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Tax Alert

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R&D tax credits – where are we now?

Greg Pratt, Aaron Thorn and Robyn Walker

As we have clocked over into April and the 2019/20 tax year, most taxpayers are now potentially eligible to apply the new, but as yet not enacted, Research and Development ("R&D") tax credit regime. In this article we explain some of the key aspects of the rules, some significant proposed improvements made to the regime following the submission process, and things taxpayers should be considering as they undertake R&D.

Status of legislation

The Taxation (Research and Development Tax Credits) Bill ("the Bill") has been considered by the Finance and Expenditure Committee and improvements have been made. The Bill will now be heading back to Parliament to complete its remaining legislative steps. We expect, subject to the priorities within Parliament, that the Bill will be enacted by mid-May 2019.

Draft guidelines to help taxpayers understand and apply the legislation were released for consultation in February and we expect these to be updated and released once the legislation is enacted. These guidelines will be a living document and will continue to be updated as issues or gaps in the guidance are identified. It is also expected that over time the guidelines will be expanded to include specific guidance on a sector-by-sector basis.

R&D tax credit – Facts

- **Applies from the 2019/20 income year**
- **15% tax credit, with imputation credits also received**
- **Non-refundable tax credit in most cases in year 1 (further work is being done in this space)**
- **Minimum spend required is $50,000; maximum level of claim is $120million of expenditure (with the ability to have this increased on application)**
- **Focus is primarily on R&D conducted in New Zealand (but some supporting activities can be undertaken outside New Zealand)**
- **Costs which are eligible for the credit include employee costs, depreciation on assets used in R&D, cost of goods and services used as part of the R&D**
- **Specific activities and costs are excluded from eligibility**
- **Internal software development has specific rules and an eligible expenditure cap of $25million**

The draft guidelines currently cover the software development, primary production, food and beverage and manufacturing sectors.

Application date

The R&D tax credit regime will provide a 15% tax credit for eligible expenditure incurred on eligible R&D activities undertaken in the 2019/20 and later tax years. This means that if you have a March balance date, the regime will apply to expenditure incurred from 1 April 2019; a December balance date can apply the rules from 1 January 2019 and a June balance date can apply the rules from 1 July 2019 for example.

What is (or is not) R&D?

The key thing taxpayers need to understand is what is R&D which may qualify for the regime. This is something which needs to be carefully considered based on the definitions contained within the Bill. The concept of R&D can also often run counter to the approach taken in business documentation, where personnel may understate the risks or uncertainties of particular activities in order to get a project approved.

R&D activities are made up of core and supporting R&D activities.

A "core R&D activity" is one that:

- Is conducted using a systematic approach; and
- Has a material purpose of creating new knowledge, or new or improved processes, services, or goods; and
- Has a material purpose of resolving scientific or technological uncertainty; but
- Does not include an activity if knowledge required to resolve the uncertainty is publicly available and/or deducible by a competent professional in the relevant scientific or technological field.
- Activities undertaken outside New Zealand will not be eligible as a core R&D activity.

A "supporting R&D activity" means an activity that has the only or main purpose of, is required for, and integral to, conducting a person's core R&D activity. Some supporting R&D activity may be undertaken outside of New Zealand.

Both core and supporting activities will have certain activities which will be legislatively excluded from qualifying. For more information about what is excluded from the regime, reference should be made to proposed Schedule 21 of the Income Tax Act 2007.

What is or is not an eligible R&D activity will really come down to the facts of each particular case, but some examples of the types of activities which may qualify include:

- The creation of new or more efficient algorithms based on new techniques or approaches
- Machine learning and robotics development

- New approaches or concepts aimed at addressing software security related issues
- Development of new devices and related software
- Plant variety development through genetic evaluation and experimentation
- Advanced animal breeding technique development
- The development of new or enhanced primary products
- Developing packaging techniques or products that improve the shelf-life or stability of products
- Manufacturing process development (e.g. scale up, process improvement, overcoming technical challenges and improving manufacturing efficiency)
- The design, development and trialling of medical devices
- The development of complex health based IT products and apps (e.g. the development of unique algorithms for analysing and displaying complex health related data)
- New product and process development from lab and bench scale development, through to larger scale trials
- Process improvement projects driven by the need to reduce costs, increase throughput or improve product quality
- Introduction of new, or significantly modified manufacturing processes to overcome major problems encountered with an 'established' process
- Development of new automated processes to improve quality consistency and competitiveness
- Investigations into the suitability of alternative raw materials and components for existing production processes
- Development of new equipment or process designs to meet emerging safety or environmental requirements

As with most aspects of the tax system, there are some complexities within the regime which taxpayers will need to navigate, aside from being able to apply the definitions of what is R&D and what is (or is not) an eligible activity or type of expenditure.

Major changes resulting from submissions

Following the consideration of the Bill by the Finance and Expenditure Committee, many aspects of the original Bill remain unchanged, however there have been some improvements, most notably:

- There are now part-year continuity rules, meaning that some R&D tax credits can still be used or carried forward in the event of a shareholding change.
- It is made clear that joint ventures will be able to be eligible for the regime. Under the regime, the eligibility will be tested at the joint venture level (including whether the $50,000 minimum spend is satisfied), with R&D credits disseminated to joint venturers in proportion to their interest in the joint venture.
- The original Bill included a requirement that the party claiming the R&D tax credits needed to hold sole controlling rights to the R&D. This requirement has been removed.
- There has been an improvement to the rules which will allow certain companies to obtain a refund of R&D tax credits if they are in a loss position. The ability to obtain refunds remains very restricted, however this will be improved over time as these rules are subject to further policy consideration.
- The original Bill contained rules which removed 20% of the cost of eligible outsourced R&D from being eligible expenditure, as this was considered a proxy for the profit margin of the party performing the R&D services. This requirement has been removed.
- The cap on internal software development expenditure has been significantly increased from $3million to $25million.
- Additional employment costs beyond salary and wages will be eligible, for example employee share scheme benefits, bonuses, fringe benefits, recruitment and relocation costs.
- Existing Callaghan Innovation Growth Grant recipients with late balance dates will be able to claim R&D tax credits for the remainder of the 2021 income year after the expiry of final Growth Grants on 31 March 2021.

Points to watch out for

As with most aspects of the tax system, there are some complexities within the regime which taxpayers will need to navigate, aside from being able to apply the definitions of what is R&D and what is (or is not) an eligible activity or type of expenditure. We set out below some details of some of the trickier aspects of the regime.

Capitalised R&D

Specifically listed as ineligible expenditure is "expenditure or loss to the extent to which it contributes to the cost of depreciable tangible property, if the depreciable tangible property is not used soley in performing a research and development activity". What this means is that if R&D expenditure is directed towards creating a new physical asset (for example, creating a brand new machine to manufacture a new product), if that expenditure is treated as capital expenditure for tax purposes then it will not be eligible for the tax credit. The stated rationale for this treatment is that if expenditure has been capitalised this can indicate that any scientific or technological uncertainty has been resolved.

While a similar approach is adopted in Australia, a key difference between the two countries is the approach taken to

capitalising expenditure for tax purposes. In New Zealand we treat expenditure as being "capital" in nature much earlier than may be the case in Australia – refer to our March 2017 Tax Alert for a summary of the New Zealand treatment of feasibility expenditure.

This rule may turn out to be problematic for some taxpayers and will put some pressure on the boundary between capital and revenue expenditure.

To the extent R&D is directed towards intangible property (e.g. software) or assets which are being created solely for R&D purposes (e.g. a prototype) any capitalised costs may still be eligible for the R&D tax credit.

Software

From the time the R&D tax credit regime was first mooted by the Government there has been concern that the regime would not allow software to qualify for the tax credit. At a high level this is because it is perceived as being difficult for software to satisfy the "scientific or technological uncertainty" test.

The draft guidelines prepared by Inland Revenue devote a number of pages to explaining how the rules apply to software development, including examples of software activities which may be eligible. Once finalised, these guidelines will be a useful resource for taxpayers.

From a software perspective, it is also important to be aware that there are separate rules for software which is developed for sale and software which will be used for internal purposes. Internal software development is subject to an overall cap on eligible expenditure of $25million and has specific activities directed towards the internal administration of the taxpayer being ineligible for the tax credit.

R&D collaborations / outsourced R&D

The R&D tax credit regime contemplates that businesses can work together with others when undertaking R&D, this includes outsourcing R&D to another party. The regime has specific rules which are designed to ensure that multiple taxpayers can't claim an R&D tax credit for the same item of R&D (obviously partners in partnerships and joint venturers can each claim their respective shares of R&D).

If your business works with others, it will be important to consider your contractual arrangements to make sure it is clear which party will be eligible for the tax credit, and also to ensure that rights and obligations are not split between parties in a way which results in nobody being eligible for an R&D tax credit.

Documentation requirements

Anyone wanting to claim R&D tax credits will need to keep records to demonstrate that the activities they undertook met the definition of an R&D activity. The type of records that must be kept include records which show:

- Basic eligibility criteria are met (i.e. that there was R&D and the taxpayer is carrying on business in New Zealand)
- The purpose of the R&D;
- The scientific or technological uncertainty the R&D intends to resolve;
- Why the scientific or technological uncertainty could not be resolved by information that is publicly available or deducible by a competent professional;
- The systematic approach that was undertaken to try to resolve the uncertainty; and
- The nature of any supporting activities, and evidence to show they were integral to the core R&D activity.

Records should be kept contemporaneously, rather than being documentation created after the fact for tax purposes.

Year one of the regime will operate slightly differently to future years. From year two onwards there will be rules which will require taxpayers to either get "in-year approval" from Inland Revenue that an activity is an eligible R&D activity, or will require "significant performers" of R&D to obtain external certification of R&D activities.

Getting ready

Now is the time to get prepared for the R&D tax credit regime. Get talking within your business to start to determine whether some of your activities may be eligible for a tax credit. Check existing documentation processes to see whether adequate information is currently in place to enable your business to identify eligible projects and expenditure. Documentation will be very important, as will the ability to separate eligible and non-eligible expenditure.

If you need any help in understanding the new rules and getting ready for them, contact one of us or your usual Deloitte advisor.

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New DTA between New Zealand and China signed

By Jenny Liu and Michelle Shi

On 1 April 2019, a new double tax agreement (DTA) between the People's Republic of China and New Zealand was signed. This agreement, when in force, will replace a 1986 agreement and therefore introduces a modern set of tax rules in relation to cross border economic activity.

Withholding tax

With regard to withholding taxes, a key change is to introduce a new lower 5% withholding tax rate for dividends where the beneficial owner is a company that has held a direct interest of at least 25% of the capital of the company throughout a 365-day period that includes the payment date.

Dividends paid to a beneficial owner who is the government of the state would not be taxed, provided that the government and its associated enterprises hold directly or indirectly no more that 25% of the voting power in the company paying the dividend.

With regard to the royalty article and specifically the definition, the trend when updating tax treaties has been to remove "the use of , or the right to use, any industrial, scientific or commercial equipment" from the royalty definition so these payments are taxed as business profits under article 7 (i.e. where there is a permanent establishment). However, there has been no change in this regard in the new agreement such that these payments will still be treated as a royalty for DTA purposes. Under New Zealand tax rules, these payments are taxed as schedular payments and so the effect of the treaty in this case is (still) to limit the non-resident contractor's withholding tax to 10%. A special rate certificate should be obtained in order to apply this reduced rate.

Dual Residence

For a person other than an individual, under the 1986 agreement, the person is treated as a resident of the Contracting State in which its head office is situated. In the new DTA, this tie breaker test has been removed meaning that in dual residence situations, the residence of the person can only be determined by mutual agreement between the competent authorities.
In the absence of such agreement, the person shall not be entitled to any relief or exemption provided by the DTA. This may prove to be difficult and therefore companies should do their best not to be in a dual residency position.

Permanent establishment

A key change to the permanent establishment article is in relation to a building site, or construction, assembly or installation project. Positively, the time frame before a permanent establishment will arise has been extended from 6 to 12 months.

Multilateral convention measures

What is perhaps interesting is that while the existing 1986 DTA is a "covered agreement" for the purposes of the multilateral convention to implement related measures to prevent base erosion and profit shifting (MLI), China's position on this when compared to New Zealand's meant that many of the new MLI articles would not actually apply to the 1986 DTA. For example, all of the changes to the permanent establishment articles (artificial avoidance through the use of commissionaire arrangements, specific activity exemption and splitting up of contracts) do not apply. Although China has not yet ratified the MLI and therefore it has not come into force for the 1986 DTA. However, the new DTA not only incorporates the new MLI articles where there was agreement, but does now incorporate some of these other articles. For example, article 12 of the MLI which concerns artificial avoidance of the permanent establishment status through Commissionaire Arrangements has actually been included in the permanent establishment article of the new agreement despite China initially reserving its right to adopt this MLI article. Broadly, this article means that if a person acts on behalf of an enterprise and in doing so habitually concludes certain types of contracts, or habitually plays the principal role leading to the conclusion of certain types of contracts that are routinely concluded without material modification by the enterprise, a permanent establishment will arise. The fiscally transparent wording (Article 3 of MLI) and definition of person closely related to an enterprise (Article 15 of MLI) have also been included in the DTA.

Application date

The other point to note is that this signed agreement will not come into force until domestic procedures in both countries have been completed and there is an exchange of diplomatic notes. This could take some months yet. If this process occurs during the 2019 calendar year, the earliest date that this agreement could apply would be from 1 January 2020 in respect of withholding taxes; or for any taxable year beginning on or after 1 January 2020 for other taxes.

From a practitioner's perspective, a new modern DTA which incorporates the MLI articles certainly makes working with DTAs easier, therefore this is a welcome development.

For more information on how the new DTA will apply to cross border transactions, please contact your usual Deloitte advisor.

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Happy New Tax Year – what you need to know in April 2019

By Emma Marr

The 2019 income year came to a screeching halt on Friday 29 March, and the dawn of the New (Tax) Year has broken. Those still recovering from the annual tax return filing festivities may be startled to discover that there is plenty left to do in the near future – Inland Revenue has been forging on with business transformation and changes affecting most taxpayers are now upon us. Read on for more information on how this, and other recent changes, could affect you. You should also refer to other articles in this edition of Tax Alert on research and development, and the Commissioner of Inland Revenue's care and management obligations, as changes are afoot in those areas too. If you want to discuss any of the changes and how they impact you further, please contact your usual Deloitte advisor.

Some Inland Revenue downtime, and then a new website

Inland Revenue is rolling out their new website on 26 April 2019, following a seven-day shut-down of core-services (including office counters and contact centres) from 3pm Thursday 18 April 2019 to the morning of Friday 26 April 2019. Inland Revenue is taking advantage of the fact that due to Easter and ANZAC day being in the same week this year, there are only two working days in this period. The website will still be available during this period and payments can be made by online banking. Inland Revenue advise that the new website will have improved functionality and present content in a crisper, more accessible style.

Payday reporting

A big change that all employers have to grapple with this month is the change to payday reporting. From April 2019 employers and intermediaries will be required to digitally file employment information, instead of the current employer monthly schedule, within two working days of payday. Different timeframes apply for those filing on paper. This will impact most employers, including those with shadow payrolls or who make schedular payments. Payday reporting was voluntary from April 2018 but is now compulsory. It is important to remember that the tax payment deadlines have not changed, it is only the employment information that must now be reported at different times.

You can read more about payday reporting in our February Tax Alert article.

Tax changes for individuals

Wage and salary earners – welcome to a brand new world. A major part of Inland Revenue's transformation process is simplifying individual tax compliance processes, and the new rules are now in force. From the tax year ending 31 March 2019, individuals who only earn salary and wages or investment income will no longer have to request, or be provided with, a Personal Tax Summary. This means Inland

Revenue will use information provided by employers and payers of investment income to pre-populate income tax returns. Using this information, Inland Revenue will determine whether it can automatically generate a refund or a request for a payment of additional tax. Individuals will have to let Inland Revenue know if they receive additional income so that their tax obligation is correctly calculated.

If Inland Revenue can't automatically generate a refund or request for an additional tax payment, taxpayers will need to provide additional information via myIR, Inland Revenue's online portal. Inland Revenue will prepopulate IR 3s with information they have gathered from employers and investment income payers. You can read more about these changes, including how individuals will claim donation rebates, in our March Tax Alert article.

A big change that all employers have to grapple with this month is the change to payday reporting. From April 2019 employers and intermediaries will be required to digitally file employment information, instead of the current employer monthly schedule, within two working days of payday.

Read your odometer

New mileage reimbursement rates apply from 1 April 2019 for those with standard balance dates. The tier one rate of 76c/km applies to the work related portion of the first 14,000km of combined business and private travel per annum, provided a log book or similar records are maintained by the employee. Tier two rates apply to travel exceeding this distance, and depend on the specific vehicle being used. Read more about the new rates in our article from August 2018, and make sure you take an odometer reading this month so you can comply with the new rules.

Recalculate your debt percentage and debt pricing

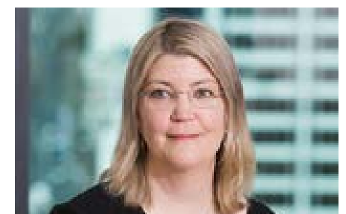
If you are controlled by a non-resident you will be subject to new rules on a range of issues, including debt pricing, debt/asset ratios and transfer pricing. The new rules apply from the income years starting from 1 July 2018 so if you have a March balance date, the rules apply from 1 April 2019. If your company is reasonably highly leveraged, you should carefully calculate whether you meet the new thin capitalisation debt/asset ratios. Any related-party debt should be considered in light of the new debt pricing rules. You can read a summary of the new rules here.

Landlords – remember the new rules

If you own investment property you should be aware of new rules about offsetting losses made from residential rental properties. The proposed legislation, which is still progressing through Parliament, intends to end landlords offsetting losses incurred on residential rental properties against other sources of income (for example salary or wages and investment income), which generally results in a reduced tax liability and in many cases an income tax refund. The rules, when enacted, will apply from 1 April 2019. You can read more about them in our March 2019 article.

Other changes

RWT certificates are now available electronically rather than being posted to taxpayers. The government has also tinkered with provisional tax, student loan and working for families rules, Kiwisaver contributions and the binding rulings regime.



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Special powers to remedy legislative anomalies re-introduced

By Hamish Tait

Special new provisions that will give Inland Revenue the power to quickly make minor, temporary 'fix ups' to tax law have recently been re-introduced to Parliament, after being comprehensively re-drafted.

This article briefly outlines the history of this proposal, discusses the changes that have been made from what was originally proposed, and comments on the merits of the proposed new powers.

Where did this proposal come from?

As outlined in our August 2018 Tax Alert, draft legislation was originally introduced to Parliament in June 2018 which included provisions that would grant the Commissioner of Inland Revenue (the **Commissioner**) additional powers to remedy "legislative anomalies". A legislative anomaly (which was a defined term in the original draft legislation) was essentially an issue with tax legislation which meant that the words could not be interpreted consistently with the underlying policy intent. It was proposed that the new powers would be an extension of the Commissioner's "care and management" responsibilities in the Tax Administration Act 1994, which charge the Commissioner with the "care and management of the taxes covered by the Inland Revenue Acts".

The specific new powers that were proposed were the ability for the Commissioner to:

- Recommend to the Minister of Finance that regulations (i.e. an Order-in-Council) be made by the Governor-General to remedy a legislative anomaly;
- Make a determination as to how a legislative anomaly should be treated; or
- Take certain "administrative action" to mitigate the effect of a legislative anomaly.

However, in November 2018, Inland Revenue officials recommended to the Finance and Expenditure Select Committee (the **FEC**) that the proposed provisions should be removed from the Bill. This was because Inland Revenue officials were still considering the draft wording of the provisions, and were in discussions with the Government's Legislation Design and Advisory Committee to ensure they were consistent with the Committee's guidelines on legislation containing "Henry VIII clauses" (i.e. laws granting someone other than Parliament the power to change or suspend laws). Agreeing to Inland Revenue's recommendation, the FEC stated "[w]e consider that a very cautious approach is warranted with respect to these powers to ensure that Parliament's law-making authority is appropriately respected".

The draft provisions have now been comprehensively redrafted, and have been inserted into *the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill*, via Supplementary Order Paper No. 193 (the **SOP**) which was released on 6 March 2019. Submissions closed on this Bill in March 2019, and the proposals are now being considered by the FEC.

What powers are now being proposed?

From a general tax policy perspective, the new proposals in the SOP remain broadly unchanged from the original draft. In particular, it will still be possible for legislative anomalies to be temporarily remedied either by way of a regulation (on the recommendation of the Minister of Finance) or by way of decision made directly by the Commissioner.

Pleasingly, the provisions have been substantially redrafted to be much clearer for the reader, and are now structured in a more logical way.

Some substantive changes have also been made to the provisions in the SOP. As a result, now only the following two specific powers are proposed in the updated draft:

- *Regulations*: The Minister of Finance may recommend that an Order-in-Council be made by the Governor-General which provides that a provision of the Inland Revenue Acts (i.e. a tax law) does not apply or applies with conditions, or which grants an exemption from such a provision; and
- *Exemptions*: The Commissioner may grant an "exemption" from a tax law.

Notably, the previously proposed powers for the Commissioner to make a determination or to take an administrative action have now been replaced in the SOP with the power to grant an "exemption". An exemption is to be a "legislative instrument" that is a "disallowable instrument" (i.e. it must be presented to the House of Representatives for review and scrutiny, as with regulations/Orders-in-Council). This should mean that there will be more oversight over the granting of exemptions by the Commissioner than there would have been with determinations or administrative action.

The key distinction between using a regulation or an exemption appears to be that regulations would be required where the issue had fiscal implications (because the exemption power may not be used where any fiscal implications are more than negligible). A Cabinet paper published with the SOP also refers to an exemption not being used where the matter is "sensitive", although this does not appear to be articulated in the legislation itself. A regulation may also be retrospective for a longer time period than an exemption, as discussed below.

In all other respects, the requirements and restrictions on the exercise of the two modification powers will be similar, and are also largely unchanged from the original proposals. In summary, these are that any modification (whether it is a regulation or an exemption):

- Must be optional for a taxpayer to apply (i.e. a taxpayer can choose to disregard the modification if it is unfavourable);
- Must apply "generally" unless it is stated to apply to a particular class of persons or circumstances (i.e. it may not expressly apply to a specified taxpayer);
- May only last for up to two income years after the income year in which the modification comes into force (i.e. essentially up to three income years);
- For a regulation, may apply retrospectively for up to four income years prior to the income year in which it comes into effect, or for an exemption, may apply retrospectively to the beginning of the income year in which it comes into effect;
- May only be made if the Minister / Commissioner is satisfied that the modification is reasonably necessary to fix an obvious error, give effect to the intended purpose of a tax law, resolve ambiguity or to reconcile an inconsistency;
- May not be broader than reasonably necessary to resolve the issue and must be the most appropriate way of doing so; and

- Must be subject to a consultative process of at least 6 weeks (formerly 4 weeks under the original proposals), unless there is "a case of urgency".

Finally, we note that there is no longer an express requirement that Inland Revenue consider whether a formal legislative amendment is required (recognising the modification is a temporary stopgap only). However, it seems implicit in the proposals that Inland Revenue officials would do this.

Are the new powers appropriate?

In an ideal world, there would be no need for the proposed new powers, as draft tax legislation would consistently be subject to an extensive consultation process allowing ample opportunity for errors and ambiguities to be corrected. However, given the increasing volume and complexity of new tax legislation in recent times (the timing of which is sometimes dictated by political considerations), a suitably fulsome consultation process is not always undertaken. Unless this changes, it seems that taxpayers and tax advisers must accept that legislative anomalies will continue to arise.

With that in mind, the proposed powers should be seen as a welcome development. It is hoped that they will allow legislative anomalies to be quickly and effectively remedied in a consistent and transparent way.

Although some have questioned whether it is appropriate for the Commissioner or the Minister of Revenue to be able to change tax laws without Parliament's approval, there are a number of specific restrictions and safeguards that apply to limit the scope of the powers. The most important of these (which critically has been retained through the redrafting process) is that the regulations or exemptions must be optional to apply. This should provide ample protection for taxpayers and prevent them from being adversely impacted by any changes. Further, the empowering provisions essentially only allow laws to be suspended, rather than allowing new substantive laws to be created. In this respect, it arguably puts the power on par with, for example, the securities law exemption powers held by the FMA, which

Although some have questioned whether it is appropriate for the Commissioner or the Minister of Revenue to be able to change tax laws without Parliament's approval, there are a number of specific restrictions and safeguards that apply to limit the scope of the powers. The most important of these (which critically has been retained through the redrafting process) is that the regulations or exemptions must be optional to apply.

have been around in various forms for many years. Finally, following the redraft, a clear "Purpose of remedial powers" provision has been included in the draft SOP, which makes it abundantly clear the purpose of the powers is only to provide the "flexibility to temporarily remedy or mitigate" a legislative anomaly: they may be used for minor 'fix ups' only.

It is also worth noting that, at present, the Commissioner's "care and management" responsibilities are the primary way that anomalies are 'fixed' (pending a remedial legislative amendment). Often this will take the form of the Commissioner stating that she will not devote resources to investigating certain breaches of a tax law. However, there can be little or no transparency over the exercise of this discretion, and taxpayers cannot generally rely on it where a specific issue in a tax return has been identified by an Inland Revenue investigator. With this in mind, the proposed new powers should be seen as a welcome development to help set more clearly defined processes for remedying anomalies, as well as increasing transparency and oversight of those remedies.

Further comments

It is pleasing to see that following the redrafting process the new legislation is now clear, logically set out and easier to understand. However, there are a number of areas that are not specifically dealt with in the legislation, on which Inland Revenue will need to provide guidance, including:

- The nature of legislative anomalies that it will be appropriate to remedy. It would be useful if the Commissioner could provide some examples of specific scenarios that may arise where the Commissioner envisages she would use the power;
- When the Commissioner considers that she will be unable to grant an exemption (and regulations will therefore be required); and
- The process for notifying Inland Revenue of a legislative anomaly or requesting the exercise of the modification power.

It would be useful for guidance to be published on these matters so that taxpayers can understand the practical implications of the new power, and to help ensure the powers are used fairly and consistently.

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Snapshot of Recent Developments: April Tax Alert

Policy Developments:

The Taxation (Annual Rates for 2018-19, Modernising Administration, and Remedial Matters) Act receives the Royal assent

On 18 March 2019, the Taxation (Annual Rates for 2018-19, Modernising Administration, and Remedial Matters) Bill ("TARMTARM Bill") received Royal assent on 18 March 2019. The Act, among other things:

- simplifies individual taxpayers' tax return filing rules (effective for 2019 year ends);
- clarifies how Inland Revenue can collect, use and disclose taxpayer information;
- introduces a "short process ruling" where small businesses can more easily apply for a binding ruling from Inland Revenue on any tax matter;
- adds new KiwiSaver contribution rates of 6% and 10% and makes the savings scheme accessible to those aged over 65.

Finalised Inland Revenue Items:

Spreading of income and expenditure under deferred payment arrangement - Special Determination S60

On 12 March 2019, Inland Revenue released Special Determination S60: Spreading of income and expenditure under deferred payment arrangement.

The determination is made under s 90AC(1)(bb) of the Tax Administration Act 1994 ("TAA 94") and applies to the applicants in relation to a deferred payment arrangement. Under the arrangement, a company assigned its rights to future cashflows to the applicants, in partial satisfaction of existing debts owed by the company to the applicants.

Optional Convertible Notes with Discretionary Interest Payments - Special Determination S61

On 12 March 2019, Inland Revenue released Special Determination S61: Optional Convertible Notes with Discretionary Interest Payments.

The determination is made under ss 90AC(1)(bb) and (h) of the TAA 94 and relates to the issue of optional convertible notes issued by the Issuer to Holders who are owned and controlled by the same persons as the Issuer's shareholders. The determination specifies whether any amount is solely attributable to an excepted financial arrangement.

Spreading method to be applied by Landowners making Infrastructure Payments to fund bulk infrastructure under a Final Encumbrance - Special Determination S62

On 20 March 2019, Inland Revenue released Special Determination S62: Spreading method to be applied by Landowners making Infrastructure Payments to fund bulk infrastructure under a Final Encumbrance.

This Determination relates to an arrangement involving an encumbrance under which a landowner is required to make payments to an LP over a fixed period. This determination prescribes the method for determining the amount of expenditure a landowner has under the financial arrangement in each income year.

Question We've Been Asked - What are the requirements for claiming tax deductions for payments to family members for services? – QB 19/01

On 22 March 2019, Inland Revenue released QB 19/01: What are the requirements for claiming tax deductions for payments to family members for services?

This QWBA deals with the requirements for claiming income tax deductions for payments to spouses, partners, or other family members for services they provide to businesses or other income earning activities. It reminds taxpayers that to claim deductions:

- the family member must provide services to the business;
- the amount paid must not be excessive, and
- if the family member is a spouse or partner, the Commissioner's prior approval for a deduction is required unless the business is run though a company (s DC 5 of the Income Tax Act 2007).

Question We've Been Asked - Depreciation – change of use event – QB 19/02

On 3 April 2019, Inland Revenue released

QB 19/02: Depreciation – change of use event.

This item considers whether depreciation recovery income may arise for a business that becomes a charity and begins deriving exempt income. The item concludes that a business that becomes a charity will have a change of use of its depreciable property, as that property is no longer available for use in deriving assessable income but will be used for deriving exempt income. As depreciation deductions will be disallowed, ss EE 47(2) and EE 47(2B) apply.

The issue was raised following an amendment to the timing of this income (now contained in s EE 47(2B)) which means that any depreciation recovery income will arise immediately before the income exemption applies.

Voluntary disclosures - SPS 19/02
On 28 March 2019, Inland Revenue released standard practice statement SPS 19/02: Voluntary disclosures.

The statement will apply from 27 March 2019 and will replace SPS 09/02: Voluntary disclosures. The finalised standard practice statement sets out the factors that the Commissioner will consider when forming an opinion as to whether a taxpayer has made a full voluntary disclosure.

Tax Cases:
Cullen Group LTD v The Commissioner of Inland Revenue [2019] NZHC 404

The High Court dismissed Cullen Group's challenge to the Commissioner's assessment that it had avoided $59.5 million of NRWT while it paid $8 million in approved issuer levies (AIL). The Court found that the use of the AIL regime in this arrangement was not within Parliament's contemplation, on the basis that Parliament had enacted the AIL regime with the objective of encouraging investment in New Zealand, by reducing the cost of New Zealand residents borrowing from non-residents. The Court considered it was relevant that the arrangement in this case in the Court's view introduced no new funds. The Court construed the arrangement as having restructured shares in one New Zealand company into loans to another New Zealand company which were assigned to overseas entities in form but not in substance.

Van Uden v Commissioner of Inland Revenue [2019] NZSC 29

The Supreme Court has dismissed an application for leave to appeal in the matter of whether a taxpayer had a permanent place of abode in New Zealand. The Court of Appeal decision that Mr van Uden did have a permanent place of abode (PPOA) was covered in our December 2018 Tax Alert. The Court found he had a PPOA in New Zealand because he 'almost always' stayed at the property in question when he was in New Zealand, despite never owning the property.

The Supreme Court determined that the appeal raises no point of general or public importance and dismissed the application for leave to appeal.

Peter William Mawhinney as Trustee of the Doug Vesey Trust v Commissioner of Inland Revenue [2019] NZHC 553

The High Court has dismissed Mr Mawhinney's challenge to a Taxation Review Authority (TRA) decision. The case concerned whether a notice of response (NOR) issued by the Commissioner was issued too late, and whether, as a result, the Commissioner was deemed to have accepted the taxpayer's notice of proposed adjustment (NOPA).

The Court held that the time available for the Commissioner to issue a NOR began on the day that the Commissioner's declined to accept the taxpayer's late-filed NOPA under section 89K(1) of the Tax Administration Act 1994. There was nothing in the relevant statutory provisions which suggested the Commissioner should issue

a NOR just in case the taxpayer brought a successful challenge to her refusal.

[*Commissioner of Inland Revenue v Chatfield & Co Limited* [2019] NZCA 73]

The Court of Appeal has dismissed Inland Revenue's appeal against a High Court decision relating to a request for information by the Korean National Tax Service (KNTS) under the New Zealand/Korean Double Tax Agreement (DTA).

The Court of Appeal confirmed the High Court decision that the Commissioner of Inland Revenue should not have issued notices, requesting information, to a Korean national with New Zealand residency, and to the Korean national's tax advisor.

The Court of Appeal held that although Inland Revenue can apply a "presumption of regularity" to a DTA partner's request, the Competent Authority under the treaty (an Inland Revenue official) had applied the wrong test when determining whether to respond to the request from the KNTS. We will cover this case in more detail in the May edition of Tax Alert.

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