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Tax Alert
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What's on the Tax Policy Work Programme?

By Robyn Walker

In early August the Government released its updated tax policy work programme ("work programme"). This was significant as it was the first real signpost after the release of the Government's response to the Tax Working Group report as to where the Government's tax priorities sit.

The work programme suggests that it will continue to be a busy time for tax policy, with 11 key areas of priority. The work programme is slightly different from previous versions, in that in many instances items are merely suggested as items which could *possibly* be included within a tax package, rather than a more committed stance to review something. That said, the work programme is always a list that can never be achieved within an eighteen month timeframe. An item being on the work programme has never been a guarantee of it happening.

What are the work streams?

1. **Land** – following the outcome of the Tax Working Group process and in particular the abandonment of a capital gains tax, refinements to deal with the taxation of land were always going to be on the agenda. The work programme confirms that the land rules will be reviewed, particularly in relation to investment property and speculators, land banking and vacant land. There are a number of initiatives specifically highlighted which could be looked at in both the short and longer term, including looking at the deductibility of holding costs of land, reviewing exemptions from the rules to deal with habitual renovators, improving information flows to facilitate compliance with the existing land tax rules and considering whether the existing rules are creating inefficient "lock-in effects".

2. **Business** – enhancing economic performance and minimising the impact of the tax system on businesses are stated as being priorities for the Government. The work programme for businesses applies two lenses, a general business and a small business lens (albeit tax changes for either could apply to both). The work programme simply lists "examples of items that could be considered for inclusion" for business and small business, so it is far from clear what might be progressed. However, those that get a mention for businesses generally are:

   - Seismic strengthening
   - Loss carry forward rules and trading when ownership changes
   - Tax treatment of innovative spending (feasibility and blackhole expenditure)
   - Research and development
   - Purchase price allocation
   - Cross-border employment
   - Financial arrangement issues; and
   - Other integrity issues

   For small business, the following are listed:

   - Closely-held company issues
   - Compliance and enforcement issues
   - Simplifying Fringe Benefit Tax (FBT)
   - Tax disputes for small taxpayers
   - Tax compliance for self-employed
   - Considering issues around the sharing economy/platforms
   - Options for assisting businesses to become more digital; and
   - A review of the Accounting Income Method (AIM)

3. **Infrastructure** – this project will consider whether the tax system should have a role in driving infrastructure investment and will consider a recommendation of the Tax Working Group to develop a tax regime that encourages investment into nationally-significant infrastructure projects.

4. **Information collection and use** – better information can contribute significantly to the integrity and fairness of the tax system. This work stream will consider the overall data strategy; information sharing; automatic exchange of information; repeat collection of large datasets; and the collection and public release of information to support policy advice, evaluation and public debate on policy issues.

5. **Business transformation** – we are part way through the transformation of Inland Revenue's systems and work will continue to complete this process. Some further work could be undertaken on items which can be better handled by the new system, such as a review of the Prescribed Investor Rate (PIR); the taxation of lump sum payments (e.g. ACC compensation); and changes to withholding taxes to minimise over/under withholding.

6. **Reforms and remedials** – this work stream is an essential part of the tax system. It represents the tidy up work which is sometimes required when there are legislative errors or unintended consequences. This work programme item could include a GST remedial issues paper; Base Erosion and Profit Shifting (BEPS) remedials; and other general maintenance work.

7. **Social policy including Government response to Welfare Overhaul** – Inland Revenue will continue to work closely with Officials at the Ministry of Social Development (MSD) and other agencies on the Government response to the welfare overhaul. This work will touch on Working for Families, child support, student loans, and KiwiSaver.

8. **Environment / sustainable economy** – this will include cross-agency work on areas such as the Emissions Trading Scheme (ETS), water quality, waste disposal levies and congestion charging, all of which are less traditional "tax" areas for Inland Revenue to be involved with. From a more traditional tax standpoint there will be consideration of how specific tax regimes, like FBT, might achieve positive environmental outcomes (e.g. promoting public transport), and regimes which may impact on natural capital may come under the microscope (petroleum mining is singled out as the first regime to undergo review).

9. **Charities** – before the end of 2019 there will be a report to Ministers to address some of the Tax Working Group's recommendations for charities (including a review to ensure that intended social outcomes are being achieved). At the same time the Department of Internal Affairs (DIA) has undertaken a review of the Charities Act and the Government's response to that review will also influence what work is undertaken for tax purposes. Potential issues which will be looked at include accumulation; business activity for significant charities; GST and not-for-profits; imputation credit refundability; and rules for donating trading stock.

10. **Tax exemptions** – this is the development of a coherent framework for determining when an entity should be eligible for an income tax exemption. The purpose of this review is to provide more consistency.

11. **International** – we will see New Zealand continuing to support multilateral work being undertaken at the OECD, as well as considering further changes to New Zealand's tax rules to address BEPS issues. This work stream also includes double tax agreement (DTA) negotiations and assisting with free trade agreements.

What next?

At the same time as the work programme was released, also released was a "Tax and Social Policy Engagement Framework" ("engagement framework") which governs how engagement will be undertaken on tax policy issues delivered by Inland Revenue. The engagement framework represents a move away from how tax policy consultation has been traditionally undertaken (e.g. large detailed discussion documents), to a more agile approach where there may be earlier and more frequent engagement and a greater variety of engagement methods used with a greater range of stakeholders. The engagement framework should see a flow of information back to submitters, allowing them to understand whether any changes have been made as a result of their submissions and why or why not.

The engagement framework represents a step in the right direction in ensuring that everyone has the ability to contribute thoughts to the design of tax policy in New Zealand.

As noted above, the work programme is very full and requires prioritisation. We will see some things progress quickly and some may continue to sit waiting to be picked up (a number of potential work programme items are carried forward from previous work programmes). At this stage there has not been any further signalling as to what will happen when, so we will all have to wait and see what happens. If you have a passion for seeing something on the work programme progress, then consider ways to make you opinions known, such as contacting the Government. For more information please contact your usual Deloitte advisor.

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A stick and carrot approach: FATCA, CRS and QI update

By Troy Andrews & Vinay Mahant

The world of operational taxes has expanded in recent years, for better and worse, with the advent of the US FATCA and OECD CRS. Though these initiatives have a shared goal of promoting tax compliance, the price paid by 'Financial Institutions' and tax authorities around the world to comply with the strict due diligence, reporting requirements and policing adherence has been an enormous task. In this month's article we highlight the application of FATCA and CRS to NZ trusts, an update on Inland Revenue's approach to audits of FATCA and CRS compliance (what stick will they use?) and the benefits (or carrot) of acting as a Qualified Intermediary. New Zealand is also looking at introducing new specific custodian rules which we touch on.

New Zealand trust problems

FATCA and CRS have been in effect for some time now. Broadly, these regimes aim to improve cross-border tax compliance and promote the global automatic exchange of information by requiring entities that are 'Financial Institutions' to conduct due diligence on their account holder base and report certain information about their US / non-resident accounts to relevant tax authorities. A common issue we have seen is applying FATCA and CRS to NZ trusts.

It is important to understand that the term Financial Institution covers legal arrangements such as trusts and partnerships and does not only encompass the 'traditional' definition of Financial Institution (i.e. not only banks and custodians).

Many NZ trusts would not fall within the definition of Financial Institution because they are not in the business of investing money on behalf of customers. However, under FATCA and CRS a trust may be deemed to be a Financial Institution by virtue of being managed by an entity that is one.

This is a common issue we see in practice as many NZ family trusts could be caught where they have investments in financial assets (e.g. shares and bank deposits) and have a discretionary investment management service (DIMS) provider (such as a wealth advisor / or Bank) that has discretion over its investments.

Inland Revenue has also issued specific guidance that a corporate trustee can also be a Financial Institution (and potentially deem the Trust to also be caught). This is an area where many have not yet turned their minds. From our correspondence with Inland Revenue, their emphasis remains on promoting education of the market in terms of understanding their compliance requirements, however they have begun to carry out a range of basic compliance review activities including following up any parties that they consider should have registered for FATCA/CRS but have failed to do so.

Given the closer Inland Revenue scrutiny and road ahead in terms of FATCA/CRS audits (see further below), you should carefully consider how confident you are with your position on these regimes.

We have come across situations where entities have not registered for FATCA on the assumption that it is only applicable if you have 'US' account holders – this is a false assumption. Entities need to consider their obligations under FATCA regardless of the fact that they may not have any US account holders. That is, you are still required to register for a FATCA Global Intermediary Identification Number (GIIN) with the Inland Revenue Service (IRS) and conduct the necessary due diligence procedures even if you don't have any US customers. Failure to register when you should has financial penalty consequences.

Many in the market are having issues completing FATCA/CRS self-certification forms (including US W-8 forms for FATCA). These forms are quite comprehensive and often require specialist tax advice to complete. This includes understanding your status as a Financial Institution or type of Non-Financial Institution, determining the account holders of a NZ trust and who may need to be disclosed as a 'controlling person'.

We have also experienced issues with NZ trusts with investments in the US seeking to claim US treaty benefits. In this context it is important to understand what a NZ trust's status is under US tax principles, i.e. if it is seen as a grantor (flow-through) or complex trust (opaque). This distinction can be difficult to apply in practice but is fundamental to completing the right documentation.

FATCA/CRS audits on the horizon

The success of FATCA and CRS in terms of meeting their goals of achieving better tax compliance will be largely driven by how effectively and consistently they are implemented across the world.

Inland Revenue has made it clear that the OECD will rigorously monitor compliance with CRS. As noted above, Inland Revenue has already commenced conducting basic compliance activities in respect to CRS. From our recent correspondence with Inland Revenue, we understand that the level and degree of their activities will increase over the next year with the frequency and intensity being based on risk assessments undertaken. These will include a mix of tailored questionnaires, desk-based reviews and on-site audits.

The shape of Inland Revenue's final audit programme will also depend on the OECD's recommended approach. Inland Revenue will provide more details on its approach following the OECD Global Forum's final recommendations.

In light of this, Financial Institutions should be reviewing their existing approach and testing this in line with best practices. This would include, amongst other things, having a centralised document covering policies and procedures, reviewing the process and review of self-certifications and client on-boarding and systems mapping to cover things such as changes in circumstances.

We are increasingly helping Financial Institutions understand their key risk areas by conducting 'healthcheck' reviews to help identify and remediate issues in advance of expected Inland Revenue audit activity. This is a clear signal that FATCA/CRS compliance has matured into its normal state as part of 'business as usual' rather than being project based.

The new challenge for Financial Institutions will be to expand their internal risk and governance functions to also help monitor their ongoing compliance.

The US Qualified Intermediary (QI) regime

Where FATCA aims to promote tax compliance of US citizens/residents with offshore assets, the QI regime is directed towards tax compliance of non-US persons receiving US sourced income (e.g. dividends and interest income from the US). Some could see it as a "carrot" for operational tax compliance rather than the "stick" of FATCA and CRS compliance.

A 'Qualified Intermediary' is an entity that acts as agent for another person such as a custodian, broker or nominee. A non-US intermediary may enter into an agreement with the US IRS to obtain 'QI status' whereby US custodians are able to rely on the QI's certification of its underlying client's identity and tax residency status for the purpose of applying the correct double tax treaty rates. QI status is seen as a 'privilege' by the IRS as it is essentially relying on the QI's documentation of its underlying clients (e.g. QI validating US tax forms such as the W-8BEN and W-8BEN-E). Many US withholding agents are also now requiring non-US persons to invest in the US through QIs for compliance purposes.

A 'big stick' that was hanging over the industry was that any accounts that were not 'documented' by a US custodian would suffer a 30% withholding tax on gross proceeds as a penalty / incentive for getting the underlying beneficial owner documented. In what was seen as a positive development for financial institutions, the US announced in December 2018 that this requirement was to be eliminated.

We have summarised some of the key benefits of becoming a QI:

1. You are able to provide your clients with reduced US withholding while at the same time not having to disclose confidential client information to upstream US custodians or the IRS.
2. Collective refund procedures for over withholding.
3. Simplified documentation process. A QI is able to document its account holders using 'documentary evidence' (that is already collected for AML) such as a NZ passport instead of complex US tax forms (e.g. W-8BEN-E).
4. Customers should receive a more efficient service in terms of quicker income reporting.
5. Streamlined administration of US withholding tax and information reporting.
6. A competitive advantage to expand business to a wider pool of customers that seek investments in the US through a QI.

The above highlights the significant benefits of acting as a QI for your customers. As with FATCA, there are compliance requirements to become a QI such as having policies and procedures and income reporting obligations. A further layer of compliance involves having to have an independent periodic review conducted every 3 years to certify compliance with the IRS.

Inland Revenue policy developments for custodians

Inland Revenue has recently released a consultation document on policy developments in relation to investment income withholding and reporting requirements for intermediary entities that provide investment products.

The proposals largely aim to provide flexibility / clarity in terms of the withholding and income reporting rules in the context of custodial institutions. Some examples of the changes proposed include, allowing payers and custodians to determine themselves which entity is best placed to carry out withholding and establishing a mechanism similar to the US QI regime for NZ custodians that pay income offshore at an aggregated level.

Please contact us if you would like to discuss any of the above in further detail.

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Customs is also interested in your transfer pricing

By Bart de Gouw and Jeanne Du Buisson

Importers who find they need to change the value of goods after importation can be subject to fines and penalties on underpaid GST and customs duty. Where goods are imported from an associated party (like a parent company or a subsidiary), the value may have to change later due to the transfer pricing rules. This might mean a different amount of GST or customs duty is payable. From 1 October 2018 some importers have been able to use the provisional value scheme to avoid penalties and interest on these adjustments.

What is transfer pricing?

Transfer pricing is the process of setting prices for the transfer of goods, services, money or intangibles with associated parties in different tax jurisdictions.

How are transfer pricing and custom duties interlinked?

For customs purposes, the transfer price between associated enterprises of goods and certain "add-ons" such as royalties can have a direct impact on determining the customs value and import GST. For goods imported by associated enterprises, due to the special relationship, the transaction value of goods imported may differ from the value of similar goods due to competing incentives. The lower the transfer price, the lower the customs value and import GST. Custom duties and to a certain extent import GST can be a toll on a company's profits and competitiveness.

However, there is no convergence between the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing methods and the methods contained in the World Customs Organisation Valuation Agreement. This can lead to potential difficulties for importers.

Customs and Excise Act 2018

The provisions in the Customs and Excise Act 2018 (the Act) came into effect on 1 October 2018. The 1996 Act had become out of step with modern business practices. One of the changes made in the Act relates to importers who cannot determine the value of imported goods at the time of importation or know that the Customs value is likely to change after importation. The Act allows for registered importers to use a Provisional Customs Value in an entry for imported goods.

Importers need to determine if the provisional value scheme is appropriate for their circumstances. If it is, importers need to determine if they automatically qualify and only need to notify NZ Customs, or whether the importer needs to apply in order to use the scheme. Without applying the provisional value scheme, under the new Act, adjustments post importation would be subjected to compensatory interest on the GST and duty shortfall and late payment penalties may also arise.

The Act specifies three instances when importers can automatically qualify to use provisional values. These are:

1. If there is transfer pricing that is governed by an Advance Pricing Agreement; or
2. If the importer pays royalties and licence fees in respect of the imported goods; or
3. The importer pays 'further proceeds' to another party.

If you use the provisional value scheme, you must provide Customs with a final value within 12 months **after** the end of the financial year in which your provisional values were made. For example, if you have a year end of 31 March 2019, you have up to 31 March 2020 to declare your final Customs value for all of your import made for that income year and the duty balance is then paid or refunded and no compensatory interest charged on the difference between provisional duty and the final duty.

What does it mean if you do not qualify automatically?

You can apply and if your application is approved, you may still use provisional values to determine your Customs value of the imported goods.

The Act has led to a much greater collaboration between Customs and the transfer pricing team at Inland Revenue in order to conform compliance with both regimes.

It's never too late...

If you have a transfer pricing arrangement that involves the supply and acquisition of goods, (i.e. the supplier is your associated party and is a cross-border arrangement for the importation of goods), then you should consider the provisional value scheme, it is not too late to apply.

You need documentation to support that the transfer pricing method applied to establish how your provisional value will be determined and why the final value at the time of importation is not available.

Our Transfer Pricing and Customs teams at Deloitte have experience with registration and implementation for a range of importers and are able to advise on specific requirements.

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Taxing telecommunication tools

By Robyn Walker and Evie Storey

Anyone who has been involved in tax for a reasonable time period has probably heard of the "50% rule of thumb" when it comes to taxing phones. The rule of thumb was first established many years ago in the days of home phone lines, and possibly before the proliferation of the internet and the mobile culture that we now have. In an attempt to bring Inland Revenue guidance into the modern era, they have released a draft determination that provides new rules for the taxation of certain telecommunication payments. Rather than the 50% rule of thumb, there is now three new rules proposed - 25% and 75% and a de minimis rule.

"*Employee use of telecommunication tools and usage plans in their employment*" ("draft determination") was released on 9 August 2019 and submissions close on 20 September 2019. It applies to arrangements where employees use their own communication tools and/ or usage plans in their employment (sometimes called a "bring your own device" or "BYOD" arrangement).

The draft determination splits the tax treatment of these allowances or reimbursements into three classes:

It is worth noting that once finalised the draft determination will be *optional* for employers and employees to follow, if either has evidence to support a different apportionment in particular circumstance.

Class A – telecommunications tools are principally used in employment

Class A covers circumstances where an employer arranges with the employee for the employee to provide their own tools and / or usage plans, and:

1. The employee incurs the cost of the tools and / or usage plan and is reimbursed; or

2. If the employee is reimbursed, an estimate amount or allowance represents a reasonable estimate of the likely expenditure to be incurred by the employee; and

3. The telecommunications tools and / or usage plan are *principally* used by the employee in their employment, and the employee also uses the tools and / or usage plan for private use.

In these circumstances, employers can treat 75% of the amount paid as exempt income for the employee. The extent to which the payment is taxable is 25%. If the employer pays only 75% of the employees' costs as an allowance or reimbursement, then the total amount is exempt. When determining the employees' costs this can include an amount of depreciation on the relevant devices used by the employee. Any depreciation is calculated using the Commissioner's rates for the items.

Determining that the telecommunications tools are principally used in employment can be done in a number of ways with differing levels of associated compliance costs:

1. Measuring the time of use or amount of data used (in many cases it may be clear that business use amounts to the principal or leading use);

2. In lieu of monitoring usage, an employer may obtain a signed declaration from the employee that the tools will be principally used for employment; or

3. Establishing the importance of the employee having access to the tools (for example they need to be available at all times for calls).

Class	Description	Tax treatment
Class A	Telecommunications tools are principally used in employment	75% of the payment by the employer can be tax exempt, or if the employer only pays 75% of costs the full amount is exempt
Class B	Arrangements where telecommunications tools are required, but not principally used for employment	25% of the payment by the employer can be tax exempt, or if the employer only pays 25% of the costs the full amount is exempt
A De Minimis Class	Business tools are used partially for business and an allowance or reimbursement of no more than $5 per week is paid to per employee	The $5 per week is tax exempt

The draft determination notes that employers are expected, at a minimum, to have a record of the usage plan or agreement entered into by the employee. The rationale for requiring this level of detail is not explained.

The draft determination envisages a level of judgment being applied. There is also some pragmatism in play, in particular if an employer is paying a regular fixed amount Inland Revenue will be satisfied that the full amount paid will be tax exempt if the employee provides a declaration that their costs are at least 1.33 times the amount of the allowance. For example, a $75 per month allowance is paid and the employee has a plan costing $100 per month.

Class B – arrangements where telecommunications tools are required, but not principally used for employment

Class B covers situations similar to Class A, the difference being that rather than the telecommunications tools and usage plans being *principally* used by the employee in their employment, the employee is required to use telecommunications tools and usage plan in their employment based on a business reason but primarily uses these tools for *private use*.

In these circumstances, employers can treat 25% of the amount paid as exempt income of the employee. The extent to which the payment is taxable is 75%. If the employer pays 25% of the costs of the employee, then the whole amount paid is exempt.

An established employment policy related to the use of the tools is sufficient to establish that the employee was obligated to use the tools for an employment reason.

As with Class A arrangements, if an employer obtains a declaration from an employee that the employees' costs are at least four times the amount of the allowance the whole amount can be treated as tax exempt. For example, an allowance of $25 is paid and the employee has a plan costing $100 per month.

De Minimis Class

The De Minimis Class covers the same situations as Class B. However, to the extent that the reimbursement or allowance payments are no more than $5 per week per employee, amounting to no more than $265 per year, the payments can be treated as exempt income of the employee. It is not necessary to support this de minimis level of reimbursement or allowance with records.

Our view

The 50% rule of thumb was successful because of its simplicity, but these new proposed rules are also relatively simple to understand. Where the real issue will arise with these proposals is the ability of employers to be able to obtain and maintain the necessary documentation in order to support a classification of an allowance or reimbursement as either Class A or Class B. It won't be a simple one size fits all employees either, so there are likely to be compliance costs for employers.

We question the need for employers to know details of employees' usage plans, particularly where some employees may be using a prepay system and may be able to dial up and down the amount they are spending on phone calls or mobile data on a monthly basis. The ability for the employees to provide a declaration of the 1.33 or 4 times cost level represents a more pragmatic outcome, however obtaining these on a regular basis may be a compliance headache especially for large employers.

So overall, the draft determination may provide better outcomes for some employees, who may now receive a greater amount of exempt rather than taxable income, but employers may be facing additional compliance costs. Submissions can still be made on the draft determination until 20 September 2019, if you think the compliance costs will be too high under this determination then have your say.

Now may also represent a good time to consider your approach to communication tools and allowances. It is worth noting that the draft determination does not apply to situations where an employer provides the communication and usage plan; in those instances Fringe Benefit Tax (FBT) and in particular the business tools exemption from FBT may apply to ensure no tax is payable.

If you would like to discuss your existing employee allowances and reimbursements please contact your usual Deloitte advisor.

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Mileage reimbursements revisited – again!

By Andrea Scatchard

Readers will recall that about this time last year Inland Revenue finalised its statement on mileage reimbursements for employees, implementing the new two tier mileage rate methodology. This was covered in our August 2019 Tax Alert. To summarise the new two tier methodology, the Tier 1 rate includes an allowance for the fixed costs of the vehicle, and can be used for the first 3,500km of reimbursement to an employee (if no logbook records are maintained), or for the business portion of the first 14,000km of total travel by the employee (if a logbook is maintained). The relevant Tier 2 rate, which only covers the variable costs of running the vehicle, must be applied to all reimbursements beyond this in an income year.

Since the publication of the statement last year, advisers and employers have been struggling with the practicalities of the statement and its application. Further submissions to Inland Revenue officials have resulted in Operational Statement OS 19/04b being issued in August 2019. This statement provides a method acceptable to Inland Revenue of calculating tax free reimbursements, and attempts to provide employers with a more practical approach to calculating reimbursements to employees who travel significant levels of business miles in their personal vehicles.

Firstly, the statement confirms the new rates that apply from 30 May 2019. These have all been increased, albeit slightly, with the exception of the Tier 2 rate for electric vehicles which has remained the same. The full rates are reproduced below, and can be used now by employers.

Secondly, the perspective of the examples in the Operational Statement has been changed. These are now aimed at a reimbursement for a specific business trip undertaken by an employee, whereas before they were looking at reimbursements from an annual perspective. While this is useful in the context of understanding the tax on a specific reimbursement payment, it does not provide a solution to the heavy compliance costs that will be faced by any employers whose employees undertake large amounts of business travel in their own vehicles.

We would have liked to see Inland Revenue take a more practical approach and endorse a methodology by which employers could use log book data to extrapolate annual total mileage, allowing an annual blended tax free reimbursement rate to be calculated for the year for each affected employee.

In our view this would allow employers to apply a fixed tax free amount for all reimbursements made to an employee during an income year, so that complicated changes to the PAYE treatment of reimbursements, or to the level of per kilometre reimbursement payment made, are not required part way through the year. Inland Revenue's concern is that this may allow the fixed costs (which are factored into the Tier 1 rates only) to be over-represented in the total reimbursement. Ultimately though, in our view provided the reimbursements made by employers are a reasonable estimate of the fixed and variable costs incurred by an employee then the reimbursement should be able to be made tax free. Operational Statement OS 19/04b is simply one acceptable method to calculate those costs, this does not mean that other methods cannot be used provided they can be demonstrated to be reasonable.

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

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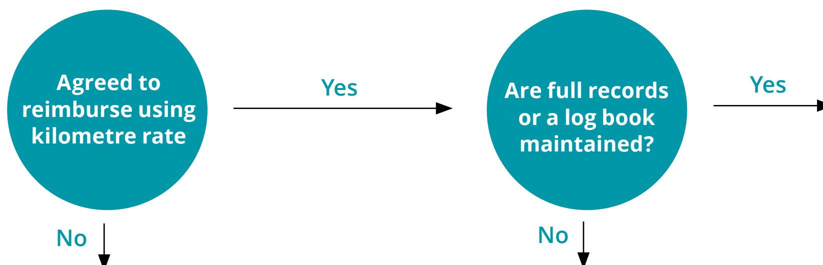

Use Tier 1 for first 14,000 total kilometres and Tier Two rates after that.

Tier 2 rates are based on vehicle type.

Reimbursements should be based on the cost method or some other appropriate method.

Reimbursements must be supported by evidence.

Use Tier 1 rate for first 3,500 business kilometres and Tier 2 rates after that.

Tier 2 rates are based on vehicle type.

2019/20 kilometre rates

Vehicle type	Tier 1 rate	Tier 2 rate
Petrol or Diesel	79 cents	30 cents
Petrol Hybrid		19 cents
Electric		9 cents

Follow the rules when deducting bad debts

By Emma Marr

A decision of the Court of Appeal has highlighted the detailed and prescriptive rules that allow deductions for bad debts. In that case a lawyer loaned money to his clients. When two clients did not pay the debt back, he took a deduction for the full amount of the debt. The Commissioner challenged this and won in the Taxation Review Authority (**TRA**), High Court, and Court of Appeal (Hong v Commissioner of Inland Revenue [2019] NZCA 336).

The Court of Appeal considered whether the High Court had correctly upheld the judgement of the TRA on three key issues, discussed below.

1. Was the taxpayer entitled to claim the deductions for bad debts in his 2011 tax return?

The Court found he was not.

Under s. DB 31 a taxpayer cannot deduct a bad debt unless:

- the loan has been written off in the income year; or
- the debtor has been released from making any payments by legislation (due to insolvency or bankruptcy); and
- where the debt is a financial arrangement, the lender is carrying on a business of dealing in or holding financial arrangements that are the same as, or similar to, the relevant bad debts.

The taxpayer failed to meet any of the requirements.

First, the Court found he had not written the loans off in the relevant year. Rather, the Court accepted evidence that he had created all relevant documents for filing the 2006-2012 income tax returns at the same time, and that was after the end of the 2011 income year.

Second, the debtors hadn't been released from making payments under the loans, neither having been declared insolvent or bankrupt.

Finally, the Court found that the taxpayer was not in the business of lending money. There was conflicting evidence from the taxpayer about the nature of his lending arrangements, and in particular whether it was a charitable activity or whether it was a commercial lending operation. The taxpayer was in the difficult position of both arguing that he intended to make money from the loans, but also arguing that he wasn't breaching the requirement that, as a lawyer, he did not have a conflict of interest in relation to his clients. On reviewing the facts, the Court found that the taxpayer did not have a commercial lending operation and was not in the business of advancing loans.

2. Did the section allowing a deduction for bad debts (s. DB 31 of the Income Tax Act 2007) override the general permission for deductions for business costs in section DA 1?

The Court confirmed that s DB 31 overrides the general permission.

The taxpayer attempted to argue that, whatever s. DB 31 said, he could still take a deduction for the bad debts under s. DA 1, which is the general permission for deductions: it allows a deduction for expenditure that is incurred in deriving assessable income or carrying on a business to derive assessable income. However, the legislation is clear that s. DB 31 overrides s DA 1. Section DA 3 states that any provision in subparts DB to DZ can override DA 1 if they expressly say they do. DA 31(6)(a) expressly says that s. DB 31(1) overrides s. DA 1.

3. Was the taxpayer liable for a shortfall penalty for failure to take reasonable care?

Unsurprisingly, the Court confirmed he was liable for the penalty.

Again, there was conflicting evidence about the lengths to which the taxpayer had gone to determine the correct tax treatment of the bad debts. He told the Court he had researched the legislation and relevant case law, but there was evidence he had previously told Inland Revenue he had not understood the tax law and had asked them to help him research it. The Court found that he had not done what a reasonable person in his circumstances would have done. This included taking steps to understand a complex area of law, keeping adequate records to substantiate the deductions, and filing returns and paying tax on time.

This case highlights the specific and unyielding nature of tax legislation. In this case, the failures to meet those requirements are quite stark given the prescriptive nature of the law. If you have any questions about this decision or deducting bad debts in general, contact your usual Deloitte advisor.

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Snapshot of Recent Developments: September Tax Alert

New UOMI rates now applying

A reminder that the new UOMI rates started to apply from 29 August 2019. The rate charged on underpaid tax increased from 8.22% to 8.35%, while the rate for overpayments of tax decreased from 1.02 to 0.81%.

Trusts Bill receives Royal Assent

On 30 July 2019, the Trusts Bill received Royal Assent. The Trusts Act 2019 is now available on NZ Legislation's website. Broadly, the Act will come into force on 31 January 2021 (18 months after the date of Royal Assent). The transition period is to allow trustees to review their existing trusts and deeds before the Act comes into force.

Swiss DTA updated

On 8 August 2019, New Zealand and Switzerland signed a protocol which will update the double tax agreement between the two countries. The main purpose is to include model treaty provisions to prevent tax treaty abuse and improve dispute resolution as recommended by the OECD and G20. The amended agreement will come into force once both countries have introduced the necessary domestic legislation.

Special report on GST on low-value imported goods

On 15 August 2019, a special report on the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 was released to provide early information on the new rules applying to "distantly taxable" goods supplied to consumers in New Zealand from 1 December 2019. Non-resident suppliers will be able to apply to be registered from 1 September 2019, with the registration taking effect from 1 December 2019. The registration form and information about registering for GST will be located on the Inland Revenue website. For general enquiries, or to apply for the Commissioner of Inland Revenue (the Commissioner) to exercise various discretions included in the rules, an email has been provided info.lvg@ird.govt.nz.

Further measures to be added to the KiwiSaver Bill

On 13 August 2019, Supplementary Order Paper (SOP) No 293 was introduced in order to add further measures to the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill. The SOP proposes further changes to the KiwiSaver Act 2006 to create a new withdrawal category to allow a person with a life-shortening congenital condition to withdraw their savings early. A member would be able to apply for a withdrawal under this new category if they have medical evidence to verify that they have a condition that is listed in regulations. Alternatively, they would be able to apply if they have medical evidence to verify that they have a condition that is a life-shortening congenital condition.

On 23 August 2019, Revenue Minister Stuart Nash announced an intention to introduce a legislative amendment to ensure that payments received by a land owner from the grant of a land right (such as a licence or a limited term easement) continue to be taxable. These changes will also be made by way of an SOP yet to be introduced.

Finalised Inland Revenue Items:

Income tax - employer issued crypto-assets provided to an employee – BR Pub 19/03

On 30 July 2019, Inland Revenue released the finalised public ruling, BR Pub 19/03: Income tax - employer issued crypto-assets provided to an employee. It considers how FBT applies where cryptocurrency issued by an employer is provided to an employee. In particular, it covers the situation where the crypto-assets are subject to conditions that the employee must satisfy to become entitled to the crypto-assets.

Commissioner's statements on using a kilometre rate - OS 19/04a and OS 19/04b

On 22 August 2019, Inland Revenue released two operational statements, OS 19/04a: Commissioner's statement on using a kilometre rate for business running of a motor vehicle – deductions where a person intends to claim an expense deduction for a motor vehicle that is used

partly for business purposes and partly for non-taxable purposes; and OS 19/04b: Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle which explains the acceptable method to establish the tax-exempt portion of an amount paid to an employee as reimbursement of expenditure incurred by that employee where the employee uses their private motor vehicle in the employer's business. These statements have also been updated with the recently announced kilometre rate figures. Refer to our Tax alert article on mileage reimbursements.

Tax depreciation rate for lay-flat hoses – General Determination DEP104

On 19 August 2019, the finalised depreciation determination General Determination DEP104: Tax depreciation rate for lay-flat hoses was released by the Inland Revenue. "Lay-flat hoses" was added into the "Hire Equipment" asset categories and has a 3-year estimated useful life. The diminishing value depreciation rate for lay-flat hoses is 67% and straight-line depreciation rate is 67%. DEP104 applies for the 2018/19 and subsequent income years.

Finalised Public Guidance work programme 2019-20

The new 2019-20 Public Rulings work programme of the Office of the Chief Tax Counsel has been finalised. This work program sets out guidance (e.g. rulings, questions we've been asked, operational statements etc) that Inland Revenue will produce over the coming year. The new programme contains items rolled over from the previous programme as well as some new items. This will be updated monthly.

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