Deloitte.

# Tax Alert

August 2020

## Are you remote working in New Zealand for a foreign employer?

We know that over 20,000 Kiwis have come home to New Zealand in the last 5 months, and many of them will be competing for a decreasing number of local jobs.

Page 2

# Are you remote working in New Zealand for a foreign employer?

By Andrea Scatchard and Mihiri Nakauchi

We know that over 20,000 Kiwis have come home to New Zealand in the last 5 months, and many of them will be competing for a decreasing number of local jobs. But a select few will be lucky enough to be able to continue working remotely for their foreign employer. Level 4 lockdown showed many employers that remote working can be very successful, and in many cases it does not really matter whether the home an employee is working from is close to their usual workplace, or on the other side of the world.

The technology that allowed remote working to be so successful during Level 4 lockdown and beyond has been available for some time now. Even before COVID-19 we had seen a rise in the number of Kiwi employees who have been able to negotiate contracts that allow them to work from home in New Zealand for overseas employers.

It is fair to say that this will only increase in future because, as we know, New Zealand is a great place to be right now. As with most things, it is best to get the finer details of such arrangements nailed down from the start so there are no unexpected outcomes. One area that can be easily overlooked is the New Zealand tax obligations that arise from cross border employment arrangements, and we address these below. So if this is you, or if you know anyone in this situation, keep reading.

## Employment income that an employee earns from services provided in New Zealand is New Zealand sourced income and therefore is taxable here, subject to some limited exemptions for visits under 93 days.

### Is my income from my offshore based employer subject to tax in New Zealand?

Employment income that an employee earns from services provided in New Zealand is New Zealand sourced income and therefore is taxable here, subject to some limited exemptions for visits under 93 days. It does not matter whether the employment income is paid by a New Zealand or foreign employer, whether the foreign based employer has a presence in New Zealand or not, or whether any PAYE type tax has been deducted in the foreign employer's country. It also does not generally matter if the employee is a tax resident or non-resident of New Zealand, although there are some exemptions available under double tax agreements (DTA) for non-residents – refer to our article on tax residence in this edition of Tax Alert. However, the rule of thumb is - as the employment income is earned in New Zealand it will be taxed here.

So the employee will need to file an income tax return in New Zealand. Generally a New Zealand tax resident is subject to tax on their worldwide income and any tax that has been deducted by a foreign employer and paid to the Inland Revenue equivalent overseas may be able to be claimed as a credit in the employee's New Zealand tax return.

But beware - just because tax has been paid in the other country does not mean a foreign tax credit is automatically available in New Zealand. There must have been a requirement for the individual to have paid tax in the other country, and in many cases where there is a double tax agreement the foreign country will have no ability to impose tax on the New Zealand sourced income if the individual is tax resident in New Zealand. The solution in such cases is to stop the foreign PAYE deductions in the first place.

### How is the New Zealand tax paid?

Generally, employment income is taxed in New Zealand through the PAYE system, where the onus is on the employer to withhold PAYE on employees' earnings, report the employment information and pay the tax to Inland Revenue. For employees that are working remotely in New Zealand for their offshore based employer, there may or may not be a liability for the employer to withhold PAYE.

Inland Revenue has recently released a draft operational statement "ED0223 Non-residents employers' obligation to deduct PAYE, FBT and ESCT in cross-border employment situations", intended to give guidance on when a non-resident employer is required to withhold PAYE. It concludes that if the employer has a sufficient presence in New Zealand, and the services performed by the employee are attributable to the employer's presence in New Zealand, the non-resident employer will have an obligation to withhold and account for PAYE. Conversely, if the employer does not have a sufficient presence in New Zealand, Inland Revenue has no legal jurisdiction over the employer and cannot enforce our tax laws on it. In this case PAYE is not payable by the employer.

The draft statement notes that a non-resident employer will have a sufficient presence if it has a trading presence in New Zealand, if it has a permanent establishment, including a branch, in New Zealand, if contracts are entered into in New Zealand or if New Zealand based employees perform contractual obligations in New Zealand.

It also states that an employer will not have a sufficient presence in New Zealand solely because an employee chooses to live and work in New Zealand as a matter of personal preference.

So for a returning Kiwi negotiating remote working from New Zealand, where there is no particular business reason or benefit in having the employee based in New Zealand, this is unlikely to cause the foreign employer to have a New Zealand PAYE liability.

We note that due to COVID-19–related travel restrictions, employees may be stranded in New Zealand. OECD guidelines confirm that non-resident companies should not be deemed to have a fixed establishment merely because employees are confined due to these travel restrictions, and the New Zealand Inland Revenue has confirmed it will follow this principle. However such concessions are unlikely to be able to be relied on where employees have chosen to return to New Zealand for COVID-19 reasons as they have not been stranded here unexpectedly.

Where the non-resident employer does not have a sufficient presence in New Zealand, and so is not liable to withhold PAYE for the employee, the responsibility for doing so falls on the employee instead. Inland Revenue requires such employees of overseas companies to disclose and pay their own taxes on their earnings as what we call an "IR 56 taxpayer". The employee is required to register as an employer and comply with the payday filing rules and PAYE payment rules. The employee will also be subject to the usual penalties and use of money interest for non-compliance with these rules.

## What other tax implications might there be?

Ordinarily any non-cash benefits provided to an employee in New Zealand, such as health insurance, availability of a motor vehicle and amounts paid into a non-New Zealand pension scheme, would create a fringe benefit tax (FBT) liability for the employer. ED0023 acknowledges that where the foreign employer is not required to account for PAYE no FBT will be payable on non-cash benefits as there is no mechanism for FBT to be paid by the employee in place of the employer.

Generally employers are required to pay KiwiSaver employer contributions in relation to their employees and an employee who is present in New Zealand and entitled to live in New Zealand permanently will be eligible to join a KiwiSaver scheme. However, while an IR 56 taxpayer may voluntarily elect into KiwiSaver and pay personal contributions from their tax paid income, they are not able to require a compulsory employer contribution.

All employees in New Zealand must pay the ACC earner's levy to cover the cost of non-work related injuries. This is withheld from earnings and as part of the PAYE amount, and this is no different for IR 56 taxpayers. IR 56 taxpayers also are required to pay additional ACC levies as an employer, which will be invoiced by ACC after the end of each employment year.

## Are you affected?

These rules can be quite complicated and we have seen many instances where the employer and the employee did not fully understand or consider the New Zealand tax implications of their remote working arrangements. Rectifying this can be quite costly, especially if the employee has been present in New Zealand for an extended period of time. While Inland Revenue has been able to exercise discretion in a number of areas for COVID-19 related tax oversights, we expect this will be lessening as travel and other restrictions ease, so now is the time for your, or your employer's, tax affairs to be sorted out if you are working in New Zealand for your overseas employer.

Please contact your local Deloitte advisor if you would like further information.

## Contact

**Andrea Scatchard**
**Director**
Tel: +64 7 838 4808
Email: ascatchard@deloitte.co.nz

**Mihiri Nakauchi**
**Senior Consultant**
Tel: +64 7 834 7878
Email: mnakauchi@deloitte.co.nz

# I'm returning to New Zealand, what does this mean from a tax perspective?

By Stephen Walker

You may be one of the many 20,000+ Kiwis that have returned to New Zealand after 1 April 2020 (the start of the New Zealand tax year). If so, and you've got questions about how you will be taxed in New Zealand, this could be the article for you!

Among a number of repatriation matters that you are having to think about, tax is probably the one that you will put off until it comes time to prepare your first New Zealand tax return which, without a tax agent, will be due on 7 July 2021 and will cover the year to 31 March 2021.

However, there are several questions you will need to consider between now and then, and a number of answers you will need to find before you can prepare your first New Zealand tax return.

## How do I work out how I will be taxed in New Zealand?

When trying to determine how you will be taxed in the context of an international move, the general approach is to:

1. Determine how New Zealand will tax you;
2. Check whether you're still going to be taxed in another country;
3. If so, determine whether a tax treaty (also known as a double tax agreement) will provide any relief from double taxation.

We explain these steps at a high level below. Every person's situation is slightly different, and we recommend you get specialist advice to confirm the right position you need to take when filing your tax returns. You can refer to our other articles for more information on employment tax considerations if you are working for an overseas employer or the COVID-19 concessionary rules announced by Inland Revenue which could apply to New Zealand's tax residency tests.

## Step 1: How will New Zealand tax me?

If you are a tax resident of New Zealand, you will be taxed here on your worldwide income, no matter where the income is earned or where the income is paid.

If you are a tax non-resident of New Zealand, you will only be taxed here on income that is sourced in New Zealand.

Remember that the concept of tax residency is not the same as immigration residency.

You can be tax resident without being a resident or a permanent resident of New Zealand for immigration purposes, and vice versa.

## When will I become a tax resident of New Zealand?

New Zealand has two tax residency tests. You will be considered a tax resident of New Zealand if:

1. You are physically present (i.e. both workdays and holiday days count) in New Zealand for more than 183 days in any 12-month period; or
2. You have a permanent place of abode in New Zealand, commonly referred to as a PPOA.

You will be a tax resident from the day you first acquire a New Zealand permanent place of abode or, if you become a tax resident first by meeting the 183 day test, from the first of the 183 days. This is an objective test, and part days are counted as whole days.

The permanent place of abode test is more subjective and the term is not defined within New Zealand tax legislation, although there is some guidance available. Relevant factors include where you usually live, what you consider to be your home, where your social and economic ties are, and, to some extent, your intentions.

If you are unable to determine whether you have a permanent place of abode in New Zealand, we recommend you seek advice from a New Zealand tax specialist.

Once you have become a tax resident of New Zealand, in order to lose New Zealand tax residency, you will need to:

1. Be physically absent from New Zealand for more than 325 days in any 12-month period (in other words, spend less than 40 days in a 12-month period back in New Zealand); and

2. Not have a New Zealand permanent place of abode.

In this sense, it is easier to gain New Zealand tax residency than it is to lose it due to the application of the day count tests.

### What is transitional tax residency and can it apply to me?

New Zealand has a special one-time tax residency category, known as transitional residency. A transitional resident is a first-time tax resident of New Zealand, or a returning resident who has been a tax non-resident for at least 10 years, and who has not been a transitional resident before.

A transitional resident is taxed here on income that is sourced (broadly income that is earned) in New Zealand, as well as worldwide income from employment or personal services. Passive offshore investments can largely be ignored for New Zealand tax purposes if you are a transitional resident.

Transitional residency lasts for up to 48 months, but this can be extended slightly depending upon which of the two tax residency tests above you trigger first.

If you think transitional residency could apply to you, you should seek advice from a New Zealand tax specialist.

### Step 2: How will I be taxed in the overseas country I've come from?

To answer this question, you will need specialist tax input from the country you have departed. You can be tax resident in more than one country (dual resident) at the same time, which creates a risk of double tax.

If you are a dual resident, the double tax agreements discussed in step 3 might provide some relief.

If you do not remain tax resident of the overseas country under their rules, it is likely (although should be confirmed by a tax specialist of that country) that you will only be taxed in that country on income that is sourced in that country.

### Step 3: How will a tax treaty apply to my residency position?

If you are a dual tax resident, you may find some relief within the so-called tie-breaker tests in a double tax treaty. Tie-breaker tests are considered in sequential order until a residency outcome is reached. Although all treaties differ slightly, generally they will consider where you have a permanent home, where your economic and personal relations are strongest, where you have an habitual abode, and where you are a national.

If you are a treaty tax resident of New Zealand under the tie-breaker tests, New Zealand has the right to tax you according to New Zealand tax rules. The overseas country may still have a right to tax income sourced in that country, subject to the terms of the treaty.

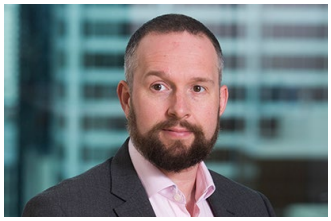
In that case, or if there is no treaty between New Zealand and the overseas country, if income is taxed in two counties you may get a tax credit against the New Zealand tax liability for tax paid on overseas income, subject to certain limits.

Alternatively, in applying the treaty tests above, if you are a treaty tax resident of the overseas country, then New Zealand will only be able to tax you on New Zealand sourced income, again subject to the terms of the treaty (if there is one).

### What should I do next?

Now you've got an overview of the rules, you've probably got more questions about how to apply those rules to your situation, following your recent move to New Zealand. We recommend that you seek specialist tax advice, which we would be happy to assist with. Please get in touch if you have any questions about your particular circumstances.

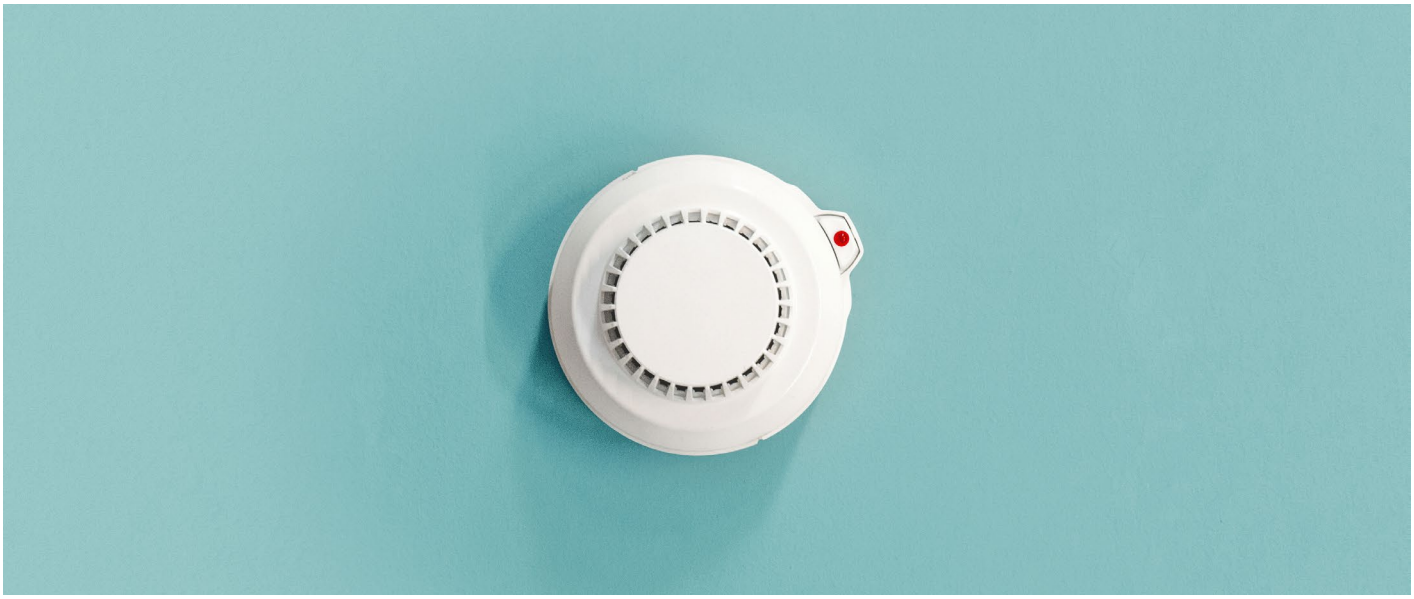
### Contact



**Stephen Walker**
**Associate Director**
Tel: +64 9 303 0892
Email: stewalker@deloitte.co.nz

# When does a smoke alarm stop being a smoke alarm?

By Robyn Walker and Blake Hawes



Everyone knows what a smoke alarm is; what its function and purpose is, and that most smoke alarms are battery powered, attached to the ceiling by a couple of screws and last about 10 years. However, some may be surprised to know that from a tax perspective when a smoke alarm is installed in a residential rental property it loses its identity and becomes part of a non-depreciable building.

The rationale for this treatment is set out in the recently released Questions We've Been Asked QB 20/01 "Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?" ("the QWBA").

The crux of the QWBA is that if something is required by regulation to be included in a residential rental property, then that item forms part of the building and it loses its own separate identity. This occurs under step two of a three-step test:

Step 1: Determine whether the item is in some way attached or connected to the building. If so, go to step 2. If not, the item will be a separate asset.

Step 2: Determine whether the item is an integral part of the residential rental property such that a residential rental property would be considered incomplete or unable to function without the item. If so, the item will be part of the residential rental building. If not, go to step 3.

Step 3: Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the "fabric" of the building. If so, the item will be part of the residential rental building. If not, the item will be a separate asset.

Smoke alarms are a compulsory item under the Residential Tenancies (Smoke Alarms and Insulation) Regulations 2016 ("the Smoke Alarm Standard"). Therefore, while a building can certainly provide shelter and function as a building without a smoke alarm, it would however be "incomplete" under the Smoke Alarm Standard. The outcome of step two is that it is not necessary to look at step 3. The installation of a smoke alarm can neither be expensed as a low value asset nor capitalised and depreciated as a separate asset (despite a depreciation rate existing for smoke alarms in the residential rental asset category).

With the upcoming expansion of requirements on landlords under the Residential Tenancies (Healthy Homes Standards) Regulations 2019 ("the HHS"), the analysis applying to smoke alarms will also start applying to other functionally separate assets once the HHS come into effect. This aspect is not articulated as clearly as it could be in the QWBA, as someone only reading the conclusion and not the full detail of the QWBA may rely on a statement that some heat pumps are separately depreciable assets. The QWBA has this to say about heat pumps: *"The Commissioner considers that heat pumps and the other forms of heating sufficient to meet the 2019 regulations are not yet a required feature of all residential rental buildings. Accordingly, at present, a building may be considered complete without these particular heating systems. As such, they are not integral to the building under step 2."* The key words are "not yet a required feature". Once the HHS heating standard is in place (which may be as early as 1 July 2021 depending on when tenancies change, or 1 July 2024 at the latest), any new heat pumps will become an integral part of the building and will no longer be treated as a separately depreciable asset.

The irony of the QWBA is that if a landlord complies with the HHS prior to them being in effect, then full and immediate deductions can be claimed for some of that expenditure (currently low value items costing less than $5,000 can be immediately expensed, with this amount moving to $1,000 from 17 March 2021). After the HHS take effect the analysis changes and the cost of acquiring any assets to comply with the standards then fails the three-step test and the costs are no longer deductible or depreciable as a separate asset, as they form part of a residential rental building (which is depreciable at 0%). The silver lining, if you can call it that, is that because the item becomes part of a larger building asset, if in the future it is necessary to replace the item (e.g. a heat pump) then that may be "repairs and maintenance" to the building which would be immediately deductible.

The QWBA essentially says if there is a legal requirement for assets to be used together, that those things are actually a single asset for tax purposes as a result of applying the three step test above. While the QWBA is limited in scope to residential rental properties, it is difficult to understand why there is a different outcome for commercial and industrial buildings, which are likely subject to much more extensive legal requirements; for example not just smoke alarms, but emergency warning systems, sprinkler systems, dry risers etc. These items would currently be separately depreciated in most instances. How or why the outcome should differ between building types is currently unclear.

For more advice on how to treat expenditure on residential rental properties contact your usual Deloitte advisor.

**Other rules for property owners to be aware of:**

### Deductibility of low value assets

A business may claim an immediate deduction for any low value assets acquired provided that:

- All assets acquired from the same supplier on the same day with the same depreciation rate have a combined cost of $5,000 or less (until 16 March 2021) or $1,000 or less (from 17 March 2021);
- The item has not been and will not become part of any other property that is depreciable property (e.g. it is not part of a building).

### Residential Rental Loss Ring Fencing

Loss ring fencing rules came into effect from the 2019/20 income year. These rules restrict the ability of property owners to claim deductions in excess of the income earned from residential rental properties. You can read more about these rules here.

### Contact

**Robyn Walker**
**Partner**
Tel: +64 4 470 3615
Email: robwalker@deloitte.co.nz

**Blake Hawes**
**Senior Consultant**
Tel: +64 4 831 2483
Email: bhawes@deloitte.co.nz

# COVID-19: Preparing for a wage subsidy audit – Would your business be ready?

By Robyn Walker and Blake Hawes


As we're now into the second half of what has been a rollercoaster of a year, New Zealand continues its long uphill climb of recovering from the COVID-19 outbreak. A climb that, while it may look daunting, may be a lot shorter than many other countries will have to complete.

While businesses will be planning their next steps as the country's economy rebuilds, the Ministry of Social Development ('MSD') have begun the mammoth task of auditing certain applications made under the Wage Subsidy Scheme ('the Scheme'); an action signalled from very early on in the Scheme. While the swift move into audit phase may seem harsh, the statistics that emerged regarding fraudulent claims on hardship grants after the Canterbury and Kaikoura earthquakes prove that some people will take advantage of 'high trust' opportunities.

Given the significant sum spent by the Government and the high level of public interest in the Scheme (evidenced by the regular media articles naming claimants), businesses should be looking to revalidate their eligibility to have claimed under the Scheme (both the original 12 week Wage Subsidy and the current 8 week Wage Subsidy Extension). Where appropriate, businesses should look to repay amounts claimed if there ultimately wasn't an entitlement to it. This is a process which is especially important for businesses who made a claim on the basis of an anticipated revenue loss under the original Scheme. Now is the time to validate and document that this loss did actually arise as predicted.

When considering your eligibility in light of a possible audit by MSD, we believe there are five key areas:

### 1. What is your degree of confidence that the business was and remains eligible for the Wage Subsidy?

To assess if your businesses was and has remained eligible, consideration should be given to the parts of the declaration that were not certain at the time your application was made. This is most likely your revenue decrease and the amount you paid your employees.

If your application for the original Scheme was made on a predicted 30% or more revenue decline, active steps should be taken to assess whether this decrease has materialised and whether the decline was due to COVID-19. The evidence of this should be documented in the event you are asked to prove it. As an aside, many COVID-19 concessions (particularly in relation to tax) only apply to businesses that have been "significantly affected by COVID-19," so there are multiple reasons why businesses should be understanding and documenting what the revenue impacts of COVID-19 have been.

When your application was made you would have declared to endeavour at your 'best efforts' to pay and retain employees at 80% of their regular income after receiving the subsidy (less than 80% is accepted in circumstances where this was not possible). Payroll data should be assessed to ensure that employees' pay remained the same, or at 80% of normal, or at a lower amount agreed to by the employee or with a union.


This information should also be held on record. It was made clear by the Government that COVID-19 has not changed any employment laws, so it is important to also document how workers' rights were complied with.

### 2. What is your degree of confidence that the business was and remains eligible in respect of all employees named on your application?

Larger employers will often see multiple changes to the makeup of their payroll costs and employment numbers every payday, with employees regularly moving in or out of the business or changing their status (for example, going on parental leave). Consideration should be given to all of the named employees in your application and whether they were all eligible for the wage subsidy during the entire 12 week period of the original Scheme and/or 8 week period of the Wage Subsidy Extension. While not an exhaustive list, some of the changing circumstances that are regularly faced by businesses that may impact on their eligibility are:

- The impact of casual or seasonal workers with varying hours;
- Any new starters or (voluntary) leavers during the wage subsidy period;
- Any redundancies during the wage subsidy period;
- Whether any employees received ACC income assistance payments during any part of the 12 week wage subsidy period; and
- Whether any employees received Government assisted parental leave during any part of the 12 week wage subsidy period.

Additionally, New Zealand is no longer in a State of National Emergency. This means that for all claims made since the State of National Emergency was lifted, businesses should now have on record written correspondence from all named employees, confirming they gave consent for you to provide their personal details to MSD as part of making your wage subsidy application.

### 3. What steps has your business taken to document evidence that supports on-going eligibility for the Wage Subsidy?

To the extent you are comfortable that your business was, and still is, eligible for a claim made on the Scheme it is important to consider taking active steps to clearly document this eligibility. Having a spreadsheet and a couple of emails somewhere on your computer is not enough. The eligibility criteria per the declaration should be considered in a 'checklist' like fashion, and a master file should be constructed which includes the evidence that your business satisfied every part of the Scheme's eligibility criteria. For example, this should include documenting:

- The necessary revenue drop;
- The steps taken to mitigate the impact of COVID-19 on the business;
- What cash reserves the business had at the time of making the claim;
- What discussions were held with bankers, insurers or business advisors;
- What payments were made to employees;
- On what basis did any employees cease employment (whether voluntarily or involuntarily) during the Wage Subsidy period.

Not only will this pro-active action make a potential audit a lot quicker and smoother, it will demonstrate that you have considered the eligibility criteria and that you are confident that your claim on the Scheme is legitimate.

### 4. What is your degree of confidence that the evidence collected will be sufficient for a Government agency review/audit?

Once you have prepared your eligibility documentation, thought should be given toward the sufficiency of the evidence gathered. If you operate a small business with few employees and your revenue is recognised under ordinary accounting concepts the documentation may be straight forward. The requirements will vary for a large employer with complex structures and revenue recognition methodologies.

If you are chosen for an audit on your claim, the sufficiency of the evidence gathered now will have a noticeable difference on the overall the audit process.

### 5. Are there any other relevant facts that may influence the appropriateness of having claimed the wage subsidy?

In addition to the four key areas listed above, business may want to consider any other factor that may impact the eligibility of their claim, whether it's beneficial or not.

A common question we have been asked is around the impact of a business paying dividends after they have made a claim on the Scheme. While many other countries have introduced dividend restrictions on companies who have claimed Government COVID-19 subsidies (some countries banning dividends all together), MSD have remained silent on the issue.

The silence from MSD indicates that there is no set answer to whether a claim on the Scheme is still valid if dividends are paid after a claim is made, or how soon is too soon to pay a dividend. This means that companies will have to self-assess to determine if the dividend declared is appropriate or not in the circumstances. On one end of the scale a small business making a claim on the Scheme and then shortly after paying a dividend of an amount that is material when compared subsidy received is likely to be looked upon unfavourably. Whereas, a company that has declared a dividend based on the full year end 31 March 2020, who does so every year and does not pay the dividend but credits the value to a current account of the owners to be paid at a later date, is less likely to give rise to questions about the eligibility of the company to claim on the Scheme.

When the government opens its books to distribute subsidies on a scale that we have never seen before, an audit process of this nature is inevitable, and something that the tax paying public demands. The steps taken by businesses now to review their eligibility under the Scheme will make the audit process for all parties easier. However, reviewing eligibility should not only be to document evidence ahead of an audit, it should be used by businesses as an opportunity to assess whether they should pay back the assistance received if they are not actually eligible.

New Zealand has been referred to as the team of 5 million who helped stop the outbreak of COVID-19; the Wage Subsidy play in our game plan has cost over $13 billion dollars and now the same team of 5 million will ultimately be the ones who will pay it all back one way or another. A voluntary repayment by those who, on reflection, were not eligible is the sensible next step on our path to economic recovery (as at 24 July 2020, 11,236 claimants have repaid a total of $344.9 million of wage subsidies).

## Contact

**Robyn Walker**
**Partner**
Tel: +64 4 470 3615
Email: robwalker@deloitte.co.nz

**Blake Hawes**
**Senior Consultant**
Tel: +64 4 831 2483
Email: bhawes@deloitte.co.nz

# Update to Inland Revenue's administrative guidance on small value loans

By Bart de Gouw and Amy O'Brien

New Zealand's Inland Revenue has recently updated its administrative guidance for small value loans (that is, for cross-border associated party loans for up to NZD 10 million principal in total per year). With effect from 1 July 2020, Inland Revenue considers 375 basis points (3.75%) over the relevant base indicator is broadly indicative of an arm's base indicator rate is, in the absence of a readily available market rate for a debt instrument with similar terms and risk characteristics. Inland Revenue considers that transactions priced in accordance with this simplification measure are likely to be a 'low transfer pricing risk,' and therefore no further benchmarking support is required. This is an increase from the previous guidance of 325 basis points (3.25%) over the relevant base indicator. The next review of interest rates for small value loans is scheduled for 30 June 2021.

It is important to note that while the arm's length margin has increased to 375 basis points, the relevant base indicators have reduced significantly in the year to 30 June 2020.

As stated, this administrative guidance applies to cross-border associated party loans (both in-bound and out-bound) up to NZD 10 million. Out-bound loans of any size remain on the Inland Revenue's list of major tax risks, especially where these are at no or low interest rates.
A common risk trigger we encounter is the lending of surplus funds to the group at rates set by the group which are well below the administrative guidance of 375 basis points over a base rate. In such cases the entity will need to be prepared to provide detailed economic support for the interest rate applied in taking its tax position.

For any in-bound cross-border associated party loans that are greater than NZD 10 million, the restricted transfer pricing regime applies. This regime requires an analysis of an appropriate credit rating

for the borrower and an analysis of any exotic features of the loan (such as a term greater than five years or subordination) to determine whether these should be modified or disregarded. Further information on the restricted transfer pricing regime can be found here.
The regime may result in a reduction of deductible interest below an arm's length level of interest determined using ordinary transfer pricing principles, and accordingly can lead to double taxation.

Following the implementation of a compulsory online BEPS disclosure form as part of income tax returns, Inland Revenue now has greater visibility over intercompany financial transactions and the application of the restricted transfer pricing regime. It therefore would be a prudent exercise for taxpayers to review all intercompany loans to determine whether these are subject to the restricted transfer pricing regime or to the small value loans practice.

If you would like to discuss any of the above in more detail, please contact your usual Deloitte advisor or Deloitte's specialist transfer pricing team.

## Contact

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

**Amy O'Brien**
**Senior Consultant**
Tel: +64 9 306 4422
Email: amobrien@deloitte.co.nz

# Inland Revenue's Interpretation Statements on overseas residential rental properties finalised

By Nick Cooke & Stephen Walker

You may recall our previous article in the May 2020 edition of Tax Alert outlining some of the main tax issues arising from the ownership of overseas residential rental properties. Inland Revenue has finalised its commentary on these issues which apply from 3 July 2020. Following feedback from across the industry, we have summarised below the key changes Inland Revenue incorporated into the final documents.

## Conversion of foreign currency into New Zealand dollars

Inland Revenue initially suggested in their draft Interpretation Statements that if you chose the 'monthly' or 'annual' method to convert foreign denominated income or expenditure to New Zealand dollars, you could not convert other items using the spot rate at the time of payment. However, Inland Revenue has now reversed its view and instead is allowing the 'monthly' or 'annual' conversion method to be used in conjunction with the actual spot rate amounts, the latter being used for specific one-off payments. For example, if you paid foreign tax and converted the amount to New Zealand dollars using the spot rate on the day it was paid, you can use this converted amount. Similarly, if you used a New Zealand credit card to pay an overseas rental expense, you may use the New Zealand dollar amount charged to your credit card. The 'monthly' or 'annual' method should then be used to convert the income and ongoing monthly expenses into New Zealand dollars for all income and expenses where the spot rate conversion has not been used.

Note that in future years, you must continue to use the spot rate conversion for the category of expenses for which you used it in the first year, maintaining consistency in the conversion method applied to the various income and expenditure types over time.

## Deduction for the cost of low-value items

Unsurprisingly, Inland Revenue has inserted a section clarifying that a deduction is available for the cost of 'low-value items' in the year they are purchased. A 'low value item' is a depreciable item with a cost equal to or less than the threshold amount.

This section has no doubt been inserted off the back of the recent announcements that the low-value asset threshold has been temporarily increased from $500 to $5,000 (for assets purchased between 17 March 2020 and 16 March 2021) and permanently increased thereafter to $1,000 (for assets purchased from 17 March 2021).
As background, the low-value asset threshold had remained at $500 since 2005, however a change to this threshold was announced as part of a number of incentives included within the Governments' COVID-19 business

continuity package. This is of course a welcome incentive for many taxpayers that is equally available for owners of overseas residential rental properties.

Note that it may be necessary to recognise depreciation recovery income if a low-value item is sold or applied for private purposes. If the asset is sold, the entire sale proceeds are assessable income in the year in which the asset is sold. If the asset becomes a private asset, the market value of the asset when it is first used privately becomes assessable income.

### Non-resident withholding Tax (NRWT)

Inland Revenue expanded on their comments in relation to NRWT obligations arising from overseas residential rental property ownership, providing additional clarity for taxpayers.

First, the NRWT rules do not ordinarily apply to an individual who uses a loan to carry on a 'business' outside New Zealand through a fixed establishment outside New Zealand. For these purposes, it is noted that an individual who owns one overseas residential rental property would not ordinarily be considered to be operating a business, although there are many factors to consider before drawing a conclusion.

Second, it is the Inland Revenue's position that an individual may have to gross-up payments to the non-resident lender to account for the NRWT payable to Inland Revenue where the lender will not bear the cost. This has been illustrated by Inland Revenue with the following example:

*For an interest payment of AUD 2,000 subject to NRWT at 10%, the gross amount of interest would be AUD 2,222, calculated as AUD 2,000 x (100/90) = AUD 2,222. The amount of NRWT payable to Inland Revenue would then be AUD 222.22 (10% of AUD 2,222).*

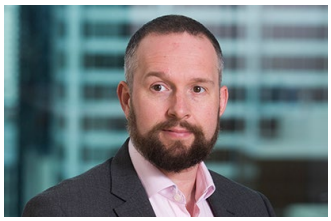
And finally, it has been confirmed that you must electronically report the amount of interest and the lender you pay it to by the 20th of the month following the month in which you pay the interest.

Note that instead of withholding NRWT, there is the ability to request approval from Inland Revenue to pay a 2% approved issuer levy (AIL) instead of NRWT. We would encourage affected individuals to consider this as it cannot be done retrospectively.

### Require further information?

If you need any further information or assistance, we recommend you contact your regular Deloitte advisor.

### Contact



**Stephen Walker**
**Associate Director**
Tel: +64 9 303 0892
Email: stewalker@deloitte.co.nz

**Nick Cooke**
**Manager**
Tel: +64 9 952 4201
Email: nickcooke@deloitte.co.nz

# Keeping up to date with GST developments

By Jeanne du Buisson and Rachel Hale


While COVID-19 has led to significant developments within the income tax world, there are also many developments within GST that have been in motion prior to COVID-19, and that have significant impacts on various parties and transactions. Set out below are some areas to watch in the world of GST.

### 10th edition of the Auckland District Law Society Agreement for Sale and Purchase of Real Estate

In December 2019, with assistance from Deloitte as well as other experts within the industry, the Auckland District Law Society published its 10th edition of its standard form Agreement for Sale and Purchase of Real Estate ("the 10th Edition Agreement"). The 10th Edition Agreement contains a number of important changes, including some quite significant vendor protections for GST purposes.

One such vendor protection will prevent a vendor from losing out financially if changes to the transaction alter the GST treatment of the sale. For example, if a change to the purchaser's (or nominee's) GST status would result in a sale being standard rated at 15% rather than zero-rated, under the 10th Edition Agreement if the purchase price has been expressed as inclusive of GST, the change to a standard-rated sale will also change the purchase price to being plus GST. Without this change, the net proceeds of the sale for the vendor are in effect reduced by the amount of GST payable.

Where a vendor is selling property using the 10th Edition Agreement it is important that the provisions within clause 14 of the 10th Edition Agreement are retained. In particular, clause 14.8 provides the most significant of the additional vendor protections and this should not be struck out from the agreement. Where a property is being sold using an older version of the ADLS standard agreement (such as the earlier 9th Edition) we would look to add as further terms of sale the same protections that are now in the 10th Edition Agreement.

### Remote services registrations and voluntary disclosures

As of 1 October 2016, remote services (typically digital services such as software and apps) being supplied to New Zealand consumers has been a taxable supply for GST purposes (at 15%) even where the supplier of those services is outside New Zealand and a non-resident for GST purposes.

The implementation of these rules has been very successful to date with much greater compliance and GST revenue than initially forecast. Up until recently, Inland Revenue have been very pragmatic with those suppliers who may have not GST-registered and returned GST as soon as liable to do so. However, as the rules have now been in place for some time, Inland Revenue's approach is beginning to transition from understanding and education, to implementing a preference for backdating registrations and requiring returns to be filed for historic periods (with consequential penalties and interest). Where there is a lack of certainty around a supplier's obligations under these rules, it is now more important than ever to address this as soon as possible particularly where supplies in historic periods may be significant.

### Concurrent use adjustments

Concurrent use adjustments are commonly required for the property / development industry. We often see instances of developers renting residential property (rental of residential accommodation being exempt for GST purposes) while the property is on the market (with the eventual sale of that property being a taxable supply, for GST purposes).

In such situations, a concurrent use adjustment is required as the developer's use of the property, while primarily taxable use, does have a small portion of exempt use. We also see this occurring at the beginning of such development projects, where properties are rented out for residential use while a developer progresses pre-development work such as obtaining resource consent. Again, such situations necessitate a concurrent use adjustment.

These adjustments have often been contentious particularly where the carrying out of an adjustment enables taxpayers such as developers to access input tax credits before a taxable project is fully commenced. However, at present this is permissible under the GST Act provided it can be clearly demonstrated that this is genuine concurrent use.

In February 2020, Inland Revenue released its much anticipated issues paper on GST (see our earlier Tax Alert article). One of the issues raised in the issues paper relates to concurrent use of land. While the issues paper makes it clear that Inland Revenue wishes to enter into dialogue around whether the current rules for concurrent use adjustments are appropriate and whether those rules achieve the desired policy outcome, from a technical perspective, the law in relation to concurrent use has not changed nor is there any proposed legislation around this. However, in recent months we have encountered some issues where concurrent use adjustments and related claims are receiving strong push back from Inland Revenue, despite situations seeming to fit with the existing approach as set out in the GST Act.

## Secondhand goods credits and associated persons

The claiming of secondhand goods credits in relation to land purchased from a non GST-registered vendor is an issue that comes up frequently.

While there can be many issues that arise which may make the claiming of such credits more difficult, one of the key issues we are increasingly seeing involves transfers between associated parties.

Under the GST Act, there is a proviso in the secondhand goods credit rules which states that where property is acquired from an associated entity, the acquiring entity's credit cannot be any more than the GST the associated entity originally paid when they bought it. If that associated entity originally acquired the property from a non-registered vendor (and thus paid no GST) the acquiring entity will be unable claim any secondhand goods credit due to the fact that the associated entity originally paid zero GST on acquisition.

We are seeing this become an increasingly significant issue as properties are transferred between entities within groups for various other commercial reasons. Accordingly, it is critical to involve your local GST specialist before any internal transfers take place as once that associated transfer occurs it will be too late to claim the secondhand goods credit.

Where property is acquired from a non-registered vendor with an expectation of receiving a secondhand goods credit, seek advice on this early on and ensure that the ability to claim these credits is not impacted by subsequent commercial decisions post-acquisition.

## Interpretation statement 20/05 – Supplies of Residences and Other Real Property

Inland Revenue have recently released "IS 20/05 Supplies of Residences and Other Real Property". The new interpretation statement is simply an update of the prior statement as the rules in this area of GST have not changed.

IS 20/05 is relevant where a private residence is sold as part of a wider supply of land (for example, a farmhouse being sold as part of a wider sale of the entire farming property).

IS 20/05 confirms that section 5(15) of the GST Act applies where a wider supply of land includes:

- A principal place of residence; or
- A property which was used as a residential rental property by the Vendor for the last 5 years.

When section 5(15) of the GST Act applies, the supply is deemed to be two separate supplies with one supply being the private residence itself and the wider supply of the remaining land being the second separate supply. Where this occurs, it is important that consideration for the entire sale be apportioned between the two deemed supplies due to the differing GST treatments (the private residence would typically be treated as exempt) where the supply of the wider land may be a taxable supply (at either 0% or 15% depending on the characteristics of the purchaser).

The apportionment of the consideration between the two deemed supplies should be done on a fair and reasonable basis. It is also recommended to include the apportionment in the agreement between the parties as well as on the tax invoice / settlement statement issued by the vendor.

It is important to get this apportionment right before the parties finalise and sign the agreement.

As we have illustrated above, there have been a number of developments in the area of GST, and despite its reputation as a "simple" tax, GST can be quite complex. Getting GST experts involved early on in transactions is a good way to ensure there are no nasty GST surprises awaiting you.

## Contact

**Jeanne du Buisson**
**Director**
Tel: +64 9 303 0805
Email: jedubuisson@deloitte.co.nz

**Rachel Hale**
**Senior Consultant**
Tel: +64 9 306 4375
Email: rhale@deloitte.co.nz

# Could you be eligible for a diesel road user charges refund?

By Jeanne du Buisson and Robert Sheetz

If you operate a fleet of diesel vehicles (including trucks that are class 2 and above) you may be eligible for a refund of diesel road user charges (RUCs).

RUCs are generally only payable to the extent that the vehicle is used on a public road. Therefore, if you have a diesel vehicle that regularly travels off public roads (i.e. on private roads such as farms or forestry roads), the RUCs should be refundable to the extent the vehicle is not used on a public road.

Companies that regularly use vehicles to travel distances off public roads should be tracking these distances if they are not already.

Some companies have systems/ technologies in place which "turn off" the odometer of a vehicle when it detects it has gone off a public road. However, for a company that does not have this kind of system in place for its fleet, incurring RUCs for regular distance travelled off public roads could represent an unnecessary additional cost to the business.

The main sectors that this is applicable to are agriculture, dairy, forestry and construction.

Refunds of RUCs can also be payable in other circumstances, for example:

- Unused distance due to hubodometer change; and
- When a vehicle is permanently destroyed, exported or its registration cancelled.

If you think any of the above may apply to you or your business, please get in touch with your Deloitte advisor and we can discuss how we may be able to assist you with applying for a refund of RUCs. We note that claims must be made within two years of the issue date of the RUCs for which the claim is made.

## Contact

**Jeanne du Buisson**
**Director**
Tel: +64 9 303 0805
Email: jedubuisson@deloitte.co.nz

**Robert Sheetz**
**Consultant**
Tel: +64 9 306 4326
Email: rsheetz@deloitte.co.nz

# Snapshot of recent developments:

## Tax legislation and policy announcements

### Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill

As covered in our last issue of Tax Alert, this omnibus bill covers the topics of feasibility expenditure, purchase price allocation, IFRS 16 on leases, habitual buying and selling of land, GST issues and many other remedial changes. Following the first reading of the bill on 24 June 2020, the bill has been referred to the Finance and Expenditure Committee with submissions open until 12 August 2020. This bill will lapse when Parliament dissolves on 12 August 2020 and will need to be reinstated by a new Government post the election.

### Fringe Benefit Tax rate on low-interest loans reduced

The Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2020 came into force on 23 July 2020. This Order in Council amends the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1995 by reducing the rate of interest that applies for fringe benefit tax purposes to employment-related loans from 5.26% to 4.50%. The new rate applies for the quarter beginning 1 July 2020 and subsequent quarters.

### Deemed rate of return on attributing interests in Foreign Investment Funds

The Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019/20 Income Year) Order 2020 came into force on 10 July 2020. The order sets, for the 2019/20 income year, the deemed rate of return used to calculate foreign investment fund income set out in section EX 55 (Deemed rate of return method) of the Income Tax Act 2007 at 5.05%. The deemed rate of return for the 2018/19 income year was 5.86%.

### Small Business Cashflow Loan application deadline extended

The Government has extended the deadline for making a loan application from 24 July 2020 to 31 December 2020. Microbusinesses (with between one and five staff) have made good use of the scheme to date. This extension will give businesses more time to carefully evaluate their situation as the economy continues to open in the coming months. More details about the scheme are included in our May 2020 Tax Alert.

### Model rules in the sharing and gig economy

The OECD has released Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy for governments to implement (if they wish to do so), which are targeted at online platforms facilitating transactions between users and sellers of 'Relevant Services', such as Uber and Airbnb.
The rules are in place to collect data on the sellers to ensure they are complying with taxes.

Under these rules, online or software based 'Platforms' in particular have to report the income information passing through their systems, as well as other identifiable information. The reporting requirements are targeted at entities who are facilitating transactions between users and sellers (i.e. the transaction between the rideshare driver and the passenger), to get these platforms to report how much money is passing hands. We understand Inland Revenue are reviewing these proposals.

### Corporate Tax Statistics Database

The OECD has released its annual corporate tax statistics. The data is aggregated from the Country by Country Reporting requirements. It covers the activities of nearly 4,000 multinational enterprise groups, headquartered in 26 jurisdictions and with operations across more than 100 jurisdictions. Information on Controlled Foreign Companies has been collected for the first time.
The OECD recognises the limitations of the data but considers these observations are 'indicative of the existence of Base Erosion

Profit Shifting (BEPS) behaviour', and reinforces the need to continue to address the remaining BEPS issues and the tax challenges arising from digitalisation. The data also shows that corporate income tax remains a significant source of tax revenue across the globe, accounting for 14.6% of total tax revenue on average across 93 jurisdictions.

## Inland Revenue statements and guidance – Finalised items

### Foreign tax credits for NZ investors in US Limited Liability Company

On 24 June 2020, Inland Revenue issued five public rulings and commentary on the circumstances in which a foreign tax credit is available to a NZ investor in a US Limited Liability Company (LLC). The rulings apply from 24 June 2020 to 24 June 2023.

The rulings and commentary set out the income tax treatment and availability of a foreign tax credit for NZ investors in a US LLC, which is taxed on a fiscally transparent basis as a partnership in the US but as a company in NZ. They demonstrate the different treatment depending on how the interest in a US LLC is classified.

### Natural love and affection exception to debt remission income for look-through company

On 24 June 2020, Inland Revenue released Questions We've Been Asked QB 20/02 – Income tax – Natural love and affection exception to debt remission income for look-through company. This is a finalisation of the previous draft consultation item issued in February 2020. The document considers whether a look-through company (LTC) derives debt remission income when a close friend or family member of the LTC's shareholders forgives a loan made to the LTC. It concludes that:

- section EW 46C (consideration when debt forgiven within economic group) of the Income Tax Act 2007 prevents the LTC from deriving debt remission income where all of the shareholders and the close friend or family member have natural love and affection for each other.
- the Commissioner will generally accept that the shareholders and the close friend or family member have natural love and affection for each other.

### Tax payments – when received in time

On 3 July 2020, Inland Revenue released

standard practice statement SPS 20/04 – Tax payments – when received in time to update and replace SPS 20/01 Tax payments – when received in time, applying from 2 July 2020. This statement reflects changes to payment methods and related processes introduced as part of Inland Revenue's transformation programme that have been discussed with community representative groups prior to implementation.

### Director's liability and the COVID-19 "safe-harbour"

On 10 July 2020, Inland Revenue released public ruling BR PUB 20/06: Income Tax and Goods and Services tax – Director's liability and the COVID-19 "safe harbour" in Schedule 12 to the Companies Act 1993. This ruling considers section HD 15 (asset stripping of companies) of the Income Tax Act 2007 and section 61 (liability for tax payable by company left with insufficient assets) of the Goods and Services Act 1985 (which relate to directors' liability for tax of a company). Specifically, the ruling considers whether these sections apply to a director of a company affected by COVID-19 who has relied on the safe harbour in Schedule 12 of the Companies Act 1993. The ruling concludes that, of itself, reliance on the safe harbour by a director, and the company continuing to trade or carry on business or incur new obligations on commercial, ordinary business terms, will not result in the application of those provisions. This ruling applies from 3 April 2020 to 30 September 2020.

### The Disputes Resolution Process and Fair Trial Rights

On 22 July 2020, Inland Revenue issued Commissioner's Statement CS 20/04 – The Disputes Resolution Process and Fair Trial Rights which applies from the date of issue. This statement sets out the broad approach that the Commissioner is taking to preserve a taxpayer's fair trial rights in criminal proceedings when there is a contemporaneous civil dispute.

### COVID-19 extended period to make election for GST ratio method

Inland Revenue has extended the date (section RC 15 – choosing to use GST ratio of the Income Tax Act 2007) by which taxpayers need to inform Inland Revenue of their election to use the GST ratio method for calculating their provisional tax payments for the 2021 tax year. Taxpayers have until 19 August 2020, or the day before the start of their 2021 income year, whichever is the later, to make the election.

### COVID-19 Provisional tax changes

On 4 August 2020 the Government passed the COVID-19 Response (Further Management Measures) Legislation Bill (No 2), under urgency. This will provide relief from interest and penalties for taxpayers who use the standard (uplift) method, have residual income tax of less than $1 million in the 2021 income year, and who have been adversely impacted by COVID-19. If these taxpayers pay a reduced amount of 2021 provisional tax, in line with their forecasted expectations, the Commissioner has the ability to remit interest and penalties on an underpayment. We will include further details of this legislation in the next edition of Tax Alert.

*Note: The items covered here include only those items not covered in other articles in this issue of Tax Alert.*

**Follow us on Twitter**
@DeloitteNew ZealandTax

**Sign up to Tax Alert at Deloitte.co.nz**

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

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

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

## New Zealand Directory

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