. While freely acknowledging the answer is not clear, Inland Revenue's tentative view is that regular payments to employees of crypto-remuneration under a valid salary sacrifice arrangement are subject to PAYE. This is because regular payments received in cryptocurrency have many of the same hallmarks of "salary or wages" (as defined in the Income Tax Act 2007). Inland Revenue consider that this definition is wide enough to capture regular payments in cryptocurrency.

The alternative view discussed by Inland Revenue is that the definition of "salary or wages" could be interpreted more narrowly so that the FBT regime applies. The primary argument being that the scheme of the Income Tax Act suggests that payments in money are subject to PAYE whereas (generally) non-monetary payments are subject to FBT and that cryptocurrency is not money in the technical sense although it shares some of its characteristics. This argument would classify crypto-remuneration as an "unclassified benefit" for the purposes of the FBT rules. However the delineation between monetary and non-monetary payments is "not hard and fast" and the salary and wages definition is wide enough to encompass regular payments in cryptocurrency, hence the preference for PAYE applying.

Issues we have encountered in practice, which are not covered in the issues paper, include: determining the New Zealand dollar value of the cryptocurrency on the relevant date; potential illiquidity of cryptocurrency (e.g. where tokens are subject to lock-up provisions) meaning that tax liabilities may be triggered but the value of the cryptocurrency changes materially before it can be sold to fund the tax; and the treatment of rewards which are provided in addition to rather than in substitution for salary.

The issues paper is seeking input on how employers are currently treating these payments and what compliance difficulties arise as a consequence.

Submissions on the issues paper were due by 3 August 2018. If you pay or receive crypto-remuneration and would like to discuss the issues further, please contact your Deloitte advisor.



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A snapshot of recent developments

BEPS update

The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 had its third reading and received royal assent on 27 June 2018, with the Act mainly coming into force on 1 July 2018.

It has been confirmed that New Zealand has become one of the latest jurisdictions to ratify the multilateral instrument (MLI) and deposit their ratification instruments with the OECD. This means a total of 80 jurisdictions have now signed the MLI and nine jurisdictions have deposited their instruments for ratification. The MLI will enter into force on 1 October 2018. For further information on the status of the MLI, read more on Deloitte tax@hand here.

Hong Kong DTA Amendment Order

The Double Tax Agreements (Hong Kong) Amendment Order (LI 2018/118) was notified in the New Zealand Gazette on 12 July 2018 and comes into force on 9 August 2018.

This Order gives effect to the Second Protocol to amend the Agreement between the New Zealand Government and the Hong Kong Government for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. The purpose of the Second Protocol is to amend the double tax agreement to facilitate automatic exchanges of information between New Zealand and Hong Kong by removing a clause prohibiting automatic exchanges of information. Further information can be found in the International Treaty Examination document prepared by the Finance and Expenditure Select Committee in February 2018. It will allow New Zealand and Hong Kong to meet their international commitments under the G20/OECD Automatic Exchange of Financial Account Information in Tax Matters initiative.

After the constitutional and legal procedures have taken place to enable the agreement to come into force, the date on which the protocol comes into force will be publicised here.

OECD releases BEPS discussion draft on the transfer pricing aspects of financial transactions

On 3 July 2018 the OECD released a discussion draft on financial transactions, dealing with follow-up work in relation to Actions 8-10 of the BEPS Action Plan (which is to “Assure that transfer pricing outcomes are in line with value creation”). The aim of the discussion draft is to clarify the application of the principles included in the 2017 edition of the OECD Transfer Pricing Guidelines, particularly the accurate delineation analysis under Chapter 1, to financial transactions. Other specific issues in relation to the pricing of financial transactions are also included, such as treasury function, intra-group loans, cash pooling, hedging, guarantees and captive insurance.

Tax Working Group’s latest release of Secretariat papers

On 2 July 2018 the Tax Working Group (TWG) released another tranche of papers that it has received from its secretariat (made up of Officials primarily from Treasury and Inland Revenue). These have been published in the ‘key document’ section on the TWG website. The advice represents the preliminary advice of the Secretariat and doesn’t necessarily represent the views of the Group or the Government. The following papers have been released and are now on the TWG website:

- Business tax – summary
- Types of business entities in New Zealand and how they are taxed
- Company tax rate issues
- New Zealand’s imputation system
- Closely-held companies
- Dividend avoidance
- Measures to approve efficiency
- Lower tax rates for small companies
- Maori authorities
- Effective company tax rates

More papers will be released as they are considered by the TWG.

Finalised items

OS 18/02: “Non-disclosure right for tax advice documents” was released on 2 July 2018. This statement sets out the process that the Commissioner will follow when issuing a notice to a taxpayer / tax adviser / third party requiring the disclosure of

documents, which may contain tax advice and may be subject to the right to claim non-disclosure under sections 20B to 20G of the Tax Administration Act 1994. The Statement incorporates amendments to the legislation (in particular the extension of the non-disclosure right in 2009 to apply to discovery and similar processes that occur during litigation), and incorporates principles established in cases since SPS 05/07 was published in 2005.

Determination FDR 2018/02 – A type of attributing interest in a foreign investment fund for which a person may use the fair dividend rate method (Units in the Two Trees Global Macro Fund) – Any investment by a New Zealand resident investor in units in the Two Trees Global Macro Fund is a type of attributing interest for which the investor may use the Fair Dividend Rate method to calculate Foreign Investment Fund income from the interest.

BR Pub 18/06: Goods and services tax - payments made by parents to state and state integrated schools concludes that GST is not chargeable on payments made by parents to the board of trustees of a state or state integrated school where the payments are made to assist the school with the cost of delivering education services which the student has a statutory entitlement to receive free of charge. GST is chargeable on payments made for supplies of other goods or services that are not integral to the supply of education to which the student has a statutory entitlement, where that supply is conditional on the payment being made.

QB 18/10: Income tax – state schools and donation tax credits and QB 18/11: Income tax – state integrated schools and donation tax credits explain when a parent's payment to a school will be a gift, so that the school can issue a donation tax receipt to the parent. A payment will be a gift when it is voluntary, does good for the school, and the parent obtains no material benefit or advantage in return for making the payment.

IS 18/01: Taxation of trusts – income tax – This statement summarises the income tax law as it applies to trusts, and replaces and updates the Commissioner's original statement on the trust rules in a 1989 Tax Information Bulletin (TIB) which was based on the Income Tax Act 1976. The Interpretation Statement sets out the Commissioner's view on the application of the trust rules for income tax purposes having regard to the changes made since the 1989 TIB item and the current Income Tax Act 2007.

Withdrawn item

SPS 08/03 Income Tax Act 2007 – Penalties and interest arising from unintended legislative changes has been withdrawn effective from 1 July 2018, and is now provided for historical purposes only. This statement sets out the treatment of shortfall penalties and use of money interest when a confirmed unintentional legislative change gives rise to a tax shortfall. The statement was issued because of concern about shortfall penalties and use of money interest arising from unintended legislative changes made during the Income Tax Act rewrite process.

Best Start tax credit

The Best Start tax credit (BSTC) is a new component of the Working for Families Tax Credits and is a payment to help families with the costs in a child's first three years. It is available to all qualifying families with children due or born on or after 1 July 2018. This tax credit replaces the Parental Tax Credit. A person cannot get the BSTC and paid parental leave for the same child, at the same time – the BSTC will start once the paid parental leave has finished.

Disclosure of information relating to other taxpayers prohibited

The Taxation Review Authority has dismissed an application by the disputants for the disclosure of information relating to the terms of any settlement between the Commissioner and taxpayers involved in other proceedings. In particular, the disputant wanted to know what (if any) concessions had been agreed between the Commissioner and the taxpayers, what arrangements had been made and what monetary payments had been agreed.

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