Connecting you to the topical tax issues

Tax Alert

September 2018

IRD guidance on withholding tax for non-resident directors' fees

By Veronica Harley

Inland Revenue has issued a draft interpretation statement which sets out when withholding tax is required to be withheld from fees paid to directors who are not resident in New Zealand. When finalised, it will complete the guidance on the treatment of directors' fees. Guidance was released in 2017 on payments of fees to resident directors (refer IS 17/06) which left the issue of how to deal with fees paid to non-resident directors hanging. This is an area where it is necessary for the

In this issue:

IRD guidance on withholding tax for non-resident directors' fees

GST change for non-profit organisations: Inland Revenue's proposals released

Transfer pricing: developments in debt pricing

BEPS guidance released to provide clarity

Automatic refunds and new tax return rules for individuals

A snapshot of recent developments

business engaging a non-resident director to know and understand when it has a withholding tax obligation.

The draft interpretation statement does provide some clarity however, far from being a straightforward issue, the rules are technically very complex and highly dependent on the facts and circumstances of the particular scenario. It's also become apparent that recent changes as a result of BEPS concerns, which were mostly targeted at multinational companies, are starting to bite in other, unexpected, areas. We have set out a high level explanation below of the draft guidance and the factors that will need to be established in determining whether a New Zealand company has an obligation or not to withhold tax.

Identify who you have contracted with

The first step is to identify who you have contracted with because both individuals and entities (such as partnerships and companies) can provide directorship services. While it may be more common to contract with an individual, it is possible to contract with an entity to provide directorship services via an entity, for example, an employee of a non-resident company. This fact will have a bearing on whether the fees have a New Zealand source. It is important to know where your director (or entity providing directorship services) is resident, as the rules may apply differently if the residence is in a Double Tax Agreement (DTA) or non-DTA country; or if the director is from the United States (which does not have a specific DTA article on directors' fees).

Determine the source of directors' fees

Withholding tax will only need to be withheld if the directors' fees are determined to have a New Zealand source, and this is where it starts to get complicated.

In the case of non-resident individuals, the Commissioner concludes (after several pages of analysis), that all directors' fees payable to a non-resident individual have a New Zealand source. This is either under sections YD 4(4) and (18) of the Income Tax Act 2007 (the Act) or under the new section YD 4(17D) of the Act if applicable (i.e. the individual is tax resident in a country which has a DTA with New Zealand and that DTA has an article on directors' fees). This is regardless of whether the services are performed physically in New Zealand or from overseas.

In the case of a non-resident entity resident in a DTA country, it is first necessary to determine whether the directors' fees are attributable to a "permanent establishment" in New Zealand. If so, the new section YD (17D) will apply here as well to treat the fees as New Zealand sourced.

If the fees are not attributable to a permanent establishment, then it is a matter of determining the extent to which the non-resident entity physically performs directorship services in New Zealand (and this may require apportionment). The example in the draft considers that in the case of monthly meetings, of which six are attended in person and six are attended via videoconference, that those attended in person will have a New Zealand source and so the fees are apportioned on this basis. It is then necessary to determine what would have been paid to an independent third party for carrying out the non-resident entity's New Zealand directorship activities and therefore the directors' fees apportioned may differ from the amount the New Zealand company has contracted to pay. However, if it is concluded that the directorship services are entirely performed from overseas, there is no New Zealand source (and no withholding tax). Significantly, in this regard it therefore makes a difference as to whether directors attend meetings physically in New Zealand or "from overseas" i.e. via videoconference.

Applying the schedular payment rules

Having determined that directors' fees paid to either a non-resident individual or entity have a New Zealand source, the next step is to consider how the schedular payment rules apply. The outcome will depend on whether the person is considered to be a non-resident contractor or not. If so, there are certain relief provisions and de minimis rules that could apply so that withholding tax need not be withheld.

Veronica Harley
Associate Director
Tel: +64 9 303 0968
Email: vharley@deloitte.co.nz

Section YD 4(17D) is a new source rule which deems an item of income to have a New Zealand source under our domestic legislation if New Zealand has a right to tax that item of income under a DTA. Whether section YD 4(17D) applies will depend on the country concerned and terms of the DTA. This section was inserted into the Act as part of the recent BEPS reform and will apply to income years beginning on or after 1 July 2018.

Further explanation on the new source rules can be found in draft BEPS guidance recently published.

Further, if the non-resident individual or entity holds an exemption certificate, then the New Zealand company is not required to withhold tax.

Withholding tax at the correct rate

Having determined that tax should be withheld, the New Zealand company has an obligation to withhold at the time of payment. Broadly, it is likely to be one of 5 rates:

- No notification rate of 45% (if the non-resident does not provide you with an IR330C form).
- Standard withholding rate of 33% (if the non-resident provides you with the IR330C form but does not self-elect a rate).
- Elected withholding rate (a non-resident can elect their own rate via the IR 330C, but it cannot be less than 15%).
- Special rate (if the non-resident presents you with a special rate certificate which means they have applied for a special rate which is below 15%).
- Prescribed rate (only if Inland Revenue determines and notifies you of the requirement to withhold at a prescribed rate).

When do the rules apply?

This is also a curly one to work through, as it depends on which source rule applies. For example, if withholding tax will only be payable because of the new source rule (i.e. s YD 4(17D)), this section only applies to income years commencing on or after 1 July 2018, which for many non-residents will not yet have started. For others, these rules will already have been technically applying, albeit the Commissioner's guidance has been lacking until now. It is highly likely there are some companies who have not been withholding tax on non-resident directors' fees historically.

On this point, the Commissioner is considering whether to issue an operational statement which specifies that if there is a change in interpretation, this guidance should have prospective application.

As noted above, the rules are complex and we would be happy to discuss your particular circumstances and how the rules may apply to your business. Submissions on the draft statement close on 5 October 2018.

GST changes for non-profit organisations: proposals released by Inland Revenue

By Allan Bullot & Amy Kimber

Significant changes to the GST treatment of assets held by non-profit organisations are imminent. If you are a non-profit body that has substantial assets, you should be considering the potential impact of these changes as soon as possible, if there is any chance of future sale or disposal of your assets.

Introduction

Significant changes to the GST treatment of assets held by non-profit organisations are imminent. If you are a non-profit body that has substantial assets, you should be considering the potential impact of these changes as soon as possible, if there is any chance of future sale or disposal of your assets.

While many non-profit bodies hold assets without any intention of future disposal, equally many non-profit bodies hold assets with the intention of retaining them for some length of time and then needing to dispose of them. The rule changes will impact any non-profit bodies that could dispose of assets that have not been used in their GST activities (i.e. not used for the purpose of earning income that is subject to GST), such as those assets used in their general charitable activities. We explore how this concept could work in practice in the example below.

What changes are being proposed?

Earlier in the year, we reported on Inland Revenue and Treasury's initial proposal to change the GST rules for non-profit bodies in this area (see our June 2018 article). The key change will be to ensure that where a non-profit body has claimed GST credits on the purchase or operation of an asset, the future sale or other disposal of that asset will be subject to GST, even where that asset has not be used to make GST-taxable supplies (e.g. a building used for general charitable administration, as opposed to a building used to earn commercial rental income).

On 4 September 2018, the Government moved one step closer to effecting this change, by releasing a Supplementary Order Paper that proposes to amend to the GST Act. The proposed amendments to the GST Act are largely in line with expectations from Inland Revenue's initial Issues Paper.

Here are the key things you need to know:

- The rules are expected to be given effect from **15 May 2018** (i.e. retrospectively to the release date of Inland Revenue's Issues Paper). This means it is essential to start considering how these rules could affect your organisation.

- Where a GST credit has been claimed on an asset's purchase, or GST credits on the asset's operating expenditure have been claimed, you will need to return 15% GST on the future disposal of that asset. Relevant disposal events will include sales, transfers, insurance settlements, and a deemed supply of the asset if it's still held when deregistering for GST.

- There will be a limited 3-year period in which you can opt to repay GST credits previously claimed on an asset within the past 7 years, rather than accounting for 15% GST on the asset's future sale/disposal. This is an important and worthwhile consideration for appreciating assets, to minimise the total GST cost over the asset's lifetime.

- To elect to repay previously claimed GST credits within the 3-year transitionary period, a formal election will need to be made to Inland Revenue and certain information will need to be provided. We anticipate Inland Revenue will release guidance on how this election process will operate and what details should be supplied, in the near future.

- There is an anti-avoidance provision that would limit a non-profit body's GST credit on purchasing a second-hand asset, where the non-profit body is associated with the original owner or is acquiring the asset from another non-profit body. This would essentially limit the GST claim on acquisition to the original owner's GST liability on the sale of the asset.

Recalling our example from the June 2018 Tax Alert article, let's examine what the implications of these changes could be for a charity that runs a food hall to feed the poor. The charity owns a dining hall that it uses for its charitable activities, along with a small office building that it regularly rents out to commercial firms. The charity returns GST on its commercial rental income for the office building. The charity claimed GST credits on the construction of both buildings in 2014, and operational costs on both buildings since then. The total GST credits claimed on the dining hall building are $50,000.

In 2019, the charity decides to sell the dining hall building, as it will no longer be required following a relocation to a larger complex that can house both the office and food hall facilities. The charity expects to fetch a $750,000 sale price from the dining hall building, as real estate prices have been steadily increasing in the area.

Under the proposed amendments to the GST Act, the sale of the dining hall would be subject to GST (potentially either at 0% or 15%, depending on the circumstances). If subject to GST at 15%, the charity could be required to return as much as $112,500 of GST to Inland Revenue on the building's sale. This is because the charity has previously claimed GST credits on the construction and operation of the hall.

The charity could **instead** elect to repay the $50,000 of GST credits claimed on the construction and operation of the hall. This would clearly be advantageous as the total repayment amount would be less than the potential $112,500 GST liability on the sale of the hall. If it made this election (prior to the 1 April 2021 deadline) and Inland Revenue accepts it, it would repay the $50,000 of total GST credits previously claimed and would not need to recognise any GST on the dining hall's sale.

Where to from here?

With the proposed retrospective effective date of 15 May 2018, it is important to start considering the proposals for any new asset purchases and whether the transitionary rules should be applied for any assets held that have appreciated in value and may potentially be sold in future. Please do not hesitate to get in touch with us if you have any questions on the potential implications for your organisation.

Allan Bullot
Partner
Tel: +64 9 303 0732
Email: abullot@deloitte.co.nz

Amy Kimber
Manager
Tel: +64 3 363 3827
Email: akimber@deloitte.co.nz

With the proposed retrospective effective date of 15 May 2018, it is important to start considering the proposals for any new asset purchases and whether the transitionary rules should be applied for any assets held that have appreciated in value and may potentially be sold in future.

Transfer pricing: developments in debt pricing

By Bart de Gouw & Young Jin Kim

Inland Revenue administrative guidance on small value loans

Inland Revenue have recently updated their administrative guidance on cross-border associated party financing. Inland Revenue now considers that for small value loans (being cross-border associated party loans by groups of companies for up to NZD 10 million principal in total per year), pricing of **300 basis points (3%) over the relevant base indicator** is broadly indicative of an arm's length rate, in the absence of a readily available market rate for a debt instrument with similar terms and characteristics. This is an increase from the previous guidance of 250 basis points (2.5%). This guidance applies from 1 July 2018 onwards and the next review of interest rates for small value loans is scheduled for 30 June 2019.

With the recent introduction of restrictive transfer pricing rules from 1 July 2018, taxpayers with cross-border associated party financing will undoubtedly face increasing scrutiny from Inland Revenue in relation to their financing transactions. Taxpayers may wish to consider the application of the administrative guidance where possible in order to manage their ongoing compliance costs.

Financing Guidance

The OECD released a discussion draft paper on 3 July 2018 which aims to clarify the application of the transfer pricing guidelines to financial transactions. This paper is still in draft format and is intended to open the following items for further discussion:

With the recent introduction of restrictive transfer pricing rules from 1 July 2018, taxpayers with cross-border associated party financing will undoubtedly face increasing scrutiny from Inland Revenue in relation to their financing transactions.

Bart de Gouw
Partner
Tel: +64 9 303 0889
Email: bdegouw@deloitte.co.nz

Young Jin Kim
Consultant
Tel: +64 9 306 436
Email: youngjinkim@deloitte.co.nz

- Accurate delineation of the actual transaction to determine the capital structure (debt versus equity determination)
- Risk-free and risk adjusted rates of return
- Treasury functions
- Intragroup loans
- Cash pooling
- Guarantees
- Captive insurance

A more substantive summary of the discussion draft by Deloitte Global can be found here. Submissions on the discussion draft close on 7 September 2018.

What this means for New Zealand taxpayers

The discussion draft is expected to be revised and updated in due course as the OECD reflects on its positions following the submission process. Nevertheless, the discussion draft provides some useful insights on the OECD's likely direction of travel with respect to financing transactions.

Discussions around risk-free and risk adjusted rates of return on intra-group loans closely resemble the guidance relating to intellectual property (i.e. ensuring that the rate of return associated with the creation and/or use of intellectual property is aligned with the level of functions performed, risks managed and controlled, and assets owned by the relevant group entity). The application of these principles to loans made by group finance companies without personnel capable of making risk-taking decisions can lead to outcomes which are unexpected.

The commentary in the discussion draft on guarantee fees may also prove to be useful for New Zealand taxpayers given that the restricted transfer pricing rules do not explicitly cover guarantee fees.

We will continue to provide updates on developments in this area.

The discussion draft is expected to be revised and updated in due course as the OECD reflects on its positions following the submission process. Nevertheless, the discussion draft provides some useful insights on the OECD's likely direction of travel with respect to financing transactions.

BEPS guidance released to provide clarity

By Brendan Ng

On 27 June 2018 the Government's taxation bill to address Base Erosion and Profit Shifting (BEPS) concerns received Royal Assent, finally bringing the BEPS proposals into New Zealand's domestic legislation, with the majority of the proposals applying to income years starting on or after 1 July 2018.

While Royal Assent would normally signal the end of the road, the breadth and complexity of the BEPS changes has seen Inland Revenue release draft guidance material, in the form of five special reports, to ensure the changes are as clear and understandable to the public as possible. This is an ambitious task, but a necessary one, and feedback is requested on the usefulness of the draft guidance (which is to be finalised and published in early 2019).

We have outlined the key areas covered by the guidance in the special reports below, noting that some areas of the guidance will need to be clarified and refined, and other areas could benefit from further examples and direction. You can read a summary about the BEPS bill as it was reported back from Parliament here and our December Tax Alert on the changes as originally proposed.

Interest limitation rules

This special report covers the new restricted transfer pricing approach, thin capitalisation changes and infrastructure project finance changes. In particular the report covers:

- The new rules requiring related-party loans between a non-resident lender and a New Zealand-resident borrower to be priced using a restricted transfer pricing approach. The report includes a flowchart outlining the process for determining a New Zealand borrower's credit rating (i.e. whether transfer pricing rules apply, a credit rating adjustment is required or no credit rating adjustment is required), with each step explained in further detail.

- If a credit rating adjustment is required, the process for determining the rating is set out in another flowchart. The concepts of 'high BEPS risk', implicit parental support, group borrower's credit rating and long term senior unsecured debt are also explained further.

- The new economic substance and reconstruction provisions that disregard legal form where it does not align with the actual economic substance of the transaction, or to allow transactions to be reconstructed or disregarded where the arrangements are commercially

irrational and would not be entered into by third parties operating at arm's length. A flowchart is included to illustrate the overall process to be taken in determining the interest rate on a particular instrument.

- The approach required for financial institutions ("insuring or lending persons") where they are generally required to use their parent's credit rating rather than the default credit rating, restricted credit rating or group credit rating (including a flowchart determining whether a feature can be included in pricing).

- The changes to the thin capitalisation rules so that debt percentages will now be based on an entity's assets net of its "non-debt liabilities", explaining what is / what isn't a non-debt liability with examples.

- The other changes made to strengthen the thin capitalisation rules including a de minimis rule for the inbound thin capitalisation rules, reducing the ability for companies owned by a group of non-residents to use related-party debt, new rules around asset valuation and an anti-avoidance rule for when a loan is substantially repaid just before year end.

- Amendments that have been made to provide entities carrying out eligible infrastructure projects with a limited exception from the thin capitalisation rules by allowing them to claim deductions on debt that exceeds the thresholds set out in the legislation.

Transfer pricing

This special report covers the strengthening of New Zealand's transfer pricing rules, providing for closer alignment with the OECD's transfer pricing guidelines and Australia's transfer pricing rules. These changes include:

- Extending the application of the transfer pricing rules to circumstances when there are transactions between members of non-resident owning bodies and companies and to specifically refer to cross-border related borrowings.

- Adding in a reference to using the 2017 OECD transfer pricing guidelines as guidance for how the transfer pricing rules are applied, noting that any changes to the OECD guidelines will be considered with a view to updating the section YA 1 definition of the OECD guidelines to refer to the most recent version.

- Giving the economic substance of a transaction and actual conduct of the parties to the transaction priority over the terms of the legal contract and requiring the arm's length amount of consideration to be determined using arm's length conditions. Where a transfer pricing arrangement is not commercially rational because it includes unrealistic terms that unrelated parties would not be willing to agree to, the approach in the new OECD guidelines may apply to disregard and, if appropriate, replace the transaction.

- Placing the onus of proof onto the taxpayer for providing evidence that their transfer pricing positions are correct, acknowledging that there may be a range of conditions that can be considered to be arm's length conditions. The special report endorses the three-tiered approach to transfer pricing documentation, where a master file, local file and Country-by-Country report are prepared and links to supplementary Inland Revenue guidance on what is required (in addition to the OECD guidelines).

- Increasing the time bar for transfer pricing positions to 7 years where the Commissioner of Inland Revenue has notified the taxpayer that a tax audit or investigation has commenced within the usual four-year time bar. The example provided applies the four years from the date of filing the tax return, so the actual position will need to be clarified with Officials as the legislation and guidance are not consistent.

Permanent establishment avoidance

This special report covers the new anti-avoidance rule for large multinationals (those with over EUR750m turnover) that structure to avoid having a permanent establishment (PE) in New Zealand, as well as the widening of the source rules. In particular:

- The special report explains the new permanent establishment avoidance rule that deems a non-resident to have a PE in New Zealand if a related entity carries out sales-related activities for it under an arrangement with more than a merely incidental purpose of tax avoidance (plus other requirements are met). This moves away from the previous test of habitually concluding contracts and instead places the focus on whether the representative of the non-resident habitually plays a principal role leading to the conclusion of contracts.

- An analysis of the criteria that, if met, deems a PE to exist in New Zealand is included in the report, as well as a table of examples that illustrate when the criteria are met. Also included are analysis and examples in relation to whether there is a more than merely incidental purpose of tax avoidance and the consequences of this.

- The new source rules are covered, whereby if income is attributable to a PE in a country, then it will be deemed to have a New Zealand source under our domestic rules. This is contrary to the current position where to tax a non-resident on its New Zealand sales income, it is necessary to show that the income both has a New Zealand source and is attributable to a PE under a DTA.

Administrative measures

This special report covers a number of the administrative changes made in relation to "large multinational groups", as newly defined in the Income Tax Act 2007 (ITA). These include:

- The increased ability of Inland Revenue to request information from large multinational groups, including the ability for Inland Revenue to impose a civil penalty of up to $100,000 for multinationals who fail to respond to requests for documents. An example sets out the process by which Inland Revenue will request information held by non-resident members of large multinational groups, and the consequences of the failure to provide this information.

- The ability of Inland Revenue to collect tax owed by a non-resident member of a large multinational group from another wholly-owned group member who is a New Zealand resident or that has a PE in New Zealand, and the requirement to file country-by-country reports.

Hybrid mismatch arrangements

The longest of the special reports covers the changes to introduce the OECD hybrid and branch mismatch arrangements recommendations into New Zealand domestic legislation, with modifications for the New Zealand context. As noted in the report, while the new rules are relatively complex, they will have no impact on the vast majority of taxpayers. This report covers:

- The rules in subpart FH addressing the hybrid and branch mismatches arising from hybrid financial instruments, disregarded hybrid payments and deemed branch payments, reverse hybrid and branch payee mismatches, deductible hybrid and branch payments resulting in double deductions, dual resident payers and imported mismatches.

- The ability for taxpayers with inbound hybrid financial instruments to elect to treat the instrument as a share for New Zealand income tax purposes and the ability to irrevocably elect to treat a wholly-owned outbound foreign hybrid entity existing on 6 December 2017 as a company for New Zealand income tax purposes. Taxpayers must send these elections to the following email address: hybridelections@ird.govt.nz.

- The consequential changes to the FIF rules, NRWT and thin capitalisation as a result of the introduction of the hybrid mismatch arrangement rules.

Deloitte comment

If you managed to read through all of that without having to take a break, remember that we are still yet to really see this legislation and guidance in force. For those entities that are affected by these rules (which is the majority of multinational taxpayers), these changes add another level of complexity and consideration to their operations. Further, even with refinement and the inclusion of more examples, the effect of these rules and their compliance burden will depend on the operational approach taken by Inland Revenue.

The majority of the new rules will become law for income years beginning on or after 1 July 2018. For companies with June balance dates, this means they effectively apply from 1 July 2018, despite the guidance on applying the rules not likely to be finalised until early 2019.

If all that isn't enough to consider, the Government has indicated that this may not be the end of the BEPS journey, and we may yet see further changes to our international tax rules – watch this space.

For more information please contact your usual Deloitte advisor.

If you managed to read through all of that without having to take a break, remember that we are still yet to really see this legislation and guidance in force. For those entities that are affected by these rules (which is the majority of multinational taxpayers), these changes add another level of complexity and consideration to their operations. Further, even with refinement and the inclusion of more examples, the effect of these rules and their compliance burden will depend on the operational approach taken by Inland Revenue.

Brendan Ng
Senior Consultant
Tel: +64 4 495 3915
Email: brng@deloitte.co.nz

Automatic refunds and new tax return rules for individuals

By Veronica Harley

Veronica Harley
Associate Director
Tel: +64 9 303 0968
Email: vharley@deloitte.co.nz

Included in a bill before Parliament are significant proposals to change the end of year filing obligations for individuals. The thing to note is that these measures, once enacted, are proposed to come into force on 1 April 2019, so will apply to filing obligations for the tax year ended 31 March 2019 which is not that far away.

The current process

Broadly under current rules, most individuals earning only salary and wages are not required to file a tax return because the PAYE withheld at source should equate to their tax liability on employment income where it has been withheld correctly. Inland Revenue may send a personal tax summary (PTS) to salary and wage earners if the information they hold suggests that PAYE has been under or over withheld for various reasons, like a wrong tax code being used for example. If you receive other income over a certain threshold, you are required to request a PTS or file an income tax return. However even if you are not required to, but think you are due a tax refund, you can request a PTS or file a tax return. Rather than claim any refund due directly themselves, many individuals use a "personal tax summary intermediary" whose business involves assisting people to claim refunds in return for a fee – usually a percentage of the refund.

However there is likely to be a number of people due tax refunds who do not make the effort to request a PTS and so miss out on any refund that might be due. Further the current process means that individuals can "cherry pick" refunds by not requesting a PTS in the years where there is tax to pay. Hence the whole filing process is to be streamlined and automated as Inland Revenue look to modernise the tax system.

What's proposed?

Individuals will no longer be "filing" tax returns as such, but checking that their "account is complete". It is proposed that Inland Revenue will pre-populate an individual's account with

Inland Revenue with information it has collected. For this purpose, individuals will fall into one of three groups:

Group A - These individuals earn only "reportable income" which is income from sources which Inland Revenue receives information about. For example, Inland Revenue receives gross salary and wage and PAYE information from employers and it receives details about interest earned and RWT withheld from financial institutions.

Under the new investment income reporting rules recently enacted and which are being phased in over the next few years, financial institutions will soon be reporting more frequent and more detailed investment information from its customers to Inland Revenue. A major reason for bringing in the investment income rules was for the purpose of pre-populating individuals' returns.

With the information it holds, Inland Revenue will pre-populate an individual's account. It is intended that the assessment will arise at the earlier time of when an individual confirms it is correct within the assessment period, or once the Commissioner notifies the individual that she is satisfied that the information held is complete and correct. The assessment period begins on 1 April immediately following the tax year end and will finish on 7 July (or later if the person has an extension of time). Once an account is complete and final, the individual is treated as having made a return of income, made a self-assessment and to have taken a tax position.

It will be possible for an individual to provide other information to the Commissioner such as deductible expenses or tax credits at this time. Any tax payable or refundable would automatically be calculated without the individual needing to provide any other information. Tax refunds would be issued automatically to individuals (preferably by direct credit) without the need to employ any intermediary or agent to act on their behalf. In theory for many individuals this process would all be automated and just happen so that any interaction with Inland Revenue is minimal.

An individual will have no obligation to provide reportable income information that has not been included in their pre-populated account to Inland Revenue unless they know or might reasonably be expected to know that the information in their pre-populated account is incomplete or incorrect.

Any amounts of tax to pay arising where tax was withheld in accordance with PAYE rules or at the rate corresponding to the individual's marginal tax rate would not have to be paid. Further amounts of tax arising from a withholding tax regime where less than $200 of income was taxed incorrectly would also not have to be paid.

Group B – These individuals earn reportable income, but Inland Revenue considers based on previous returns it holds that the individual may also have other income or deductions. In this case individuals will be required to provide further information (subject to some de minimis rules) about other income items (e.g. trust income, partnership or look through company income, rental income, employment share scheme or self-employment income). Further the individual may (but is not required to) provide information about deductions, tax loss balances, donation tax credits or amounts of income protection insurance paid.

These individuals will be able to submit this information manually or electronically. This will be added to the individual's pre-populated account which then becomes an "adjusted account". This becomes final (and therefore a self-assessment arises) at the earlier time of when an individual confirms it is complete or correct within the assessment period, or once the Commissioner notifies the individual that she is satisfied that the information held is correct. If the Commissioner is not satisfied with information submitted (or not submitted), she has the power to issue a default assessment.

Group C - These individuals have no or very little reportable income and will be required to provide income information, such that the process will be similar to the current IR 3 process.

Error correction

It will be possible for individuals to change the information in their pre-populated account at any time before these are confirmed. The Commissioner may also amend any information in the pre-populated or adjusted account to correct errors, but she must notify the individual of any amendments made.

Once an account has been assessed as final, the individual may ask the Commissioner to exercise her discretion to amend the account information under section 113 of the Tax Administration Act 1994 (TAA94). Section 108 of the TAA94 (the time bar rule) will apply as it does now to restrict the Commissioner from amending a tax return to increase tax payable if four years have passed since the end of the tax year in which the account was filed. However, this limit will not apply if the return is fraudulent, wilfully misleading, or omits all mention of income of a particular nature or derived from a particular source.

Tax rates and codes

The success of these rules requires individuals to use the right tax codes so that the right amount of tax is collected and ends up in their pre-populated account. Therefore, new rules will allow the Inland Revenue to monitor and be more proactive about contacting and suggesting people correct their tax code. However, Inland Revenue accepts that at the end of the day it is the individual themselves who have the best understanding of their likely overall income for the year and ultimately the decision lies with the individual as to whether to make the changes suggested. The exception is where an unsuitable RWT code is being used for investment income. The Commissioner will be able to instruct the payer to update the rate if, after making contact, the individual accepts the suggested rate or does not respond within 20 working days.

It will also be possible for individuals to apply online for a tailored tax code so that the right amount of tax is withheld throughout the year. This would be most relevant for individuals with secondary jobs, or who also receive social benefits.

Donations tax credits

As part of these changes, the current process of claiming a tax credit for donations made is to be simplified. New options are being added which should help make it easier for individuals to claim donations. With effect from 1 April 2019 (for the 2018-19 income year) there will be four ways to claim a tax credit:

- Upload donation receipts throughout the year to MyIR so that, at year end, the refund will be issued without the need to submit a tax credit form; or
- Complete the relevant donations section when providing other tax return information through the pre-populated account; or
- Complete a separate return online through myIR (that is after other income information is provided); or
- Compete a paper form (which is the current process).

Overall the new proposals and automated process is to be commended if all goes to plan with Inland Revenue's new computer system. There are some great taxpayer friendly measures in this package, particularly the fact that many can look forward to receiving an automatic tax refund and may have literally nothing to do in order receive this.

However, likewise, if some individuals do not want an automatic tax bill at the end of the year, some individuals will have to be more proactive than they currently are in managing tax codes and responding to requests for information.

There will be those that will need to think about what further information, income or deductions needs to be submitted. If a taxpayer takes no action to submit information about income when it should, it would appear there are pretty easy grounds for the Commissioner to issue a default assessment. In theory this is no different to the current process, so it will be interesting to see how this aspect will be managed in practice before default assessments are issued to errant taxpayers.

For individuals with no reportable income, the process will be similar to the current approach and these are the people more likely to utilise a tax agent and have an extension of time within which to submit their income information to the Commissioner.

The key question is whether Inland Revenue's new system will cope, giving the short lead in time and the fact there have been a few teething issues to date with regard to the Business Transformation process.

Submissions on this bill closed last month with oral hearings currently being heard by the Finance and Select Committee. The bill is expected to be reported back until early in 2019 with the final rules passed before 31 March 2019.

Overall the new proposals and automated process is to be commended if all goes to plan with Inland Revenue's new computer system. There are some great taxpayer friendly measures in this package, particularly the fact that many can look forward to receiving an automatic tax refund and may have literally nothing to do in order receive this.

A snapshot of recent developments

Finalised Inland Revenue items

GST Treatment of Distributions Made by a Trading Trust to a Beneficiary: IS 18/02

On 31 July 2018, Inland Revenue released a finalised Interpretation Statement IS 18/02: Goods and Services Tax – GST Treatment of Distributions Made by a Trading Trust to a Beneficiary. This Statement considers the GST treatment of distributions made by a GST-registered trading trust to a beneficiary where the distribution consists of goods forming part of the trust's taxable activity. It notes that the supply will be an associated supply, and the different timing and value of supply rules that apply to associated supplies will apply. Also considered in this statement is the issue of when supplies may trigger obligations on the trading trust to register / deregister from GST.

Effective date of GST registrations: SPS 18/03

Standard Practice Statement SPS 18/03: Effective date of GST registrations was released on 7 August 2018 and applies from 19 July 2019. Where a person is required by legislation to register for GST, registration will generally be effective from the date the person becomes liable to be registered. However where a person does not make an application to register as required, the Commissioner has discretion to make registration effective from such later date, but only under the circumstances that the Commissioner considers equitable, although this discretion is rarely applied. In the case of a voluntary registration, the Commissioner has complete discretion as to the effective date. This will usually be prospective, and in only very limited cases will the Commissioner agree that a person can be registered effective from an earlier (retrospective) date.

Options for relief from tax debt: SPS 18/04

The Commissioner has issued a finalised practice statement SPS 18/04 *Options for relief from tax debt* which sets out when the Commissioner may be able to provide assistance to taxpayers who are not able to pay on time, or if the imposition of penalties and /or interest is not appropriate. Depending on the circumstances, the Commissioner may be able to write off or remit amounts owing, or enter into instalment arrangements. This statement sets out the options that are available. This SPS replaces SPS 11/01 and SPS 15/03. SPS 18/04 will be published in the October 2018 Tax Information Bulletin. The options for relief from tax debt statement is now available on the Inland Revenue website.

Attribution Rule for Income from Personal Services: IS 18/03

This Interpretation Statement concerns the attribution rule for income from personal services in ss GB 27 to GB 29 and expands on "Attribution of Income" Tax Information Bulletin Vol 12, No 12 (December 2000): 49. The income attribution rule only applies where various threshold tests are met and no exemptions apply. The Interpretation Statement provides guidance on the application of each of those threshold tests and exemptions, to assist readers in determining **whether** the income attribution rule applies to their situation. It does not provide guidance on how to calculate the amount to be attributed. IS 18/03 will be published in the October 2018 Tax Information Bulletin, and will be available on the Inland Revenue website shortly.

Serving documents on Commissioner updated

The Taxation Review Authorities Amendment Regulations 2018 (LI 2018/127) has updated how documents are required to be served on the Commissioner in the case of:

- Objection under Part 8 of the Tax Administration Act 1994; and
- Challenges under Part 8A of the Tax Administration Act 1994.

These regulations come into force on 30 August 2018 (after having been notified in the New Zealand Gazette on 2 August 2018).

Claiming the wine equalisation tax (WET) rebate

Approved New Zealand participants of the WET rebate with an excise identification number are able to claim the rebate. This page has examples of common errors,

average Reserve Bank New Zealand rates and example statements.

Liquidation proceedings – application for interim relief

Shane Warner Builders Ltd v CIR HC Christchurch [2018] NZHC 1654, 5 July 2018

Mr Warner, the sole shareholder of Shane Warner Builders Ltd (the taxpayer company), argued that liquidation proceedings from the Commissioner should be stayed until the final disposition of judicial review proceedings that had been filed. It was contended that if the company was liquidated, it would be impossible to continue with the judicial review proceedings, ultimately rendering those proceedings worthless. The High Court declined the taxpayer's application for interim relief as it had no defence to the liquidation proceedings, no reasonable prospect of succeeding in the judicial review application and had no position to preserve that would justify the Court granting interim relief. The full decision of the High Court can be found here.

Lease surrender payment deemed to be income

Easy Park Ltd v Commissioner of Inland Revenue

The Court of Appeal has held that Inland Revenue was correct to treat lease surrender payments as revenue receipts in a ruling over the former Whitcoulls building in Wellington (now home to the flagship Glassons store). The payment at issue arose when Whitcoulls decided to leave the site, which Easy Park treated as a capital payment and therefore not taxable. The Court of Appeal unanimously decided that rent is indisputably income and that the lease surrender payment essentially had the same characteristics as the payment of rent in the hands of Easy Park. Easy Park's argument that it was capital in nature because it was part of the capital asset that Easy Park purchase when it bought the Whitcoulls building was rejected by the judges. Given that the law on treatment of lease surrender payments was changed in 2013, it is unlikely that this case will be appealed.

The full judgment can be found here.

Default income tax assessments upheld

Krasniqi v CIR

On 14 August 2018, the High Court delivered its judgment regarding an appeal of aspects of a TRA decision from 2017, broadly the correctness of default income tax assessments issued to Mr Krasniqi for the 2015 to 2011 income years. The issues under appeal included process issues under section 138G(2) and whether unexplained deposits and funds paid and applied to Mr Krasniqi's behalf were assessable to him as income under "ordinary concepts". Upon issuing the default assessments, the onus passed to Mr Krasniqi to establish on the balance of probabilities that the assessments were wrong, why they were wrong and by how much they were wrong. Mr Krasniqi failed to persuade Wylie J that the TRA was wrong in the decisions it reached and dismissed all matters of the appeal (including the Commissioner's cross-appeals).

Tax Working Group – latest release of Secretariat papers

On 6 August 2018, another series of papers was released by the Tax Working Group (TWG). These papers do not necessarily reflect the views of the TWG, the Government, or the final view of the Secretariat. The following papers were released:

- Tax Policy Report: Estimating the underreporting of income in the self-employed sector: summarises research work undertaken by Victoria University of Wellington in conjunction with Inland Revenue which estimates the underreporting of income in the self-employed sector in New Zealand.
- Government reviews that could impact the Tax Working Group: provides a brief overview of Government reviews, inquiries and policy work that could significantly intersect with the work of the TWG.
- Tax and the environment – Paper 1: Frameworks: introduces frameworks

for taxing negative externalities and taxing resource rents, and also considers the use of tax concessions and hypothecation for environmental reasons.

- Environmental tax frameworks – findings of external reviewers: summarises the findings of two external reviewers which were appointed by the TWG to review the Secretariat paper "Tax and the environment – Paper I: Frameworks."

Legislation

June Bill SOP introduced

Last week, the Government introduced a supplementary order paper (SOP) to the Taxation (Annual Rates, Modernising Tax Administration, and Remedial Matters) Bill which will:

- extend tax relief for Canterbury businesses affected by depreciation issues following the earthquakes. Specifically it extends the depreciation roll-over provisions for a further five years to the end of the 2023-24 income year; and
- amend the Goods and Services Tax Act 1985. This is discussed in an article in this edition of Tax Alert.

The press release made by Revenue Minister Stuart Nash can be found here.

Customs and Excise Act 2018 Commencement order

While the Customs and Excise Act 2018 was assented to on 29 March 2018, only a few sections came into force at that time with the rest on a date to be specified. The Customs and Excise Act Commencement Order 2018 (LI 2018/148) brings the rest of the Customs and Excise Act 2018 into force on 1 October 2018.

2018-19 Public Rulings Work Program

The work programme for the new year has now been finalised and is available on the website. There is a balance between items that were in progress last year and new items. It is pleasing to note that Inland Revenue has included on the list an item on provisional tax (some specific interpretive issues) which Deloitte suggested be added.

Follow us on Twitter
@DeloitteNZTax

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

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

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

New Zealand Directory

Auckland Private Bag 115033, Shortland Street, Ph +64 (0) 9 303 0700, Fax +64 (0) 9 303 0701
Hamilton PO Box 17, Ph +64 (0) 7 838 4800, Fax +64 (0) 7 838 4810
Rotorua PO Box 12003, Rotorua, 3045, Ph +64 (0) 7 343 1050, Fax +64 (0) 7 343 1051
Wellington PO Box 1990, Ph +64 (0) 4 472 1677, Fax +64 (0) 4 472 8023
Christchurch PO Box 248, Ph +64 (0) 3 379 7010, Fax +64 (0) 3 366 6539
Dunedin PO Box 1245, Ph +64 (0) 3 474 8630, Fax +64 (0) 3 474 8650
Queenstown PO Box 794 Ph +64 (0) 3 901 0570, Fax +64 (0) 3 901 0571
Internet address http://www.deloitte.co.nz