If you are an employer that has been using the Commissioner’s published mileage rate as a reasonable estimate of costs to reimburse employees for the use of their private vehicle, then beware, the rules have changed with effect from 1 April 2018. Essentially, the flat mileage rate has been replaced with a more complicated two-tier set of kilometre rates which potentially means a lot more compliance for employers than is currently the case.

Historically, Inland Revenue has published a mileage rate for use by a self-employed person to calculate the cost of using their private vehicle for business purposes. Inland Revenue has also accepted the use of this mileage rate as a reasonable...
estimate of costs for employers to use for the purposes of reimbursing employees for using their private vehicle for employment related use. The most recent rate was set at 73c/km for petrol & diesel vehicles, with slightly different rates for hybrids and electric vehicles. However, the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 made several small business changes to the rules in subpart DE of the Income Tax Act 2007 which applies to sole traders (and now also eligible close companies who wish to opt out of FBT) who claim tax deductions for the use of their motor vehicle for both business and private purposes. The new rules require such people to choose between using the costs method (which is based on keeping records of actual costs incurred) or a kilometre rate method which has replaced the mileage rate method from 1 April 2018. These changes also affect employers who were using the mileage rate for reimbursement purposes. Inland Revenue is required to set and publish kilometre rates, and has recently published a draft operational statement proposing a tiered rate method.

Under the kilometre rate method, there are two tiers of rates - based on the type of engine (i.e. whether petrol, diesel, hybrid or electric) and size of the engine of the motor vehicle. The first tier will apply to the first 14,000km travelled in the year (inclusive of both business and personal travel) and will represent both fixed costs and running costs. The second tier will represent only the running costs and applies to the business portion of any travel in excess of 14,000km.

Note that when the employee maintains a log book, or there is other evidence establishing the proportion of employment use for an income year, the kilometre method can be used and the tier one rates apply for the first 14,000km. However where no log book or other record is maintained, the use of the tier one rates is limited to the first 3,500km.

We have a number of concerns about how practical this new method will be for employers. Further, it is not helpful that the actual set of tier rates have not yet been released (due in late April or May), even though they will apply from 1 April 2018. The draft statement uses rates in its examples ranging from 53c to $1.03, but these are for illustrative purposes only.

While this new, more complicated system is more likely to accurately capture the costs of running a vehicle, it will also mean more compliance for employers. Currently employers can reimburse employees using the flat rate and can easily understand the tax consequences (if any). Under this new approach, employers will need to know the type of vehicle and total travel for each employee in order to determine the applicable amount of tax free reimbursement. Pragmatically we expect that employers may only offer to reimburse at the lowest available kilometre rate in order to minimise compliance costs, noting that it is currently unclear what the spread of rates will be between small and large vehicles. We understand that these rates will broadly mirror the New Zealand Automobile Association rates which are published annually, although there may be some differences.

The key message for employers who have been historically using the Commissioner's mileage rate is to consider how practical it will be to comply with the new kilometre rate method. This decision will depend on the number of employees being reimbursed and how easily the required information can be collected. It may be necessary to consider whether other alternative sources or methods may be preferable in coming up with a reasonable estimate of costs and also whether any of the company reimbursement policies (and employment agreements) need to be reviewed and updated for any changes.

If current reimbursement rates payable to employees cannot be changed, an employer will be faced with the situation where reimbursements to different employees may have differing levels of tax free and taxable components. The employer will need to decide whether to deduct PAYE from the taxable component, or to gross up the taxable component so that the employee receives the agreed reimbursement amount in the hand. This decision may be driven by the wording of employment agreements or policies.

Where there is a taxable amount included in a particular reimbursement this will need to be fed into the payroll system for reporting purposes – as many employers do not pay expense reimbursements through payroll, this adds another layer of compliance for employers and could require manual changes to each payroll.

It’s perhaps ironic that a well-intentioned small business measure aimed at simplifying dual use vehicle deduction calculations has in the process done anything but simplify matters for employers.

Submissions on this draft operational statement can be made until 30 April 2018 so if you have any comments or would like to provide input for a submission, please contact your usual Deloitte tax advisor.

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

Andrea Scatchard
Associate Director
Tel: +64 7 838 4808
Email: ascatchard@deloitte.co.nz
Inland Revenue issues the first Large Enterprises Update of 2018

By Mel Meyer & Reyah Tham

In its most recent issue of the Large Enterprises Update (Issue 42, February 2018), Inland Revenue provided an update on several transfer pricing topics. Coming off the back of pending legislative reform currently being considered by the Finance and Expenditure Select Committee, the updates provide a timely indication of the increased awareness Inland Revenue has for developments in this area.

In this article we briefly discuss the Inland Revenue’s position as indicated by the Large Enterprises Update, what this means and what steps potentially affected taxpayers should take.

Inland Revenue adopts OECD approach for services

Intercompany service charges are a common feature of a multinational’s transfer pricing arrangements, especially in the age of centralised administrative functions and shared services.

Most taxpayer financial controllers and tax specialists (especially in New Zealand and Australia) will be familiar with Inland Revenue’s administrative practice for intragroup services and the ubiquitous 7.5% mark-up on costs allowed without further support for either (1) non-core services or (2) any services with a total cost under the de minimis threshold of NZD1m.

This mark-up has been a common element going back to the introduction of the transfer pricing rules, and like many other elements of New Zealand’s aging transfer pricing regime, is about to receive a make-over.

Specifically, Inland Revenue has confirmed that it will adopt the new guidance provided by the Organisation for Economic Development and Cooperation (OECD) as part of the revised Chapter VII of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the OECD Guidelines) for the pricing of “low value adding intra-group services,” to which Inland Revenue has given the somewhat unpronounceable abbreviation of “LVAIGS”.

LVAIGS is essentially a replacement for the current “non-core services” category, which typically refers to services without a direct connection to the group’s income generating activity – i.e. support services.

LVAIGS are similar to non-core services, with the OECD specifying that they:

• Are of a supportive nature;
• Are not part of the core business of the MNE Group;
• Do not require the use, or result in the creation, of unique or valuable intangibles; and
• Do not involve the assumption of control, or result in the creation, of substantial risk by or for the service provider.

The OECD Guidelines go on to provide some examples, such as

• Accounting, finance and payroll services;
• Human resources;
• IT support;
The new approach will apply from income years starting after 1 July 2018.

**Inland Revenue comments on topical issues**

1. Guaranteed returns and risk

Inland Revenue issued a brief statement confirming its view on the relationship between guaranteed returns to an entity and its risk profile.

Specifically Inland Revenue has confirmed that the transfer pricing mechanism (i.e. a guaranteed return to the entity) cannot of itself determine the entity’s risk profile for the purposes of assessing the appropriateness of the transfer price, as this argument becomes circular. This is consistent with Inland Revenue’s established view, as well as the OECD’s position.

We recommend that all multinationals keep this in mind when determining their transfer pricing approach and preparing documentation. Any arrangement involving a guaranteed return should be supported with reference to the limited functions and risks of the entity in commercial business terms, rather than relying on the guaranteed return policy as being evidence of a limited risk profile.

2. Synergistic benefits

Inland Revenue has also provided a brief update on its considerations regarding the transfer pricing aspects of group synergies which can arise from, for example, integrated system implementation and centralised procurement.

Inland Revenue does not view synergistic benefits as intangible property, meaning that they should not give rise to royalties or other charges to a New Zealand entity. When determining the allocation of cost savings (profit enhancements) arising from synergistic benefits, Inland Revenue notes that consideration should be given to which parties actually drive these benefits, so that the allocation appropriately reflects the parties’ contributions. For centralised procurement for example, Inland Revenue would not accept that cost savings are solely attributable to the activities of the procurement entity.

Inland Revenue also notes that where synergistic benefits have a material impact on a group’s business operations, comparability adjustments may be necessary when applying a transfer pricing method in the preparation of transfer pricing documentation.

If your group has arrangements that result in group level cost reduction, now would be a good time to consider how this is reflected in your transfer prices.

If you have any questions in relation to the above topics, or need any assistance with your transfer pricing generally, please reach out to a member of our national transfer pricing team.
Don’t forget your GST entertainment expenditure adjustment

By Andrea Scatchard

In the rush to file income tax returns by the final deadline of 31 March, and working through the financial year end (if you have a March balance date), the need to make an adjustment for GST on non-deductible entertainment expenditure is easily overlooked. If your income tax return includes an adjustment for entertainment expenditure that is only 50% deductible, and you are GST registered, you will need to make an output tax adjustment in the GST return that covers the date on which you filed the income tax return. If for some reason you did not get the income tax return filed by 31 March, you still need to include the GST adjustment in the GST period covering 31 March.

The amount of the income tax adjustment is currently treated as a GST inclusive amount (even though it will actually exclude GST if your accounts are prepared on a GST exclusive basis) so the GST adjustment is calculated as follows:

\[
\text{Disallowed income tax deduction} \times \frac{3}{23} = \text{GST payable}
\]

Further points to note are that the GST payable is not an allowable deduction for income tax purposes so you should ensure you can identify this cost in your accounts when it comes to preparing your next income tax return, and the calculation method changes for GST adjustments required after 1 April 2018. From this date the income tax adjustment is deemed to be a GST exclusive amount and the adjustment will be 15% of the disallowed income tax deduction.

If you have any questions regarding the GST adjustments you are required to make, please contact your usual Deloitte tax advisor.

The GST payable is not an allowable deduction for income tax purposes so you should ensure you can identify this cost in your accounts when it comes to preparing your next income tax return, and the calculation method changes for GST adjustments required after 1 April 2018.
Changes contained in the Financial Reporting Act 2013 eliminated the requirement for many small-to-medium enterprises (SMEs) to prepare New Zealand general-purpose financial statements. From 1 April 2014 many SMEs have instead prepared financial statements in accordance with Inland Revenue minimum financial reporting requirements, or the CAANZ Special Purpose Financial Reporting Framework.

If your business currently prepares financial statements that are compliant with Inland Revenue’s minimum requirements or the CAANZ Special Purpose Financial Reporting Framework, you are required on an annual basis to determine whether you must instead prepare general-purpose financial statements.

General-purpose financial statements are financial statements that are prepared in accordance with the standards issued by the External Reporting Board. There are two tiers under which these financial statements can be prepared; the Tier 1 Accounting Requirements (NZ IFRS) or Tier 2 Accounting Requirements with reduced disclosures (NZ IFRS RDR).

Generally, your statutory financial reporting obligations will change, and general purpose financial statements required, if you become ‘large’. A New Zealand private company will be ‘large’ if the following threshold is met:

- Total assets are more than $60 million at balance date in each of the two preceding accounting periods; or
- Total revenue is more than $30 million in each of the two preceding accounting periods.

For an overseas company or a subsidiary of an overseas company, there is a lower threshold for what constitutes ‘large’. For these entities, general purpose financial statements will be required where:

- Total assets are more than $20 million at balance date in each of the two preceding accounting periods; or
- Total revenue is more than $10 million in each of the two preceding accounting periods.

Note that the above thresholds should be calculated to include the entity and its subsidiaries (if any).

Importantly, the thresholds for ‘large’ are based on total revenue and total assets calculated in accordance with NZ IFRS RDR. These may therefore not be the amounts currently reported under the Inland Revenue minimum financial reporting requirements or the CAANZ Special Purpose Financial Reporting Framework. If there are material differences it is important to understand what these are in order to have comfort that you are compliant with your financial reporting obligations.

Have your statutory financial reporting obligations changed?

By Alex Mitchell & Belinda Spreeuwenberg

Changes contained in the Financial Reporting Act 2013 eliminated the requirement for many small-to-medium enterprises (SMEs) to prepare New Zealand general-purpose financial statements.

Alex Mitchell
Partner
Tel: +64 4 470 3778
Email: alexmitchell@deloitte.co.nz

Belinda Spreeuwenberg
Senior Consultant
Tel: +64 4 470 3744
Email: bspreeuwenberg@deloitte.co.nz
It is not just changes in your business revenues/assets that could impact the assessment of whether you are ‘large’. There are several accounting standards that have been issued that may impact the recognition of revenue and assets. For example, NZ IFRS 16 Leases is effective from accounting periods beginning on or after 1 January 2019 for for-profit entities, and requires lessees to recognise a “right to use” asset and lease obligation in the statement of financial position. This could have a significant impact on your businesses total assets if you are a lessee currently reporting an operating lease.

So what does this mean for you? Simply, if your business currently prepares financial statements in accordance with the Inland Revenue minimum requirements or the CAANZ Special Purpose Financial Reporting Framework, but one of the ‘large’ thresholds has now been met for two consecutive years, on the face of it your reporting obligations will have changed.

Our team of accounting advisors can guide you through what that means in practice.

It is not just changes in your business revenues/assets that could impact the assessment of whether you are ‘large’. There are several accounting standards that have been issued that may impact the recognition of revenue and assets.
Do you have assets used for making both taxable and non-taxable supplies?

By Hana Straight

You will have seen us regularly write about complicated aspects of GST – GST is rarely as simple as 15% of supplies made or 15% of expenditure incurred. One of the more complicated areas of GST relates to claiming input tax credits when an asset is used for making GST taxable and non-taxable or exempt supplies; for example:

- A sole trader using a work car for personal use
- Apartments residentially rented above shops (where both are owned by the same person)
- Properties rented out for short term use via Airbnb (or similar sites) that were historically used for long term residential purposes
- Properties rented out for short term use only for specific periods during the year and are lived in the rest of the year
- Properties that are residentially rented while being advertised for sale
- Financial service providers
- Properties purchased for development but used for residential rental prior to the development commencing

Where an asset is used for mixed purposes it is necessary to consider whether a GST change of use adjustment is required on an annual basis (subject to the time limits discussed below). This adjustment is required to correspond with the taxpayer’s year end, so with many businesses having a 31 March year end, GST adjustments should be top of mind for the next GST return.

What is the adjustment?
Under the “change in use provisions”, in the simplest form, taxpayers claim GST based on their intended taxable use of the assets at the time they are acquired e.g. if a car will be used for 80% business purposes and 20% private purposes, 80% of the input tax can be claimed. Each year, in the GST return that aligns with the entity’s balance date, a comparison is generally required between the actual use (since the asset was acquired) and the intended use (if the assets were acquired in that year) or the prior period’s actual use. GST adjustments are then made where the taxable use of the asset varies by more than the lesser of 10 percentage points or $1,000. These adjustments can result in additional GST to claim or addition GST to pay.

The rules are comprehensive and also include special rules in relation to claiming GST where an asset has been acquired pre-GST registration and is now being used in a GST registered business, or where land was treated as zero-rated on acquisition but is now being used for non-taxable use.

While in theory these rules can sound straightforward, they can be complex, particularly where land is involved, and are often overlooked. For land there is an unlimited number of adjustment periods, and two different regimes apply depending on whether the land was purchased pre or post-April 2011.

For other assets there are limited adjustment periods depending on the value of the asset (two for assets $5,000-$10,000, five for assets $10,000-$500,000 and ten for assets over $500,000).

Given the complexity of the rules we recommend you discuss the treatment of assets with your tax advisor.

Hana Straight
Manager
Tel: +64 4 470 3859
Email: hastraight@deloitte.co.nz

Where an asset is used for mixed purposes it is necessary to consider whether a GST change of use adjustment is required on an annual basis. This adjustment is required to correspond with the taxpayer’s year end, so with many businesses having a 31 March year end, GST adjustments should be top of mind for the next GST return.
Tax Working Group – submissions are open

By Emma Marr

On 1 March 2018 the Tax Working Group (TWG) announced that it is seeking the views of as many New Zealanders as possible about the future of tax. Submissions opened immediately, and an updated website and Future Tax, the Submissions Background Paper (the Paper) was launched on 14 March to provide more assistance.

Group chair Sir Michael Cullen says now is the time for people to start thinking about what changes they would like to see to the tax system. "This won't be your regular tax consultation," Sir Michael said, "The experts will have a role to play but we're really keen to hear people's own experiences about what works and what needs improving."

The TWG's two-month consultation period will run until the end of April, with an interim report due in September 2018, and a final report in February 2019. Submissions can be sent to submissions@taxworkinggroup.govt.nz.

The Background Paper

Sir Michael Cullen also spoke about the TWG at the International Fiscal Association conference on Friday 1 March 2018. After noting that the scope of the terms of reference is being interpreted very widely, he gave an advance outline of the issues covered in the Paper, which is intended to help inform submissions. Now released, the Paper covers six topics:

- The future environment
- The purposes and principles of a good tax system
- The current New Zealand tax system
- The results of our current system
- Thinking outside our current system
- Specific challenges

The future environment

The Paper asks submitters to identify the main risks, challenges, and opportunities for the tax system over the medium-to-long term, and how the tax system should change in response to them. Challenges and opportunities identified by the TWG include changing demographics (the ageing population), the role of the Maori economy, the changing nature of work, technological change, environmental change and the impacts of globalisation.

Purposes and principles of a good tax system

This section of the Paper discusses what tax is, and the role taxes play in the wellbeing and living standards of New Zealanders. The Paper outlines Treasury's Living Standard Framework, which seeks to measure intergenerational wellbeing. The Paper discusses the concepts of distribution and equity, the efficiency of taxes, and the principle of tax incidence – who ultimately bears the cost of tax.

The current New Zealand tax system

The Paper poses the question: New Zealand’s broad-based, low rate system has been in place for over 30 years – is it still the best approach for New Zealand, or should it be replaced?

The Paper outlines how much tax is collected in New Zealand and what is taxed. New Zealand collects 90% of tax revenue from individual income, company income and GST. The role of taxes in altering behaviour, and the role taxes should play in retirement savings is also discussed.
The results of the current tax system
This section of the Paper expands on the discussion of the outcome of our current tax system, asking the following questions:

- Does the tax system strike the right balance between supporting the productive economy and the speculative economy? If it does not, what would need to change to achieve a better balance?
- Does the tax system do enough to minimise costs on business?
- Does the tax system do enough to maintain natural capital?
- Are there types of businesses benefiting from low effective tax rates because of excessive deductions, timing of deductions or non-taxation of certain types of income?

Thinking outside the current system
In this section of the Paper the TWG asks whether we should consider introducing any new taxes, and discusses taxes that other countries have, such as financial transaction taxes, wealth taxes and payroll and social security taxes. The potential role of hypothecated taxes is raised – taxes that are raised to fund specific spending objectives.

Specific challenges
The TWG’s Terms of Reference provide some specific areas for the TWG to consider:

- How and to what extent does the tax system affect housing affordability, and how should the tax system change to address that?
- Should New Zealand introduce a capital gains tax (that excludes the family home)? If so, what features should it have?
- Should New Zealand introduce a land tax (that excludes the land under the family home)? If so, what features should it have?
- What are the main opportunities for effective environmental taxation?
- Should the tax system do more to support small businesses? Is there a case for a progressive company tax?
- Should the tax system exclude some goods and services from GST? If so, what should be excluded? What else should be taxed to make up for the lost revenue?

Scope of the TWG
Some issues are specifically outside the scope of the TWG. This includes increases in the rates of income tax or GST, a capital gains tax on the family home or the land under it, and matters already under review by Inland Revenue, such as BEPS and the IRD’s Business Transformation Programme.

Further information
Any recommendations made by the TWG are expected to be fiscally neutral, and also to be capable of sustaining higher government spending if that is desired in future. Further information on the TWG can be found on the TWG website, and Sir Michael’s speech, with more detail about the terms of reference, process, timelines, the Submissions Background Paper and various fact sheets can be found here.
A snapshot of recent developments

Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Bill
On 27 March this bill had its third reading and it received Royal Assent on 29 March 2018. A further Supplementary Order Paper (No 16) was added which makes minor amendments of a technical nature to ensure the drafting of the bill as intended.

Customs and Excise Bill
The Customs and Excise Bill passed its third reading on 22 March 2018 and received Royal Assent on 29 March 2018. It replaces the Customs and Excise Act 1996. It includes measures to deal with raised standards of trade security, new free trade agreements, and the use of new forms of information and technology for passenger facilitation and risk targeting. It is aimed at making the law less prescriptive, easier to understand and apply and, in some areas, reduce unnecessary compliance costs.

Land Transport Management (Regional Fuel Tax) Amendment Bill
This bill, introduced on 22 March 2018, proposes to introduce a mechanism under which regional fuel taxes can be established to provide a way for regions to fund transport infrastructure programmes that would otherwise be delayed or not funded.

Changes to myIR going live in April
Significant changes will be made to myIR, effective from 17 April 2018, to enable more functions to be completed online. The My GST section of the IRD website will change to My Business and taxpayers will be able to file, pay and amend fringe benefit tax, gaming machine duty and portfolio investment entity returns. Further information on the changes is available here.

Inland Revenue issues paper – ring-fencing losses on residential properties
Officials have released an issues paper, Ring-fencing rental losses for comment, regarding the introduction of rules ring-fencing rental losses arising on residential properties held by speculators and investors. The paper outlines the scope and general approach of the proposed rules and is seeking feedback on some of the design aspects. Generally there are currently no restrictions on using losses from one source to reduce income from other sources. It is proposed that the rules will apply to “residential land”, they will apply on a portfolio basis, and there will be special rules to ensure that trust, company, partnership or look-through company structures cannot be used to get around the ring-fencing rules. These rules will either apply in full from the outset, or could be phased in over two or three years. Submissions for this paper will close 11 May 2018.

Commissioner of Inland Revenue v Lin [2018] NZCA 38 CA
The Court of Appeal has allowed an appeal by the Commissioner of Inland Revenue (CIR) from a High Court decision. The Court held that a New Zealand resident is not entitled to a credit against income tax liability in New Zealand for tax spared by China on income earned by companies in which the resident had an income interest. You can read our earlier article on this case here.

In May 2017, the High Court held that Ms Lin, the plaintiff, could use the full tax credits to which she was entitled to under the double tax agreement between New Zealand and China (the China DTA) to lower her income tax liability. The CIR appealed on the ground that the judge misconstrued critical provisions of the China DTA and their application to New Zealand domestic law.

The outcome of the case turned upon the proper construction of Article 23 of the China DTA and its relationship to domestic revenue legislation, in particular, the controlled foreign company regime in the Income Tax Act 2007 and earlier versions of that legislation.

Public ruling and QWBA on school donations
The Commissioner has issued a draft public ruling and QWBA for consultation regarding donations to state and state-integrated schools. Draft public ruling PUB00298 discusses which payments made by parents to state and state-integrated schools are subject to GST. 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 the education services if the student has a statutory entitlement to receive those education services for free. This ruling is a reissue of BR Pub 14/06 and is substantially the same, but has been rewritten to improve readability and incorporate legislative changes.

The two QWBAs in PUB00288 explain when a payment to a school will qualify as a gift, so that a school is able to issue a donation tax receipt to the parent. As a summary, a payment will be a gift where it is voluntary, does good for the school in some way, and where the parent does not expect to obtain a material benefit or advantage for making the payment. The guidance is accompanied with easy-to-apply examples of situations that do and don’t qualify for a tax credit.

Revenue Alert RA 18/01: Dividend stripping

The CIR has issued a Revenue Alert to provide information about an emerging tax planning issue that is of concern to Inland Revenue. Specifically this concerns the sales of shares to related entities in situations where IR consider the sales proceeds are a dividend under the general tax avoidance rule in section BG 1 or the specific dividend stripping rule in section GB 1.

ED0202: Non-disclosure right for tax advice documents

The draft operational statement ED0202 has been issued for comment to replace SPS 05/07 with regard to the process that the CIR will follow when an information demand is made and the taxpayer has a right to claim non-disclosure of a tax advice document pursuant to sections 20B to 20G of the Tax Administration Act 1994. The draft incorporates amendments to the legislation and other principles established in cases (namely Blakeley v C of IR (2008) 23 NZTC 21,865) since SPS 05/07 was released in 2007. Submissions close 11 May 2018.

IRD releases guidance on cryptocurrency

Inland Revenue has, on 3 April 2018, confirmed that cryptocurrencies are to be treated like property for tax purposes. This means that generally any gains made on selling cryptocurrency are expected to be taxable. Inland Revenue has released a media statement and a set of Questions and Answers addressing a range of tax issues relating to cryptocurrencies.