Connecting you to the topical tax issues

Tax Alert

December 2019

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Inland Revenue: "No place to hide overseas income"

By Stephen Walker and Nick Cooke

In September 2018, Inland Revenue received its first wave of information under the OECD's Automatic Exchange of Information (AEOI) framework from 66 different overseas tax authorities. Inland Revenue is now in the process of following up on this information and has started contacting taxpayers giving them the opportunity to provide an explanation or to submit a voluntary disclosure. According to an article recently published by Inland Revenue, the AEOI is "proving a potent tool in the fight against tax evasion."

What is AEOI?

Under the AEOI, participating jurisdictions collect and exchange financial account information concerning residents who invest or maintain assets in a country other than the one in which they are tax resident. The "Common Reporting Standard" (CRS) is, broadly, a set of guidelines that provides the technical detail of how the information is collected and exchanged. As of August 2017, 102 jurisdictions around the world (including New Zealand) had committed to exchanging information under the CRS via the AEOI framework.

Inland Revenue's initial approach

In September 2019, armed with the information received from overseas tax authorities over the previous year, Inland

Revenue sent letters to the first group of taxpayers identified as having overseas accounts. These letters gave a brief background to the AEOI and requested that taxpayers confirm their tax position by either completing a voluntary disclosure or making a declaration to confirm that their tax affairs are "up to date". The letters received by taxpayers in this group were all the same, suggesting it was a "one size fits all" approach, meaning in a lot of instances the letters were not fit for purpose. For example, taxpayers that are transitional residents are not generally required to declare overseas passive income. This meant that the declaration Inland Revenue was asking the individual to make, which included the wording "…I have declared all my offshore income and gains", was not applicable.

A change in tactic

Following feedback from Deloitte and no doubt a number of other tax agents, Inland Revenue has now adapted its approach with a second wave of letters having been released with a more targeted approach. So far, we have identified up to 6 different versions of the letter which have been tailored to the taxpayer's position and most likely, the information received from overseas tax authorities. This is evident from statements such as "We have received financial account information from one or more foreign jurisdictions that indicates you are a New Zealand tax resident. However, our tax records indicate that you are not a New Zealand tax resident." Whilst the consideration of the taxpayer's specific circumstances is a welcome update from Inland Revenue, the letters are still not without their limitations and so care should be taken when responding to them.

What if further explanation is needed?

What is interesting is the facility for taxpayers to provide further information to help Inland Revenue understand their circumstances. Inland Revenue explains in the letters that such information "…may include changes in your tax residency (including dates of when this occurred), how any attributable income has been returned and the nature of your foreign accounts." This facility has likely been provided as a result of feedback from tax agents and will, in the majority of cases, allow taxpayers to reassure Inland Revenue that their tax returns filed to date are complete and correct. Taxpayers should consider whether to provide additional information very carefully and it goes without saying that any information that is provided to Inland Revenue must be correct. In the event that the information received by Inland Revenue doesn't add up, Inland Revenue may seek further clarification or notify the taxpayer of their intention to complete an audit of their tax affairs.

If you have received an AEOI letter or would like further advice in relation to your New Zealand personal tax affairs, please reach out to Stephen Walker, Nick Cooke or your usual Deloitte tax advisor.

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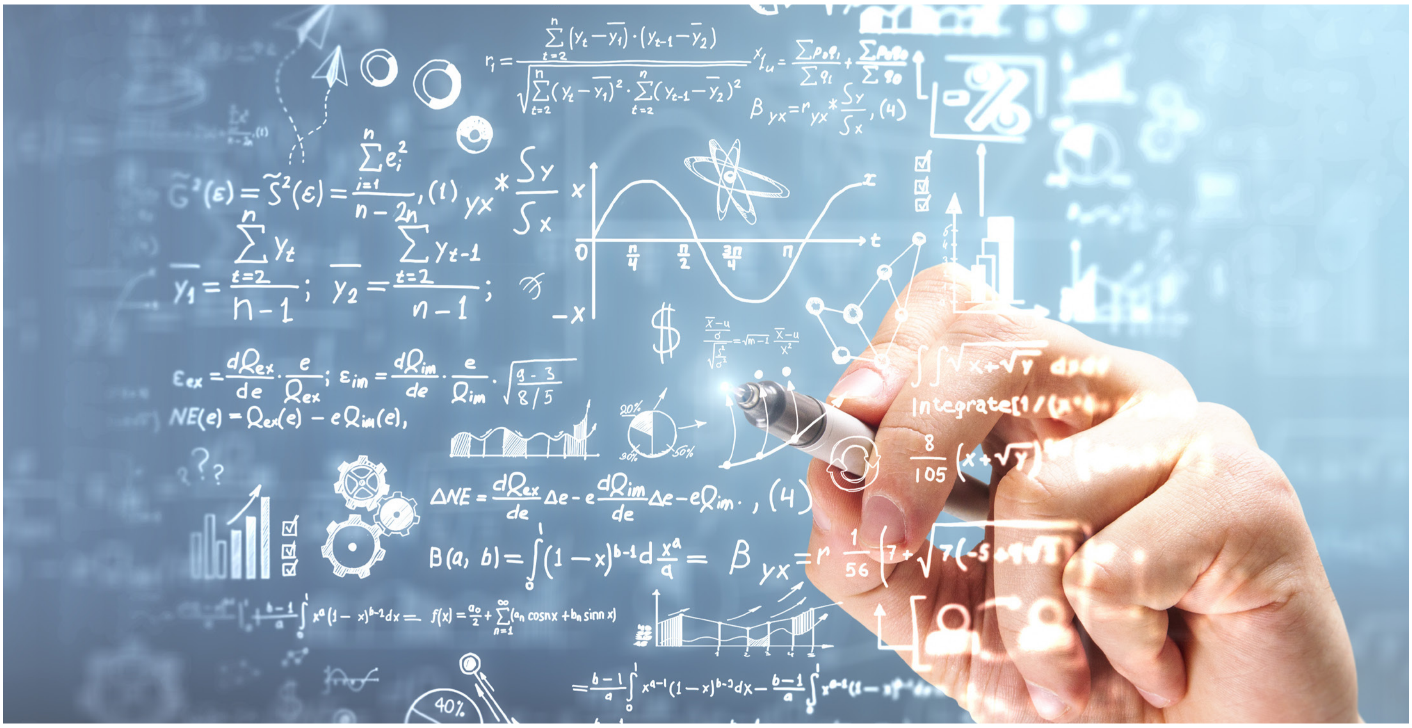
"You Do The Math" – 10 Simple Ways to Keep Inland Revenue Away

By Bart de Gouw and Eleanor Yew



Last month, amongst other significant developments in the International Tax space, Inland Revenue released its latest Multinational Enterprises Compliance Focus 2019 document (the Compliance Focus document). The aim of this document is to make tax compliance more transparent for businesses and give them certainty.

One thing is for sure, with Inland Revenue's Basic Compliance Package, International Questionnaire and account management processes already in place, combined with greater international transparency (i.e. Country-by-Country reports and information exchanges), Inland Revenue can tailor interventions to facilitate compliance with tax law. The Compliance Focus document states, "In the coming year we will be asking for more information and clarification of changes in MNEs tax affairs to give us a clearer view of the impact of the new anti-BEPS measures". The recent Transfer Pricing questionnaire for wholesalers and distributors as well as the new BEPS disclosure requirements are evidence of this new approach. Next year, further targeted questionnaires will be sent covering the topics of losses, intellectual property and royalties, debt and thin capitalisation.

The Compliance Focus document also includes a simple transfer pricing checklist. If taxpayers identify that one (or more) of the risk indicators apply, they are on notice that Inland Revenue may request more information. We have expanded on the checklist below to provide further insights and examples.

2 consecutive years of tax losses

A company reporting two years of consecutive losses may trigger Inland Revenue's curiosity on the viability of the company. Inland Revenue's concerns are that if there are constant periods of losses for either foreign-owned multinationals operating in New Zealand, or New Zealand owned multinationals with loss making associates abroad, this may suggest commercially unrealistic transfer pricing transactions and policies. For example, an associated enterprise making losses may remain in business if the business is beneficial to the MNE group as a whole, but this not the case for an independent company, which will not be prepared to tolerate losses for a continuous period or indefinitely.

This could affect Small and Medium-sized Enterprises (**SMEs**) and start-ups, especially in their early years of incorporation. It is not uncommon for SMEs to incur significant expenses, i.e., research and development expenses during their infancy which can often result in losses being reported over a period of time.

Prevention is better than cure, thus we recommend that documentation is in place to support and provide explanation of the losses. Additionally, forecasts of the next couple of years' financials to support the strategies to be taken towards making profits in the medium term are helpful.

Negative Earnings Before Interest and Tax (EBIT)

A negative EBIT (which would indicate a company is failing to turn a profit), is another cause for suspicion in the eyes of Inland Revenue. EBIT basically focuses on a company's ability to generate earnings from its operations and it does not take into account interest, taxes and capital structure. Therefore, a negative EBIT gives Inland Revenue indicators that the company is purchasing goods from related parties at a high price (Cost of Goods Sold), or is paying high management service recharges from associated parties, and royalty payments.

>5% cost plus margin on service charges

Consistent with OECD's simplification measure for qualifying low value-adding intra-group services (**LVAIGS**) charged to a New Zealand taxpayer with a total value below NZ$1m per annum, 'qualifying services' may be priced at cost plus a 5% mark up without having to provide benchmarking support. Entities that are pricing their services at more than 5% for qualifying services, without benchmarking support, may hear from Inland Revenue, as Inland Revenue will want to understand the basis for the level of pricing.

You need to be aware of what a "qualifying service" is. For example, management fees that include the services of the senior management will fall outside of this category. For more information about LVIAGS, refer to our recent Tax Alert Article.

<3% Distributor EBITE

For foreign-owned wholesale distributors with an annual turnover of less than NZ$30m, Inland Revenue currently maintains that a weighted average earnings before interest, tax and exceptional items (**EBITE**) margin of 3% of sales or greater is broadly indicative of an arm's length rate. Foreign-owned wholesale distributors that fall within this threshold will not be required to be provide benchmarking support to Inland Revenue. However, distributors that do not fall within the annual turnover threshold should consider revising their positions by having adequate benchmarking support on hand. For more information refer to our recent Tax Alert Article.

<5% Retailer EBITE

In respect of retailers, Inland Revenue is likely to maintain that a weighted average EBITE ratio of 5% or greater is broadly indicative of an arm's length outcome. However, Inland Revenue does not have published guidance on whether businesses will not be required to provide benchmarking support below a level of turnover. If retailers are below 5% EBITE, we recommend explanations of the reasons for the results be documented.

<7% Manufacturer EBITE

For foreign-owned manufacturers, Inland Revenue is likely to maintain that a weighted average EBITE ratio of 7% or greater is broadly indicative of an arm's length outcome. There is no indication of size limits or benchmarking requirements. Manufacturers that do not fall within this threshold should consider their positions and have benchmarking support and explanation of the results ready to support the positions taken.

Our advice is to be prepared, start early and be generous with your supporting documentation and abide by the New Zealand Transfer Pricing legislation.

Royalties >33% EBITE
Inbound licensing of intangibles, trademarks, patents as well as other intellectual property are a current focus for Inland Revenue. Inland Revenue has recently updated its risk assessment threshold for royalties. Royalty payments exceeding 33% of EBITE are assigned a high risk rating pending further review. We therefore recommend that taxpayers consider applying this as a cross-check if they have licenced intangibles from foreign related parties. Taxpayers should be on notice that an upcoming Inland Revenue questionnaire will focus on royalties.

Debt >40% (Assets – Non-debt Liabilities)
New Zealand based borrowers need to ensure they are not at risk of 'excessive debt gearing' in relation to their capital structures. For the purposes of the restricted transfer pricing rules, a New Zealand borrower will be considered a "high BEPS risk" if it has a New Zealand Group debt percentage (as measured for thin capitalisation purposes) that is greater than 40%, unless its ratio is within 110% of its world-wide group (where relevant).

Interest >20% EBITDA
Inland Revenue also has concerns where a taxpayer's interest expense is more than 20% of EBITDA. A high ratio can be due to a commercial or industry issue, as well as a bad year for a company, for example, where there is a decrease in revenue or increase in one-off expenses. In such circumstances, the company may wish to re-look at what caused the high ratio and have supporting documents readily available.

Purchases + other operating expenses > $20m (involving low/no tax jurisdictions)
If taxpayers have been purchasing goods or services from non-resident associated persons located in certain jurisdictions, Inland Revenue will likely raise their eyebrows. Inland Revenue has identified Hong Kong, Ireland, Luxembourg, Netherlands, Singapore or Switzerland in their recent transfer pricing survey as higher risk jurisdictions.

Conclusion
Our advice is to be prepared, start early, be generous with your supporting documentation, and abide by the New Zealand Transfer Pricing legislation. Talk to your usual Deloitte advisors or the authors if any of these items raise red flags in your company.

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Corporate Tax Governance – From the Top Down...

By Annamaria Maclean and Kirstie Anderson

In a world that is increasingly concerned with where tax is being paid, and who is (or rather, who is not) paying their "fair share" of tax, tax governance remains a hot topic for corporates and tax authorities alike around the globe. But what does tax governance actually mean?

Let's explore what good tax governance looks like and what tax authorities are doing to assess whether corporates stack up to expectations.

Many tax authorities are implementing initiatives that require large companies to be more transparent about the amount of tax paid and their tax strategies. It is now expected that Board members have an understanding of, and take responsibility for, the tax risks of the companies they act for.

Here in New Zealand...

While New Zealand has not (yet?) introduced prescriptive requirements relating to tax governance, it is clear from the recently released Multinational Enterprises Compliance Focus document that corporate tax governance remains a key focus area for Inland Revenue when it comes to multinational enterprises. In particular, Inland Revenue has endorsed the OECD's recommendations regarding tax governance and has included as part of its Compliance Focus a helpful checklist of 10 things for Boards to tick off to ensure the right tone is set from the top:

Checklist for boards of directors of New Zealand Companies

1	Does the board have a well-documented overarching tax strategy?	☐
2	Is this strategy actually followed in practice by the company's management?	☐
3	Is the strategy and it's implementation regularly reviewed and updated?	☐
4	Does the company have a tax control framework to manage day-to-day tax risks?	☐
5	Is senior management confident in the capacity and capability of the systems, procurements, personnel in place to achieve overall company tax compliance?	☐
6	is the tax or finance team on top of all relevant law changes (such as the anti-BEPS measures, the Common Reporting Standard and revisions to tax treaties)?	☐
7	Does management report regularly to the board on potentially material tax issues and risks?	☐
8	Has the operation of the tax control framework been tested independently in the last three years?	☐
9	Is a clear statement made in the company's annual report as to tax governance?	☐
10	Is annual reporting of tax payments and provisions sufficiently transparent for all relevant stakeholders to fully understand the company's overall tax position in New Zealand?	☐

Around the world...

The UK and Australia are examples of jurisdictions that have taken more prescriptive action in this area:

- In the **UK**, Her Majesty's Revenue and Customs (HMRC) introduced legislation requiring large businesses within its scope to publish their tax strategy in relation to UK taxation on their website before their financial year-end, with penalties applied if this is not complied with.
- **Australia** has introduced a structured governance assurance programme following the implementation of the ATO's *Justified Trust* methodology in 2016. The ATO has published prescriptive tax control framework expectations in its *Tax Risk Management and Governance Review Guide* (the *ATO Guide*), setting out the key tax controls that it expects corporates to implement. The Australian Board of Taxation has also developed a *Voluntary Tax Transparency Code* directed at greater public disclosure of tax information by large businesses.

One aspect that resounds through the guidance from all of the tax authorities mentioned above (including Inland Revenue's checklist) is the existence of a ***tax control framework***. So, what actually is a tax control framework and how do we know whether we can tick that box?

Tax control framework (TCF)

Under New Zealand's current approach to tax governance, best practice is to put in place a TCF that picks up the Board-level controls of risk appetite and approach to risk management, while also endorsing the internal control framework to be implemented by management.

There is various guidance from around the world on what constitutes a TCF, with jurisdictions adopting different approaches to what they require of taxpayers. However, there are common themes that pop out of the guidance we have seen as to what a TCF should look like.

The OECD's 2016 report on *Co-operating Tax Compliance – Building Better Tax Control Frameworks* identifies six essential building blocks of a TCF:

1. Tax strategy established:
   This should be clearly documented and owned by the Board.
2. Applied comprehensively:
   All transactions entered into that are capable of affecting its tax position in one way or another should be governed.
3. Responsibility assigned:
   The Board is accountable for the design, implementation and effectiveness of the TCF. The tax team is responsible for the implementation of the TCF.
4. Governance documented:
   The governance process should be explicitly documented and sufficient resources should be deployed to implement the TCF and review its effectiveness periodically.
5. Testing performed: Compliance with the policies and processes embodied in the TCF should be the subject of regular monitoring, testing and maintenance.
6. Assurance provided:
   The TCF should be capable of providing assurance to stakeholders, including external stakeholders such as a tax administrations, that tax risks are subject to proper control.

The essential components of a TCF should therefore address the following:

- **Defining tax risk** – what are we trying to manage?
- **Tax risk management processes** – how do we go about managing risk?
- **Tax risk appetite** – what risks are we willing to take?
- **Tax risk management segregation of duties** – who is responsible for what?
- **Tax risk governance** – how do we oversee tax risk management?

Also think about: how do we engage with the tax authorities and is our tax risk policy published internally and in our annual report?

While the Board owns the tax strategy, management (the finance team and the tax team) is responsible for how the TCF is implemented. The *ATO Guide* provides insight into what management controls are expected:

- **Roles and responsibilities are clearly understood** – tax compliance and risk management roles are documented including segregation of duties and escalation of tax risks.
- **Senior management confident of capacity and capability** – tax staff experience, qualifications and training; KPIs include tax risk management; tax risks are escalated and tax reports are presented to senior management.
- **Significant transactions are identified** – policy to identify significant transactions (including which need to be reported to Tax/the Board) and where external advice is required. Tax risks are rated and reported.
- **Controls in place for data** – IT controls ensure systems accurately calculate, record and report tax data.
- **Record-keeping policies** – record retention policy with staff training plus audited compliance.
- **Documented control frameworks** – documented procedures for reviewing tax return and reconciling to financial statements.
- **Procedures to explain significant differences** – documented procedures for preparing deferred tax and tax return, and explaining differences between tax return and financial statements.
- **Complete and accurate tax disclosures** – income tax return review prior to lodgement, controls in place to review other taxes.
- **Legal and administrative changes** – processes, systems and controls are updated for law and administration changes.

While many large New Zealand corporates have a tax strategy policy in place that is endorsed by the Board, many corporates should now be looking more closely at how this is being implemented at a management level, and whether this is being regularly monitored.

In terms of tax planning and identification of risks, a **tax management plan** is a tool that is commonly used among corporates and forms a key part of identifying tax risks. An effective tax management plan should include rolling reviews of key risk areas for the business – including for example fixed assets, GST, customs, PAYE, FBT and other indirect taxes.

Inland Revenue has been more focused on indirect taxes and has been undertaking more auditing in this area. As this is often an area where returns aren't regularly subject to external signoff, best practice is to ensure that periodic health checks are undertaken.

In our experience, a tax management plan serves two key purposes:

1. Ensures the organisation's tax strategy is monitored and implemented across all tax types;
2. Provides a platform for the organisation to address tax risks and optimise tax planning.

If you are interested in putting in place or refreshing an existing tax management plan, we can assist you with putting this together.

Independent testing of a TCF

Another point on Inland Revenue's checklist asks whether the operation of the TCF has been tested independently in the last three years. We understand the ATO generally adopts a walkthrough approach when conducting a review of tax governance processes to determine if controls and assurance processes are adequate, depending on the level of risk involved.

From a New Zealand perspective, this is not something we have seen Inland Revenue do to date, but is something that corporates should be doing to ensure the effectiveness of their TCF once this is in place.

In terms of tools for assisting with this, our Tax Cube workshop is a risk assessment tool that assists taxpayers to develop an initial assessment or benchmark the current state of their tax controls. The Tax Cube is a comprehensive set of questions based on views of best practice in the area of tax risk governance. The Tax Cube output gives an indicative assessment of risk based on the responses to the questions, displaying a "heat map" that allows the tax manager, financial controller or CFO to understand and identify priorities for change and actions recommended. The heat map can also provide a simple way to report to the Board on the tax risks in the business and allow the business to develop a plan to address these.

Reporting to the Board and in the annual report

Other key factors in Inland Revenue's Compliance Focus is regular reporting to the Board on tax risks and including relevant statements in your annual report on tax governance.

So ask yourself – how often does your company report to the Board on tax risks? Best practice is that tax risks are included in a risk register with appropriate ratings (high, medium, low) and reported on a regular basis to the Board (our Tax Cube can assist with this as noted above).

Reporting on tax governance in the annual report should also be regular practice for large New Zealand corporates. Inland Revenue expects to see a clear statement around tax governance in the annual report, much like other areas of governance.

Way forward

If you would like to learn more about how your business stacks up on the tax governance front, or if you are interested in running a Tax Cube diagnostic workshop, our tax team would be happy to help.

Reporting on tax governance in the annual report should also be regular practice for large New Zealand corporates. Inland Revenue expects to see a clear statement around tax governance in the annual report, much like other areas of governance.

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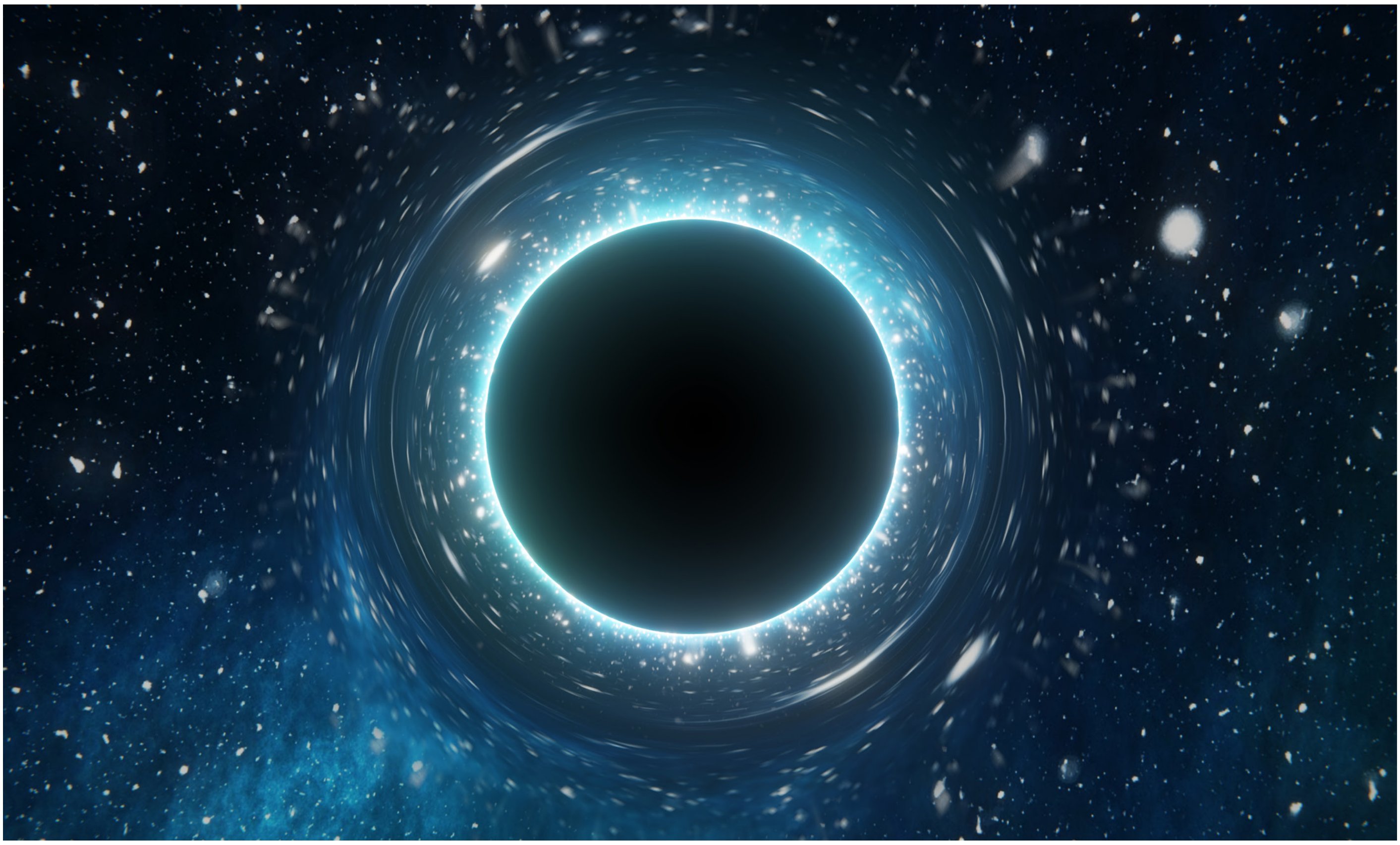
Tax Policy: What to expect in the twenties

By Robyn Walker and Emma Faulknor



We're about to wrap up a busy year in tax policy in a much different space to what many would have predicted at the start of the year. While in the first half of the year a lot of resource was invested in the capital gains tax people expected to see adopted as a result of the Tax Working Group process, with that proposal being relegated to the scrap-heap, the second half of the year has seen more 'behind-the-scenes' tax policy development. As such, 2020 is likely to be a year of delivery from a tax perspective.

Based on the Tax Policy Work Programme, below are our predictions of some of the hot topics for discussion in 2020.

Feasibility and Black Hole Expenditure

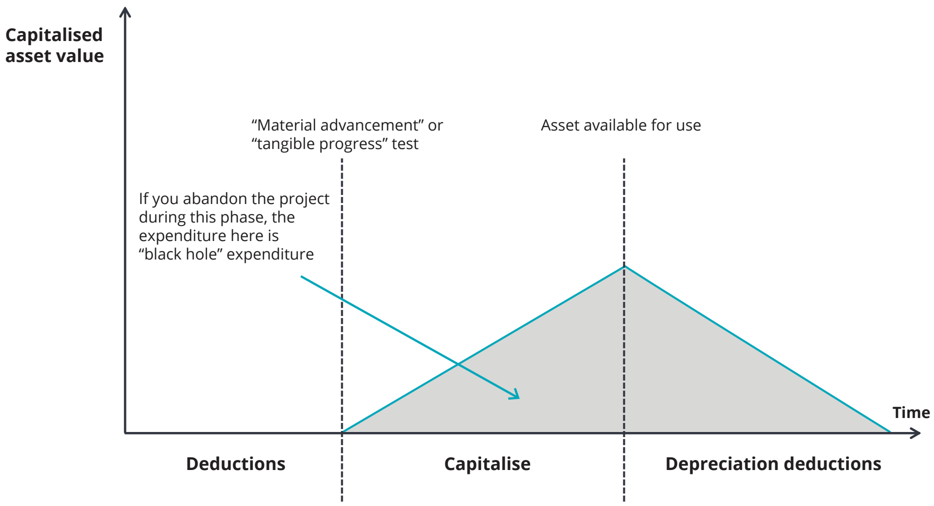
Taxpayers have been waiting a while for the Government to reconsider its position on feasibility and black hole expenditure after the Trustpower decision and Inland Revenue's subsequent interpretation statement reduced the threshold at which taxpayers could deduct feasibility expenditure.

The current test under Inland Revenue's Interpretation Statement, *Deductibility of feasibility expenditure*, IS 17/01, has two limbs:

1. There must be a sufficient nexus with the taxpayer's income earning activities; and
2. The expenditure must not be of capital nature.

Feasibility expenditure will generally not be subject to the capital limitation and will therefore be deductible where it is not directed towards a specific project or, if a specific project has been identified, the expenditure is "so preliminary as not to be directed towards materially advancing that specific project".

If expenditure doesn't meet this test, unless it results in a capital asset that can be depreciated, the expenditure will never be eligible for a deduction even if it would have created a depreciable asset if the project was not abandoned (often referred to as "black hole expenditure") – this is illustrated by the shaded triangle in the diagram overleaf.



The Government acknowledged this issue and in September made an announcement that legislation that addresses this problem "... will be included in a taxation bill to be introduced into Parliament early next year, meaning the change can kick in from the start of the next tax year."

So what is the proposed solution to the black hole problem? Officials are currently undertaking some limited consultation on the detail of the proposal, however we can advise that the proposals are broadly as follows:

1. For businesses undertaking smaller amounts of feasibility expenditure, potentially not as a recurrent part of their business, there will be a $10,000 de minimis rule whereby total annual expenditure under this amount can be deducted. This rule will be similar to the existing rules for deducting legal fees, and will remove some of the compliance costs around navigating the capital / revenue gateway.
2. For businesses spending over $10,000 in a given year, to the extent the business has incurred expenditure in considering or developing an intended depreciable asset which is then abandoned, those costs will be able to be deducted over a five year period. This rule is intended to apply to expenditure incurred in the 2020/21 and later income years.

These proposals are really positive for businesses, particularly those that are asset intensive. However, will they be a wholesale solution to the problem of black hole expenditure? No, but they are also not designed to be. These proposals are just intended to fix the specific problem of black hole expenditure for depreciable capital assets.

A range of other categories of black hole expenditure will continue to exist, including all costs attributable to land and buildings, costs associated with purchasing shares, equity raising costs, defence costs in a takeover bid, and costs relating to mergers and acquisitions (successful or unsuccessful).

We expect to see more detail on these proposals around March 2020 when a tax bill will be introduced to Parliament. At this point, all interested parties will have the opportunity to comment on the proposed law change.

Loss continuity rules

In addition to proposals on feasibility, we are expecting to hear more on the loss continuity rules in early 2020.

Currently companies have to maintain 49% shareholder continuity to carry forward losses to future years. This can be a problem for many businesses, most prominently start-up companies where they are most likely to incur losses before bringing on additional sources of capital resulting in a breach of continuity.

One solution may be to replicate the same or similar business test used in Australia or lowing the 49% threshold, although the Government has not yet indicated what specific solutions it will be pursuing. We expect a public consultation document to be released in the first half of 2020.

Purchase price allocation

Purchase price allocations have been a focus area by Inland Revenue investigators over several years as they attempt to ensure the values used by vendors and purchasers reflect market values (we have previously commented on this here). The primary concern is that the tax positions taken by taxpayers' are resulting in asymmetrical tax outcomes, for example, an amount treated by the purchaser as deductible may be treated as non-assessable by the vendor. This often happens where a purchase price allocation is not specifically set out in the sale and purchase agreement and each party adopts their own position.

These proposals are really positive for businesses, particularly those that are asset intensive. However, will they be a wholesale solution to the problem of black hole expenditure? No, but they are also not designed to be.

The tax policy work programme includes a project on purchase price allocations. We expect the outcome of this will be to have legislative requirements for parties to either agree a purchase price allocation or to provide a basis to ensure both parties use the same values.

Obviously the best approach is to agree the price allocation in the agreement for sale and purchase.

The tax policy work programme includes a project on purchase price allocations. We expect the outcome of this will be to have legislative requirements for parties to either agree a purchase price allocation or to provide a basis to ensure both parties use the same values. We expect to see a public consultation document on this topic, potentially before Christmas.

Land tax

Over the last two months there was consultation on the treatment of habitual buying and selling of land and the treatment of holding costs for privately used land that is taxable on sale. We expect that the feedback received on those proposals will be considered by Officials and the Government and incorporated into the first tax bill in 2020.

GST

The biggest recent change in GST has been the introduction of the new low value goods rules which took effect from 1 December 2019. Moving forward, our expectation is that 2020 will see the release of a discussion document on a range of additional GST policy issues.

Charities

The Government's tax policy work programme states there will be a report to Ministers on charities by the end of 2019 addressing the Tax Working Group's recommendations. We'd expect this to be followed up with some form of public consultation on the issues of interest to Ministers in 2020.

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Don't hold back; investment income reporting is almost here

By James Arbuthnott and Yulia Borodina

Do you, or does an entity you are connected with, pay interest, dividends, royalties or make other taxable distributions? If so, is that payer set up to comply with the new investment income information reporting rules that are **effective 1 April 2020**? It's only four months away!

Further to the detail included in our related [July Tax Alert article], we discuss below some key practical implications to be aware of to ensure that an investment income payer will be ready to comply with the new requirements.

Key changes and steps to take now

Some of the key points to be conscious of and prepared for in advance of 1 April 2020 are:

1. Even if a payer has not had a reporting requirement in the past, they may have a reporting requirement going forward. In that case, the payer should set up a myIR account now (if one is not already set up), and also register with Inland Revenue for RWT if required.
2. Unless explicitly exempted, a payer will have to file the relevant information electronically. They will need to be set up to do this through myIR by either using an online form or an upload of information in a specific file format. As such, we suggest testing this now and identifying any issues or changes required in terms of the format and detail of the information to be reported. It's worth noting that the rules are currently optional so taxpayers can start applying the rules any time before they become compulsory.
3. The types of information to be submitted to Inland Revenue are likely to have increased, with the specifics of that being dependent on the type of investment income being paid. So, get familiar with the 21 rows of information set out in [Schedule 6] of the Tax Administration Act 1994 (the Act) and which of them applies to the investment income you are dealing with. If there is any missing information, then efforts should be made to collect that as soon as practicable.
4. Even if a payer does not have an obligation to withhold tax in relation to an amount being paid, they could still have an information reporting requirement.
5. Communicate with your customers / members / recipients so that they clearly understand any impact of the changes. As an example, a new non-declaration rate of 45% applies for RWT on interest income when the recipient does not provide their IRD number to the payer, and additional information may have to be provided to Inland Revenue. Understanding and communicating these requirements early should help mitigate the risk of any recipients having a "negative experience" as a result of the new requirements.

On the plus side, reporting will no longer be required for periods during which no payments of investment income are made (albeit nil returns can be filed) or for amounts paid to RWT-exempt recipients. Further, Inland Revenue is going to produce a searchable, electronic list of RWT-exempt taxpayers, so finding and maintaining that information should be simpler going forward.

On the plus side, reporting will no longer be required for periods during which no payments of investment income are made (albeit nil returns can be filed) or for amounts paid to RWT-exempt recipients.

Timing of information reporting requirements

In general, the reporting of investment income information, and the payment of any related withholding tax, will need to be done by the 20th of the month following the month in which the investment income was paid.

For example, if a payer pays a taxable dividend of $6,000 on 27 April 2020, they will need to pay any withholding tax and report the relevant information to Inland Revenue by 20 May 2020.

However, a payer of royalties to non-residents or a payer with no withholding obligation should only need to report investment income information on an annual basis, and PIEs also have different requirements.

No withholding tax? You may still have an information reporting obligation

As mentioned above, a payer of investment income that does not have a withholding requirement may still have an investment income information reporting obligation.

For example, assuming none of the parties below has RWT-exempt status:

Scenario	Withholding obligation?	Investment income information reporting obligation?
Mike lends funds to his company on an interest-bearing basis. The annual interest paid is less than $5,000. The company does not use the funds in a taxable activity.	The company has no RWT withholding requirement as the funds are not used in a taxable activity. If company used the funds for a taxable activity, the $5,000 threshold may be applicable such that there would still be no RWT withholding requirement.	Mike's company will likely need to register and file investment income information for the interest it pays to Mike.
Anna lends funds to Tim on an interest-bearing basis. The annual interest paid is greater than $5,000. Tim does not use the funds in a taxable activity.	Tim is not required to withhold RWT from interest paid because he does not use the funds in a taxable activity.	Tim is not required to register for and report investment income information for the interest he pays to Anna as he is not allowed a deduction for the interest.

If you have any questions or need any assistance with implementing these new rules, please contact your usual Deloitte advisor.

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OECD consults on "GloBE" global minimum corporate tax rate

By Patrick McCalman and Hamish Tait

The OECD Secretariat has recently released for consultation further details of a draft proposal entitled Global Anti-Base Erosion, or **GloBE**, which would in effect establish a global minimum corporate income tax rate for certain multinational businesses (refer to the heading "carve-outs and thresholds" below). The proposal, initial details of which are outlined in the November 2019 GloBE – Pillar Two consultation document, comprises four key rules intended to require multinational corporate groups to 'top up' their tax in one jurisdiction where there is insufficient tax paid in other jurisdictions. A public consultation meeting will be held in Paris on 9 December 2019.

This proposal represents *Pillar Two* of the OECD's two-pronged approach to "addressing the tax challenges of the digitalisation of the global economy". Pillar One relates to the reallocation of taxing rights between countries, as discussed in this article in our November 2019 Tax Alert.

Why was GloBE proposed and how would it work?

The GloBE proposal comprises a series of complex rules designed to strengthen the ability to tax the profits of multinationals where income is subject to a low effective tax rate. This would be achieved by requiring "top up" tax to be paid where the effective tax rate on income is below a global minimum rate (the rate is yet-to-be-agreed, but there have been suggestions that it may be between 10-15 percent). The intention of the proposal is to reduce the incentive for multinationals to undertake "profit shifting", or for governments to engage in "tax competition". The OECD considers that these rules are necessary to prevent a harmful "race to the bottom" on corporate taxes, which could be damaging, including for small developing countries.

As the proposal currently stands, GloBE's four key mechanisms would collectively seek to:

- Impose tax on foreign income that is taxed at below the minimum rate, either through an "income inclusion rule", or by a "switch-over rule" that would switch off the benefit of tax exemptions in respect of that income; and
- Impose tax on "base-eroding payments" subject to low tax overseas, by denying deductions in respect of those payments, by imposing source-based taxation (e.g. withholding tax), or by denying tax treaty relief.

What is being consulted on?

The consultation document does not represent a 'consensus view' of the G20/ OECD Inclusive Framework (the group that has tasked itself with developing the GloBE and Pillar One proposals). Rather, it has been put together by the OECD Secretariat primarily for the purpose of seeking public comments on three technical design aspects, summarised below.

Determining the global tax base

The consultation document discusses how the global tax base (i.e. the global 'net income' amount to which the global minimum tax rate would apply) should be calculated, and how the balance should be struck between accuracy and minimising compliance costs for businesses. The document suggests the use of financial statements as a starting point, and discusses which financial statements (e.g. subsidiary accounts versus group consolidated accounts), and which accounting standards, might be acceptable.

The document also discusses whether global 'tax adjustments' might be required to allow for the differences between taxable income and accounting profits – essentially, establishing a new global method of calculating taxable income specifically for the GloBE proposal. This canvases both permanent and temporary differences. To address the effect of temporary or 'timing' differences, the document suggests some combination of:

- allowing the 'carry forward' of excess tax paid over the global minimum rate;
- basing the global tax adjustments on the deferred tax treatment in the accounts; or
- allowing multi-year averaging of profits and tax paid.

Such calculations have the potential to materially affect the complexity and resulting compliance costs of these proposals.

Blending: The extent to which income should be combined when calculating the effective tax rate/rates

As GloBE is an effective tax rate (**ETR**) test, it is necessary to consider how the rate should be calculated. The document discusses whether the ETR should be calculated on a global basis by 'blending' all foreign income together, whether the 'blending' should be limited by jurisdiction (i.e. separate ETRs for each country), or some other combination (e.g. an entity blending approach).

Each approach has different policy implications and implementation challenges, and the document notes that whether low or high tax income spread across entities and jurisdictions is able to be blended could materially impact on the fairness and effectiveness of the proposal. Again implicit in a drive for more accuracy, is more complexity with a resulting increase in compliance costs.

Carve-outs and thresholds

A number of possible carve-outs and thresholds are mentioned in the document, although very few details on the Secretariat's views in that regard are provided. The possibilities listed include:

- the exclusion of smaller corporate groups from the regime;
- carve-outs for regimes compliant with BEPS Action 5 on harmful tax practices or similar;
- carve-outs for groups with low levels of related party transactions; and
- whether specific industries or sectors should be excluded.

Possible implications for NZ business

The proposal is still at a very preliminary stage, and there is currently little consensus within the Inclusive Framework on the direction the proposal will take. However, if or when consensus is reached, history would suggest that New Zealand would take steps to adopt the proposal within our tax law.

Despite this, the impact this proposal would have on New Zealand businesses will be substantially affected by the extent to which carve-outs and thresholds are adopted. For example, if GloBE is restricted in application to businesses with a global turnover of €750 million (as has been the case with a number of other OECD proposals), very few New Zealand-owned businesses, would be subject to the regime. (It could also be argued that this threshold is too low and a higher threshold is more appropriate.) Similarly, if there were carve-outs for certain sectors or industries, this could further reduce the impact (however the consultation document does not indicate what those sectors are likely to be).

Conversely, for significant foreign-owned businesses operating in New Zealand, it seems more likely that the regime would apply. Accordingly, there are likely to be additional compliance costs incurred in New Zealand for businesses, in terms of collecting and calculating the relevant information required to determine the tax base and ETR, as outlined above. Most businesses may not, however, be required to pay substantial 'top up' tax in respect of their New Zealand operations, given New Zealand's relatively broad tax base and relatively high corporate tax rate. A possible exception to this is businesses that generate significant untaxed income (for example, capital gains) which would drop the ETR, particularly if the ETR was required to be calculated a jurisdiction by jurisdiction basis.

General comments

GloBE is notable in that it appears to go much further than the OECD's existing BEPS mandate – that is, it is not specifically targeted at artificial arrangements that are driven by tax, and will apply to ordinary commercial transactions based on the tax system of the country in which they occur. GloBE can be contrasted with (for example) the hybrid mismatch arrangement rules recently implemented as part of New Zealand's BEPS reforms, which target only

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specific arrangements that are considered to give rise to inappropriate tax advantages obtained from differences in tax treatments between multiple jurisdictions.

A possible criticism of the GloBE proposal is whether it limits the ability of sovereign nations to be able to make their own decisions about their economic settings, including their tax system. Within a tax system there are a range of trade-offs which risk a focus on tax rate being overly simplistic (for example, the rate of tax and the tax base, as well as the mix of taxes). It could also impact on the ability to offer tax incentives , such as the research and development tax credit in New Zealand.

In our view, it is critical that consideration be given to whether an appropriate balance is able to be struck between the complexity and fairness of the GloBE proposal. For example, overly simplistic ETR calculations may risk giving rise to an unfairly blunt instrument, whereas more detailed ETR calculations (with a new set of global rules for calculating taxable income) may risk imposing unwarranted compliance costs on businesses. Similarly, if the proposal were to proceed, it would be critical to ensure an appropriate size threshold is developed to ensure only the largest businesses are captured, given the potential for imposing disproportionate compliance costs on both businesses and revenue authorities.

Finally, if implemented we need to consider what this will achieve: if countries are already using their tax systems to incentivise or attract economic activity is there a risk that these changes will simply result in tax competition between sovereign nations being replaced with some form of other incentive competition?

Further information

For some further detail and more general Deloitte comment on the GloBE proposal and the next step, please refer to this Deloitte article.

To discuss the potential implications for your business, contact your usual Deloitte advisor.

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Update on Pillar One

Last month we reported on Pillar One of the OECD work, work continues on these proposals and the next major milestone is a meeting of the Inclusive Framework in late January 2020.

After that meeting there may be greater clarity on the likelihood of reaching consensus. That may trigger the New Zealand Government to make a decision whether to pursue its proposed Digital Services Tax (DST) (refer to our July Tax Alert for more information.

DST's remain controversial, with a decision by the United States Trade Representative that the DST proposed by France is discriminatory against United States companies. The United States Trade Representative is proposing a 100% tariff on certain French products as a consequence.

Snapshot of Recent Developments:

Policy and legislative developments

Updated R&D information and draft guidance on the latest proposals now available

Inland Revenue has published updated information on R&D. This includes a guide on claiming the R&D Tax Incentive, a fact sheet on the R&D Tax Incentive supplementary return, and draft guidance on proposed changes to the R&D Tax Incentive included in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill.

Suggestions for improvements to the draft guidance close on 11 February 2020.

FBT rate for low interest loans reduced

The Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2019 come into force on 26 December 2019 and amend the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1955. The regulations reduce, from 5.77% to 5.26%, the rate of interest that applies for fringe benefit tax purposes on employment-related loans. The new rate applies for the quarter beginning 1 October 2019 and for subsequent quarters.

OECD update on MLI

An OECD announcement dated 30 October 2019 notes that representatives covering a total of 90 jurisdictions have signed the Multilateral Instrument (MLI), which will now cover over 1,600 bilateral tax treaties (once all ratification processes have been completed). Instruments of ratification, acceptance or approval covering 37 jurisdictions have been deposited with the OECD, and the MLI now applies to 99 tax treaties concluded among these jurisdictions. The OECD status document showing the deposit and entry into force dates has been updated as of 26 November 2019. You can also follow the progress of the MLI through Deloitte's MLI status tracker.

OECD releases further guidance on CbC reporting

The OECD/G20 Inclusive Framework on BEPS has released additional interpretative guidance to give greater certainty to tax administrations and MNE Groups on the implementation and operation of Country-by-Country (CbC) Reporting (from BEPS Action 13). In addition, a summary of common errors made by MNE Groups in preparing CbC reports has also been posted on the OECD website. The release of this summary will help MNE Groups in avoiding these errors and tax administrations in detecting them where they occur.

Draft Inland Revenue items released

ED0222: Loss offset elections between group companies

Inland Revenue has released ED0222: Loss offset elections between group companies. This is a draft standard practice statement which will replace SPS 17/03 once it is finalised. The draft SPS sets out the application of certain pre-requisites and other aspects of the loss offset provisions. It also discusses the requirements for giving notice to the Commissioner, the practice for part-year losses, what happens if one of the parties has a reassessment, and the requirements for a valid election and/or subvention payment. Submissions close on 31 January 2020.

ED0218: Student loan repayments

Inland Revenue has released ED0218: Student Loan repayments – options for relief, which is a draft standard practice statement setting out how the Commissioner of Inland Revenue will exercise her discretion when borrowers apply for hardship relief. Submissions close on 24 December 2019.

PUB00326: Income tax – when is development or division work minor?

On 7 November 2019, Inland Revenue released a draft interpretation statement PUB00326 which updates IG 0010: "When is development or division work minor". The update reflects the change of wording from section CD 1(2)(f) of the Income Tax Act 1994 (which IG0010 was based on) to section CB 12 of the Income Tax Act 2007. The central conclusions are largely unchanged. The updated draft statement also reflects the conclusions reached in two more recent public items:

- "QB 15/04: Income tax — whether it is possible that the disposal of land that is part of an undertaking or scheme involving development or division will not give rise to income, even if no exclusion applies", Tax Information Bulletin Vol 27, No 4 (May 2015); and
- "QB 15/02: Income tax – major development or division – what is 'significant expenditure' for section CB 13 purposes?", Tax Information Bulletin Vol 27, No 4 (May 2015).

Submissions close on 19 December 2019.

Consultation on correct tax treatment of derivative contracts

On 6 November 2019, Inland Revenue Officials released a draft financial arrangement determination on the correct tax treatment of MKP Milk Price Futures Contracts, which are derivative contracts traded on the NZX Derivatives Market. Draft determination 31 – NZX milk price Future Contracts: an expected value approach, proposes an expected value approach to the taxation of these contracts when they are entered into by farmers who do not use IFRS and who enter into the contracts for the sole purpose of hedging the price received for all or part of their anticipated future milk production. Inland Revenue proposes to release this determination in order to clarify and simplify the tax treatment of these contracts. The finalised determination is intended to apply to all such transactions entered into on or after 1 April 2020.

The closing date for submissions is 13 December 2019.

Tax cases

Dowden v Commissioner of Inland Revenue [2019] NZHC 2729

In this appeal from a TRA decision, Mr Dowden challenged the Commissioner's assessments for PAYE, student loan deductions, GST and income tax over an eight year period on the basis that his former partner was running the business at this time and was therefore liable for the tax assessed. The Court dismissed the appeal, instead agreeing with the TRA's determination. Some of the assessments were potentially affected by the time bar rules in sections 108 and 108A of the Tax Administration Act 1994. The Court also agreed with the TRA decision that as Mr Dowden's true tax position was misleading and deliberately so, and because income had been omitted, section 108 did not apply. It also found that Mr Dowden had knowingly failed to disclose all material facts in relation to his GST returns so the GST returns were also not time barred.

Other items of interest

Inland Revenue Annual Report

Inland Revenue has released its annual report for the year ended 30 June 2019. This contains some interesting statistics and facts about the money collected and its sources, how it is distributed, the services offered, how Inland Revenue has helped taxpayers meet obligations, governance, performance, financial accounts and more.

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