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Tax Alert

October 2020

Election 2020 – What role does tax have to play?

By Robyn Walker and Brendan Ng

The lead up to an election is always an intriguing time, with parties and politicians competing for airtime and taking turns to gain the upper hand. While tax might seem like a more minor issue this time around (think capital gains tax and the proposed Tax Working Group from the last election), COVID-19 and its disruptive effects mean that tax, the government's main source of revenue, is actually an important driver in helping New Zealand's economy recover and thrive. It can also be a lever to pull (or not to pull) to incentivise spending to stimulate the economy, to redistribute wealth, and drive investment in the right areas.

With this in mind, in this article we've summarised some of the key tax policies from the major political parties in one place for easy reference, highlighting any noteworthy differences, surprises, and other points to note.

Will my personal income be taxed the same?

With COVID-19 directly affecting the earning power of many New Zealanders, employment levels, and economic confidence, it's no surprise that many parties are suggesting changes to the personal tax rates / thresholds. On one end of the spectrum are Labour and the Greens, with Labour proposing a new personal income tax rate of 39% for any income earned above $180,000. The Greens have proposed introducing two new income brackets, at 37% for income earned between $100,000-$150,000 and 42% on income earned over $150,000.

The parties at the other end of the spectrum are focused on what are effectively tax cuts, with ACT suggesting flatter tax rates by cutting the 30% tax rate (on income earned between $48,000 to $70,000) to 17.5%. National has suggested adjusting the tax bracket thresholds upwards (temporarily until 31 March 2022) so that individuals on average incomes pay less tax. The New Conservatives also suggest raising the tax thresholds (with an income free tax threshold of $20,000), and both the New Conservatives and National propose to index the brackets (to inflation and the cost of living respectively).

Table of personal tax thresholds and rates

Status quo	Labour	National	Green	Act	TOP	New Conservatives*	Maori Party
$0 - $14,000 **10.5%**	$0 - $14,000 **10.5%**	$0 - 20,000 **10.5%**	$0 - $14,000 **10.5%**	$0 - $14,000 **10.5%**	Flat tax of **33%** (with a $13,000 universal basic income provided tax free)	Below $20,000 **0%**	$0 - $14,000 **10.5%**
$14,001 - $48,000 **17.5%**	$14,001 - $48,000 **17.5%**	$20,001 - $64,000 **17.5%**	$14,001 - $48,000 **17.5%**	$14,001 - $70,000 **17.5%**		$20,001 - 60,000 **17.5%**	$14,001 - $48,000 **17.5%**
$48,001 - $70,000 **30%**	$48,001 - $70,000 **30%**	$64,001 - $90,000 **30%**	$48,001 - $70,000 **30%**	$70,001 upwards **33%**		$60,001 - 100,000 **30%**	$48,001 - $70,000 **30%**
$70,001 upwards **33%**	$70,001 - 180,000 **33%**	$90,001 upwards **33%**	$70,001 - $100,000 **33%**			$100,001 upwards **33%**	$70,001 upwards **33%**
	$180,001 upwards **39%**		$100,001 - $150,000 **37%**				
			$150,001 upwards **42%**				

*New Conservatives also have a family policy that proposes to allow parents to split their combined income for tax purposes.

Tax liability caused by proposed changes in marginal tax rates or thresholds

Example income levels	Status quo	Labour	National	Green	Act	TOP	New Conservatives	Maori Party
$20,000	$2,520	$2,520	$2,100	$2,520	$2,520	$6,600	$0	$2,520
$70,000	$14,020	$14,020	$11,600	$14,020	$11,270	$23,100	$10,000	$14,020
$100,000	$23,920	$23,920	$20,900	$23,920	$21,170	$33,000	$19,000	$23,920
$250,000	$73,420	$77,620	$70,400	$94,320	$70,670	$82,500	$68,500	$73,420

Election 2020 – Tax Policies

Labour	• Introduce a new personal income tax rate of 39% for any income earned above $180,000. • No other new taxes or further increases to income tax next term. • No increase in fuel taxes. • Continue to work with OECD to find a workable global solution for taxing digital services but will work towards implementation of a Digital Services Tax if a global solution cannot be found.	• The Small Business Cashflow Loan Scheme will be available for a further three years. Second year of the loan will be interest-free. • Overhaul the AIM tax regime to make it easier for SMEs to move to a 'PAYE' model throughout the year.
National	• No new taxes • A temporary tax stimulus package (from 1 December 2020 to 31 March 2022) which will adjust the tax thresholds for individuals to provide more money to individuals. • National will amend the Income Tax Act so tax thresholds are adjusted every three years in line with the cost of living. • Depreciation changes: – Immediate deduction for assets costing <$150,000 – Double depreciation for Equipment and Machinery costing over $150,000 for 12 months. – Consolidate depreciation rates. – Review depreciation rates for investments in energy efficiency and safety equipment. – Allow assets to be expensed once the book value falls below $3000.	• An electric vehicle plan will exempt EVs from FBT until 2025. • GST changes: – Raise the compulsory GST registration threshold to $75,000 turnover per year. – Increase the threshold to obtain a tax invoice to $500. • Provisional tax changes: – Increase the provisional tax threshold to $25,000. – Change the timing of certain payments. – Review UOMI rates. • Implement a business continuity test (rather than ownership test) to allow the carry forward of tax losses.
Green	• Introduce a new net wealth tax of 1% on an individual's net wealth above $1 million and 2% on an individual's net wealth over $2 million. • Introduce two new top income tax brackets: – 37% on income from $100,000 - $150,000. – 42% on income over $150,000.	• Tax the money made by Facebook, Amazon, and other big digital giants in Aotearoa. This will either be through a unilateral Digital Services Tax of 3% on gross revenues that are attributable to New Zealand users or through working multilaterally through the OECD if international progress can be achieved.
New Zealand First	• No tax rate increase for individuals and companies • Accelerated depreciation – allowing business to depreciate at the same rate as Australia to help them bring forward their investment decisions • A "Give it a Go" Scheme – offering special tax concessions for certain business start-ups in rural and regional New Zealand	• An Instant Asset Write-Off Scheme – allowing small businesses with turnover less than $1 million to claim immediate deductions for new or second-hand plant and equipment purchases such as vehicles, tools and office equipment up to a combined value of $3,000 annually (note, this policy was announced prior to the Government changing the low value asset threshold to $5,000 from 17 March 2020-16 March 2021).
act	• Temporarily cut the GST rate from 15% to 10% (ending June 2021).	• Flatter marginal tax rates for individuals by permanently cutting the marginal tax rate on income between $48,001 and $70,000 from 30% to 17.5%.
TOP.	• Universal basic income for everyone $250 per week. • Flat tax of 33% on all income from all sources for all entities. • Abolish provisional tax for SMEs. • Remove FBT on all electric vehicles.	• Introduce a Property Tax – The equity value (total value less debt) of property investments would be the subject of this tax. – The Taxable Income minimum on property would be the Equity Value multiplied by the Risk-Free Interest Rate of 3% each year. – Tax on this income would be derived using a new standard rate of tax of 33% (refer to TOP's Kiwi Dividend policy).
New Conservative	• Introduce an income tax-free threshold of $20,000. • Higher thresholds apply to tax brackets. • Remove tax-on-tax effect that GST has, such that GST will not be payable on fees, rates, and excises imposed by the government. • Repeal the regional fuel tax and roll back petrol tax and road-user charge increases.	• Explore Every Transaction Tax (ETT) as a possible replacement to GST. • Tax imports that are non-essential or have high waste value. • No tax on KiwiSaver contributions, with a new levy that is paid on withdrawals.
Māori Party	• Capital gains tax of 2% per annum on the appreciation in value of homes that are not the whānau or family home.	• A 2% tax on vacant "ghost" houses.

What changes are proposed for business?

A few of the parties have suggested tax changes for businesses, largely to incentivise spending and investment, or to reduce compliance costs. None of the party policies are particularly radical (at least not as radical as a capital gains tax), but there are some potential savings / accelerated deductions available for businesses as a result of some of the proposals.

National proposes to temporarily raise the threshold for an immediate deduction for capital assets from $5,000 to a whopping $150,000 per capital asset, with a doubled depreciation rate for property, equipment and machinery over this amount to incentivise investment in these assets. Further, National also proposes:

- Any assets whose depreciated value falls below $3,000 can be fully expensed.
- The number of depreciation rates will be consolidated and reduced, and also reviewed to incentivise investments in energy efficiency and safety equipment.

Some changes are proposed to reduce the compliance costs imposed on business through the tax system, particularly in relation to small businesses. Labour proposes to overhaul AIM to make it easier for SMEs to move to a pay as you earn model throughout the year, while National proposes increasing the provisional tax threshold from $5,000 to $25,000 and raising the GST registration threshold from $60,000 to $75,000 turnover per year. National also proposes changing the UOMI rates to reflect appropriate credit rates and increase the interest rate paid on amounts owed by IRD to its customers.

NZ First proposes to accelerate depreciation (at similar rates to Australia) and also proposes tax concessions for certain business start-ups in rural and regional New Zealand.

The Opportunities Party proposes a flat 33% tax rate on all income from all sources (up from the current 28% company tax rate or 17.5% Māori Authority tax rate). They also propose to abolish the provisional tax regime for SMEs.

Changes to the taxation of property

While a capital gains tax may not be getting the usual amount of airtime this election, a 2% unrealised capital gains tax on residential property (other than the whānau / family home) is a policy of the Māori Party.

The Opportunities Party proposes a yearly minimum property tax under which the equity value (total value less debt) of property investments would be subject to tax, as calculated annually using a 3% risk free rate of return approach. This tax would be paid at a rate of 33%, with various options available if there was no cash to pay the tax.

While not overtly announced (at time of writing), National's economic and fiscal plan includes in its figures the cost of repealing the recently enacted rules to ring-fence residential property losses and to reduce the residential property brightline test from 5 years to 2 years.

Other points of note

Some other noteworthy proposals include:

- The award for the most radical approach probably goes to The Opportunities Party, who propose a tax-free universal basic income for every New Zealander of $250 per week.
- The New Conservatives suggest exploring an "Every Transaction Tax" (as a possible replacement for GST), under which all transactions would be subject to a small amount of tax. They also propose removing the tax-on-tax effect that GST has, such as removing GST from fees, rates and excises imposed by the government.
- None of the parties suggest using the tax system to incentivise positive environmental behaviour, other than National and The Opportunities Party who suggest removing FBT from electric vehicles (in National's case only until 2025) to encourage businesses to move to electric vehicles in their fleets.
- Both Labour and the Greens refer to working with the OECD to find a workable global solution for taxing digital services, but propose to implement a digital services tax to tax highly digitalised businesses if a global solution cannot be found.
- The Greens propose to introduce a new net wealth tax of 1% on an individual's wealth above $1 million and 2% on an individual's net wealth over $2 million.
- ACT proposes to temporarily cut the GST rate from 15% to 10% (ending June 2021).

All in all, most of the political parties have put forward tax proposals that could affect you or your business, using different levers to achieve different outcomes that fit with their party policies.

In saying that, of the myriad of policies that have been announced, the likelihood is that the tax policies of either Labour or National will ultimately shape any post-election tax changes.

If you would like to discuss how any of the proposed policies could affect you, please contact your usual Deloitte advisor.

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So, you claimed the wage subsidy, now what?

By Robyn Walker and Blake Hawes

The Wage Subsidy, Wage Subsidy Extension and Resurgence Wage Subsidy ('the Schemes') are all now officially closed for further applications. At their height, over 1.66m jobs were being supported and in total there were 756,649 applications approved for the three schemes, including 249,582 self-employed individuals. Over $13.9 billion was spent on the Schemes.

The period through which the Schemes provided assistance should now have come to a close for most applicants and the funds received should have been paid out to employees in most instances (only late applicants for the eight-week Wage Subsidy Extension would still be passing through the wage subsidy amount to employees).

So, what now?

Many businesses would consider that their obligations under the wage subsidies finished at the time the subsidy ran out. However, there are some matters which people should still be considering:

1. Were all the wage subsidy eligibility criteria met?
2. Have all amounts been correctly paid through to employees, and have any 'unusual' employment scenarios been correctly dealt with?
3. Has the wage subsidy been correctly treated for income tax and GST purposes?
4. Have you been compliant with all other tax rules, including calculating PAYE and paying taxes on time?

When it comes to item one, we're increasingly seeing scrutiny of large wage subsidy claimants and in respect of item four, Inland Revenue have publicly announced they will be completing tax compliance reviews of those who claimed any of the Schemes. What was advertised as a 'high trust' regime to apply for, is being followed up with some not so high-trust audits.

Through the Schemes the Government did its part by supporting employment and reducing redundancies, and now it's the turn of the beneficiaries of the Schemes to ensure they've done the right thing.

Were all the wage subsidy eligibility criteria met?

When the eligibility criteria for the Schemes is mentioned, the first thing that comes to mind is the clear, objective "revenue drop" test; a business must have suffered a 30% or 40% (depending on the scheme that was applied for) drop in revenue over a set period. As this measure is objective, in most instances it can be easily satisfied using sales and revenue data. However, there are many other criteria which are not so obvious, that also must be considered.

The most subjective criteria is the requirement to have taken active steps to mitigate the impact of COVID-19 on your business's activities, which included making insurance claims, proactively engaging with your bank and drawing on cash reserves if appropriate. What is considered to be

What was advertised as a 'high trust' regime to apply for, is being followed up with some not so high-trust audits.

sufficiently taking "active steps to mitigate the impact of COVID-19" must be self assessed by any business that made a claim on any of the Schemes.

We highly recommend that the assessment against all the eligibility criteria should be sufficiently documented now if it hasn't been done already. This will prove invaluable in the event a business's wage subsidy claim is audited by the Ministry of Social Development (MSD) as reconstructing the financial position and environmental context will get harder as time passes. An earlier article published by Deloitte on this topic which includes further information can be found here.

Have all amounts been correctly paid through to employees, and have any 'unusual' employment scenarios been correctly dealt with?

In addition to the point above, finer criteria exist around the individual facts of each of the employees named in a wage subsidy application. Businesses who have made a claim on any of the Schemes need to assess whether any of their employees' circumstances changed during the wage subsidy period, or if the individuals named in their claim were even eligible in the first place.

For example, situations that may cause an employee to not be eligible for part, or all, of the wage subsidy under any of the Schemes include:

- 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 a wage subsidy period.
- Whether any employees received Government-assisted parental leave during any part of a wage subsidy period.

Businesses should undertake a review of their payroll reporting during any of the wage subsidy periods to determine whether any of their overall claim on a wage subsidy should be repaid due to the employees themselves not being eligible for inclusion in the claim, in full or part.

An earlier article published by Deloitte on this topic which includes further information and examples on scenarios where employees may not be eligible under the Schemes can be found here.

Has the wage subsidy been correctly treated for income tax and GST purposes?

Once businesses have determined the correct amount of wage subsidy they are eligible for (taking into account amounts that may be required to be repaid) the GST and income tax treatment must be considered.

The key points in this respect are the following:

For businesses that claimed on behalf of employees:

- The wage subsidies received are not taxable income to businesses (however the on-payment to employees is treated as a normal payment of salary and wages and is taxable in the hands of the employee).
- Businesses do not get a tax deduction for the cost of salary and wages that was funded using a wage subsidy.
- Where the cost of salary and wages that was funded using a wage subsidy was capitalised to the cost base of a depreciable asset, the cost base of the asset used for determining the tax depreciation expense going forward must be reduced by the amount of salary and wages that was funded using a wage subsidy.
- The wage subsidy is not subject to GST.

For self-employed claimants:

- The receipt of the wage subsidy is taxable income – the taxable amount is the total amount received less any amount repaid.
- Where the Wage Subsidy was received in March 2020 but related to two income tax years (i.e. an application was made and payment received before 31 March 2020) an apportionment of the wage subsidy should be undertaken, to include part of the wage subsidy as taxable income in the 2020 income tax year, and the remainder as taxable in the 2021 income tax year.
- The wage subsidy is not subject to GST or ACC levies.

As a result of this taxable treatment for the self-employed, thought should be given to whether the entire amount received was spent when received, as the income tax liability arising upon the receipt of the wage subsidy will be required to be funded from somewhere.

The reason the wage subsidy is taxable to the self-employed but not taxable to businesses is because payments of salary and wages paid to employees of a business that has received a wage subsidy are still taxable to the employee. The income tax exempt status for businesses is to assist in the wage subsidy flowing through the business to the intended recipient without any adverse tax effects.

Have you been compliant with all other tax rules, including calculating PAYE and paying taxes on time?

As mentioned above, Inland Revenue have announced that they will be reviewing employers who have received wage subsidies to ensure they are meeting their tax obligations. This does not mean that where certain taxes have not been paid (or filed on time) the wage subsidies received must be repaid, but will result in Inland Revenue reaching out to those taxpayers and asking the question around why their tax compliance is not up to date.

Businesses that are still struggling to meet tax obligations are able to set up tax instalment arrangements which can allow for the cost of a certain tax bill to be spread over a selected period (i.e. paying a GST output tax liability in three instalments over the three months following the due date of the liability). This can be arranged by contacting Inland Revenue and setting out the specific request (i.e. the amount and frequency of repayments) and the reason why the tax liability cannot be settled in full.

> To assist in ensuring all tax obligations are met, and to appease Inland Revenue in the event they ask questions, businesses should put together a comprehensive tax governance plan, to show their commitment to meeting tax obligations on time.

More on tax governance is covered in this article.

Changes to the COVID-19 Leave Support Scheme

On 22 September the Government announced changes that will be made to the COVID-19 Leave Support Scheme ('LSS'). There are two key changes to the LSS:

1. The eligibility criteria has been expanded to include more people who are self-isolating because they have been advised to (and a list of people who can officially advise that an employee should self-isolate has also been published) ; and
2. The payment period has been reduced to 2 weeks instead of 4.

The Leave Support Scheme is still able to be applied for multiple times (if the two weeks is not sufficient) however no employer may make more than one claim on the Leave Support Scheme for the same employee at the same time.

These changes came into effect from midday on 28 September. More information on this can be found on the MSD website here and in our previous article here.

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R&D Tax Incentive Regime – Where are we at?

By Aaron Thorn, Simon Taylor and Brendan Ng

The Research and Development tax incentive (RDTI) regime has been in place for over a year now, and as with any new regime, we are starting to see how the rules are being applied in practice, and whether they are in line with expectations.

This article covers some of the practical applications for software, developments to be aware of and what to do next. Other proposed changes to the regime and the answers to some frequently asked questions are covered in our [July 2020 article](#).

Where are we at with software R&D?

The application of the R&D tax incentive regime to software has received some media attention, with the Minister of Research, Science and Innovation Megan Woods recently stating:

"Software is an essential part of the innovation ecosystem and we expect it will be strongly represented in the R&D activity that receives the RDTI. A number of very promising RDTI applications relating to software R&D have been submitted."

When it comes to software, it is important to remember that the definition of R&D is the same no matter what the underlying activity is. This means that the same requirements around a scientific or technological uncertainty, systematic activity, and new or improved knowledge, process, product or service must be met, identified and articulated in order to be eligible.

The key step is to assess your organisation's activities against the legal criteria, and Inland Revenue's [R&D guidance](#), with particular reference to the sections on software in the guidance. The guidance provides a comprehensive interpretation of this relatively new legislation, and its content is followed very closely by Inland Revenue when reviewing claims.

Whilst many software claims have already been prepared, a number of businesses are still receiving Callaghan Innovation Growth Grants, and are assessing the impact of the transition to the RDTI. For all potential software claimants, the key focus areas in assessing eligibility are the learnings gained from the R&D activity, and the technical risks overcome in the development programme. Questions to ask include: What new technical knowledge has resulted from the activity? What was uncertain in how or whether the technical objectives could be met, and why?

The software development process typically requires a systematic approach, involving testing, in order to develop new products or services. It is important in tracking eligible activities to apply the above criteria early in the process, identifying the scientific or technologically uncertain aspects of the design, development and testing undertaken.

The R&D support for software development is undeniably different under the RDTI compared with Growth Grants (as admitted by the Government) however despite some public concerns, the Minister has confirmed that she is aware of and expects that further software will be able to access the RDTI - it is accordingly essential to focus on the RDTI eligibility requirements to get the claim right, with a focus on identification of the eligible aspects.

Inland Revenue's guidance begins with an overview of the policy intent of the regime, with an expectation that it will lower the cost to businesses in performing R&D, to help transform the New Zealand economy into a high-skill, knowledge-based and productive economy. A tax credit was chosen as the method to provide a subsidy because of the wide reach of the tax system, with the ability for claimants to access support based on predefined rules. This was expressed by the Minister, in the comments quoted above, when referring to her expectations of the regime. It is clearly contemplated that software development can receive funding under the RDTI, with the key to a successful claim being an accurate focus on how activities meet the eligibility criteria.

What else should I be aware of?

For R&D claims in the 2020-21 income tax year onwards, organisations must get their R&D activities approved by the Commissioner before they will be eligible for the R&D tax credit. This is known as 'general approval' and is mandatory for organisations wishing to claim. Under general approval organisations gain certainty from the Commissioner (in advance of submitting their R&D supplementary return) that their activities meet the definition of an R&D activity, with this approval being binding on the Commissioner. General approval can be granted for an activity for up to 3 years.

To obtain general approval of an activity an organisation must provide to the Commissioner information about the project and details of the activities proposed to be undertaken. This means organisations will need to prepare write ups describing their R&D activity and how it meets the requirements of the legislation (i.e. what the scientific or technological uncertainty is, whether a systematic process has been undertaken and what the intended new knowledge, or new and improved process, product or service is).

General approval applications must usually be received by the 7th day of the 2nd month following the end of your income year (i.e. a 31 March balance date must submit its general approval applications by 7 May, and a 31 December balance date must submit its general approval applications by 7 February 2021). This is a very short timeframe after year-end, combined with financial reporting and audit commitments, so the timing for completion of applications should be planned carefully – early applications are consistent with Inland Revenue's expectations around contemporaneous supporting documentation.

However, in response to the disruption caused by COVID-19, the Commissioner has extended the deadline by which a general approval application must be submitted, to the 7th day of the fifth month after the end of the first income year (i.e. a 31 March 2021 balance date must submit its general approval applications by 7 August 2021).

This deadline variation only applies to the 2020-21 income tax year and where "the planning or conduct of eligible research and development or the ability to appropriately obtain necessary information, seek advice and formulate an application… on time has been materially delayed or disrupted by the COVID-19 outbreak and its effects." At this stage it is unclear what evidence is required to show that such disruption has occurred, but it will be worth considering what documentation your organisation has to substantiate any delays.

Other notable changes to the regime, already covered in previous Tax Alert articles, include favourable changes to the refundability criteria and eligibility of expenditure on tangible fixed assets.

Key milestones

For easy reference, set out below are some key milestones to be aware of:

- *Enrol in R&D tax credit regime* – before filing a claim a taxpayer must enrol for the regime in myIR to access the supplementary return (and application form for general approval).
- *Apply for general approval (2020-21 income year onwards)* – this must be done by the 7th day of the 2nd month following the end of the income year in which the R&D activity was undertaken (or, as noted above in relation to COVID-19, by the 7th day of the 5th month in certain circumstances).
- *Significant performer regime (2020-21 income year onwards)* – organisations expecting to incur more than $2 million of eligible R&D expenditure in an income year may opt out of the general approval regime (i.e. they will not be required to get project-by-project approval) and make an application under the significant performer regime by the 7th day of the 2nd month after the end of their income year. These organisations will also need to apply for approval of their criteria and methodologies (CAM) for determining whether R&D activities and expenditure are eligible. Some points to note:
  - When making a significant performer notification, CAM approval must be sought which involves a very detailed presentation of the procedures used to identify and track R&D, and sufficient time should allocated to this process to ensure the information required by Inland Revenue is provided to them.
  - Applicants under the significant performer regime may still choose to seek general approval for selected projects – for example, for those where upfront certainty of their eligibility status is desired. This should be considered because CAM approval is not binding on the Commissioner.
  - The choice of pre-approval mechanism requires careful consideration, because there is no fall-back ability to apply for general approval if a CAM application is denied after the deadline for applying for general approval has expired. Significant performer applicants should submit their CAM applications as early as possible to allow for the review period – this is partly why a change to the CAM application date has been proposed for the 2021-22 income year, bringing the deadline forward to six months before the end of the applicant's income year.
- *Prepare and file income tax return* – this must be done by your organisation's usual due date and will include an entry for the amount of the R&D tax credit to be claimed.
- *Prepare and file R&D supplementary return* – this must be filed within 30 days after the due date of the income tax return.

If you would like to discuss how the R&D tax credit regime could benefit your business, please don't hesitate to contact our specialist R&D team or your usual Deloitte advisor.

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Tax Governance, are you ready?

By Annamaria Maclean, Jodee Webb & Kirstie Anderson

Tax governance is working its way up the agenda of Boards of Directors as a result of tax authorities around the world becoming highly focused on tax governance and best practices.

The New Zealand Inland Revenue is no exception and in its refreshed Multinational Enterprises Compliance Focus Document it reiterated its stance that corporate tax governance should be a key focus for Boards. Inland Revenue has endorsed the OECD's recommendations regarding tax governance and has included as part of its Compliance Focus a helpful checklist for Boards to tick off to ensure the right tone is set from the top. Inland Revenue's expectations around corporate governance do not just apply to significant enterprises, but also those organisations that currently file a basic compliance package and also high net wealth individuals who have complex business interests. All these types of taxpayers are expected to have appropriate and robust tax control frameworks in place. See our [article in December 2019] where we discussed in more detail what this means.

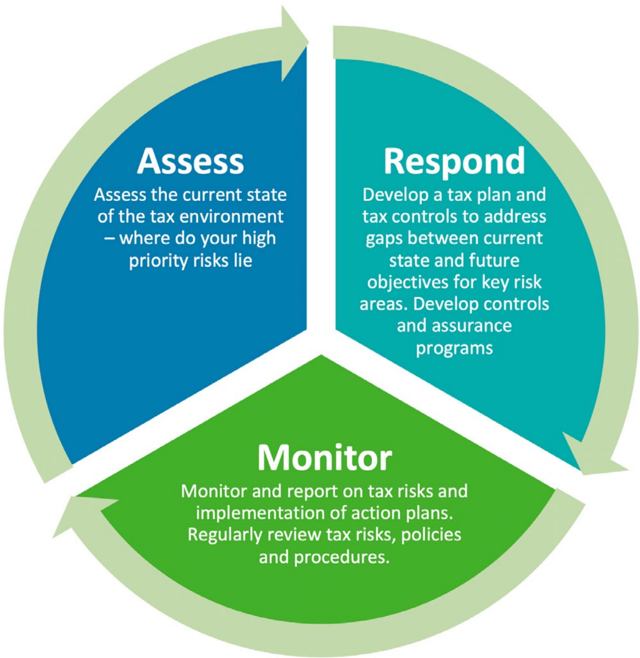
Recently, Inland Revenue's tax governance focus has progressed, with questions on tax governance being included in the most recent International Questionnaire.

But it is not just tax authorities that are raising questions around tax governance, investors are increasingly interested in knowing that businesses are sustainable long-term and part of this is their "social licence to operate". The Global Reporting Initiative (GRI) Standards, which are designed to be used by organisations to report on their impact on the economy, the environment and society have introduced a standard for reporting on tax which is applicable to reports and materials published on or after 1 January 2021. This helps an organisation communicate with its stakeholders on a range of topics, including: management's approach in relation to tax; its tax governance and control framework; how the organisation engages with the tax authorities; tax policy advocacy; and the level of direct and indirect tax paid by the organisation on a country by country basis.

With the global attention corporate tax governance and tax risk management is receiving from multiple avenues, now is a good time for taxpayers to reflect on their tax governance frameworks and tax controls, and consider whether their current framework is robust enough in the current climate.

How to strengthen your tax risk management framework

We suggest a three-step approach to strengthening your tax risk management framework and ensuring it is fit for purpose.



Assess

Organisations should undertake an initial assessment of the current state of their tax governance position. To help you develop an initial assessment or benchmark we can use Tax Cube, a risk assessment diagnostics tool. The Tax Cube is a comprehensive set of questions based on best practice in the area of tax risk management and is completed in a half day workshop with your tax / finance team and other key stakeholders. We generally recommend the company's CFO attends the first hour when we cover Board level controls and overriding tax governance.

The results of the workshop are summarised in a heat map which will then enable you to identify priorities for change and clear actions to take forward.

Respond

Risks identified during the Assess phase can be responded to by implementing a robust tax control framework or refining an existing framework where one already exists. There are several elements to consider when putting in place a robust tax control framework. These can be categorised under the five interrelated components of the Tax Cube. Tax controls should be applied comprehensively to cover all transactions that have an impact on all relevant tax positions.

The Tax Cube

	General tax management	Income tax	GST	Employment taxes	Customs & excise	Other taxes
Governance	78%	34%	56%	33%	31%	34%
People	56%	45%	33%	55%	66%	54%
Process	81%	68%	81%	71%	80%	80%
Data & Systems	63%	40%	76%	38%	73%	62%
Technology	77%	33%	62%	34%	54%	62%

- High priority risk
- Medium priority risk
- Low priority risk

Governance	Process	People	Data	Technology
• Tax strategy/policy • Executive reporting • Stakeholders • Incident management • Decision escalation • Tax transparency • KPI setting and monitoring	• Process design/ documentation • Risk management • Transaction/tax risk register • Control activities and testing • Assurance framework • Document retention • Significant transactions • Regulatory changes • Tax authority relationships	• Role descriptions • Capability and training • RACI matrix – responsible, accountable, consulted, informed • Headcount capture • Capacity • Stakeholder relationships • Tax awareness • External advisers	• Data integrity • Data analytics • Spreadsheet controls • Data flow and controls • Data access rights • Tax information management • Tax and business data integration • Tax forecasting model	• Tax technology/ transformation strategy • Tax and IT integration • ERP systems • Tax software deployment • Workflow management • Document storage • Robotic process automation • Automated controls • Information gathering and processing

Tax controls and documentation

Once in place, the tax frameworks and control documentation should take a top down approach, with the Board having overall responsibility for the tax strategy for the organisation.

Documentation should include:

- Tax strategy document set and owned by the Board, covering areas such as the organisation's tax risk tolerance and approach to relationships with tax authorities;
- Tax control framework to assist management with managing tax risks, including tax management plans and tax risk registers;
- Tax control processes for each specific tax type;
- Tax policies and procedures to provide guidance at a day to day operational level.

Review of specific tax risks

If risks in relation to specific tax types have been identified during the Assess phase, we can assist clients undertake more focused reviews on certain tax types. This will help close any gaps in the tax control framework, tax policies and procedures and ensure the risk is better managed going forward.

Given Inland Revenue's increasing use of data analytics to identify risks, our reviews are more and more data analytics focused and our findings are often shared with Inland Revenue in order to limit the scope of any review they undertake.

Even if risks regarding a specific tax type are not identified at the Assess phase, it is best practice to have rolling independent reviews of key tax risk areas for the business (for example, fixed assets, GST, customs, PAYE, FBT and other indirect taxes), including a review of the tax controls in those areas.

Monitoring and ongoing compliance

As with any process, tax governance is not a "set and forget" exercise but requires regular attention and testing to ensure it meets the organisation's needs.

Ongoing monitoring and regular reporting to the Board and other stakeholders is essential to ensure that tax risks are continually monitored and reviewed. To facilitate this, Tax Cube can be re-performed to see how an organisation is tracking against the original benchmark assessment.

Contact us

If you would like to discuss tax governance further or are interested in running a Tax Cube diagnostic workshop, then please get in touch.

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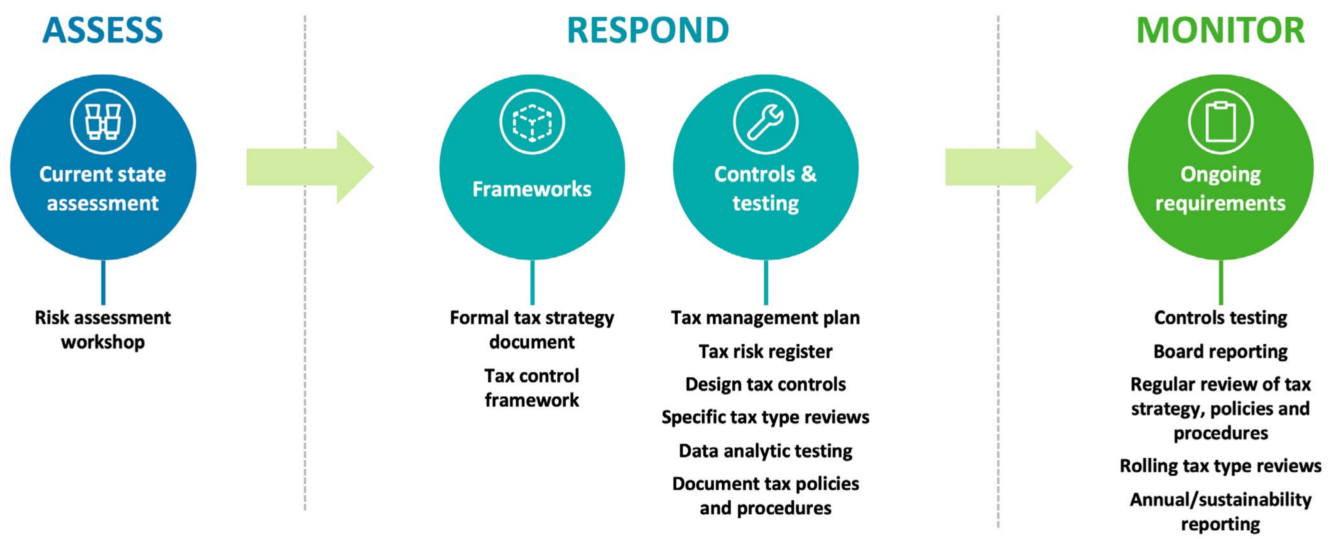

Frucor: Commercial and economic reality is in the eye of the beholder

By Campbell Rose, Matthew Scoltock, and Mahi Kumar

On 3 September 2020, the Court of Appeal handed down its highly-anticipated judgment in [Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited](), overturning the judgment of the High Court and ruling that a complex financing arrangement involving the issuance of an optional convertible note to a third party was a tax avoidance arrangement and therefore void as against the Commissioner of Inland Revenue (**Commissioner**).

The Court's conclusion was based upon what it saw as the commercial and economic reality of the arrangement. In that regard, the Court seemed to rely heavily on a suite of evidence, comprised of e-mails and letters/memoranda, in which "tax efficiency" was a stated goal of the arrangement (including thin capitalisation thresholds affecting transaction sizing), and in which there was a focus upon overall financial exposures on an assumption that each party would inevitably comply with its contractual obligations.

The judgment is a timely reminder that, in assessing tax avoidance, the Court will only examine the arrangement that was actually entered into, and not what could or would have been done in the alternative. Applying the Parliamentary contemplation test established by *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue*, the Court concluded that the arrangement was, in substance, a "dressed-up" subscription for equity, and that it was "tax driven", "repackaged" and "engineered" in an artificial and contrived way.

There was a win for the taxpayer with the Court finding that Frucor Suntory New Zealand Limited (**Frucor**) was not liable to shortfall penalties. The Court reaffirmed that a taxpayer will not have taken an "unacceptable tax position" if there is "substantial merit in [the taxpayer's] argument" or if "the taxpayer's argument would be seriously considered by a court". It will be interesting to see if Frucor has the appetite to appeal the judgment to the Supreme Court; or if *IS 13/01* (in relation to tax avoidance) is updated by Inland Revenue to reflect the Court's judgment, given that a review of *IS 13/01* is already on Inland Revenue's work programme.

The Facts

- In January 2002, a third party investment bank (the **Bank**) discussed with Group Danone S.A. the possibility of using a convertible note structure (the **Note**) to fund the proposed acquisition of Frucor Beverages Group Limited in an amount of approximately $300 million. In its proposal, the Bank identified that the interest payable by Frucor on the Note was to be fully deductible.
- The Bank advanced $204,421,565 to Frucor in exchange for a fee of $1.8 million and the issuance of the Note. The Note had a face value of $204,421,565 and a five year term. Interest on the Note was payable bi-annually at a rate of 6.5% per annum.
- At maturity, the principal of $204,421,565 was to be repaid in cash unless the Bank opted to take 1,025 non-voting shares (the **Shares**) in Frucor in satisfaction of the loan. The Court noted that "[i]t is common ground that [the Bank] would elect to have repayment of the principal amount satisfied by the issue of the [Shares] in all but a doomsday scenario".
- At the same time, Frucor's immediate parent (the **Parent**, as purchaser) and the Bank (as vendor) entered into a forward purchase agreement in respect of the Shares. Under the forward purchase agreement, the Parent was required to make a $149 million upfront payment to the Bank in return for the transfer of the Shares on maturity of the Note.

- Of the $204,421,565 loan, $149 million was therefore financed by the forward purchase price payable by the Parent. Approximately $55 million was financed by the Bank's offshore group treasury vehicle.
- Frucor applied $60 million of the $204,421,565 loan to buy back and cancel certain of its shares. The balance of the loan was used to repay an existing loan from Danone Finance S.A. (**Danone Finance**). Frucor also paid the Bank's approximately $1.8 million arrangement fee. Over the term of the arrangement, Frucor paid interest to the Bank in the sum of $66 million, in accordance with the terms of the Note.
- The Commissioner denied Frucor's $66 million interest deduction on the basis that, in reality, Frucor only borrowed $55 million from the Bank, being the $204,421,565 face value of the Note less the $149 million paid to the Bank by Frucor's Parent under the forward purchase agreement. Instead, the Commissioner sought to limit Frucor's total interest deduction to just $11 million.

Frucor in the High Court

In the High Court, Muir J found that the Commissioner had not appropriately invoked the general anti-avoidance provision, section BG 1 of the Income Tax Act 2007 (the **Act**). In particular, he concluded that:

"Interest was incurred by [Frucor] both legally and, at a single-entity level, economically. And it was actually paid. The deduction did not depend on the taxpayer reverse engineering a deduction by application of the financial arrangement rules. Nor did the transaction involve back-to-back arrangements, each akin to the other, in the manner now typically assumed to infringe [section] BG 1".

Frucor in the Court of Appeal

Tax Avoidance Arrangement

The Court of Appeal disagreed with Muir J. While recognising that "[t]here is no doubt that, as a matter of legal form, Frucor was able to make use of the relevant specific provisions to claim a full deduction for the interest expenditure on the sum of $204,421,565", the Court found that "Frucor used the specific provisions to claim deductions for interest in an artificial and contrived manner that cannot have been within Parliament's contemplation". The Court considered that, when the economic and commercial effect of the arrangement was examined in its context, it became clear that tax avoidance was, at least, not a merely incidental purpose or effect of the arrangement.

In reaching its conclusion, the Court noted that:

"The primary purpose of the funding arrangement was the provision of tax efficient funding to Frucor. That was its stated goal. The tax advantage was gained in New Zealand through the interest deductions Frucor claimed. [The Parent] (in effect) paid $149 million to Frucor for the shares on day one but with the payment being structured to enable Frucor to claim interest deductions on it over a five-year term".

In the Court's view, the Parent's subscription for equity was "effectively repackaged" as an artificial and contrived loan from the Bank to achieve the intended tax benefits for Frucor. To that end, the Court also noted that "[t]he artificial and contrived features of the funding arrangement are not seriously in dispute" and that:

"Taken together, they reveal that the purpose of the arrangement was to dress up a subscription for equity as an interest-only loan to achieve a tax advantage".

The Court concluded that, as a matter of commercial and economic reality, the payment of $149 million by the Parent did not bring with it any liability for Frucor to pay interest. Rather, in the Court's view, the only interest-bearing debt was the $55 million advanced in reality by the Bank to Frucor.

Significantly, the Court also found that:

"It is not relevant that Frucor could have borrowed the $204 million from Danone Finance at an arm's length rate of interest and be entitled to claim the same interest deductions. The focus must be on the arrangement that was entered into, not one that might have been entered into but was not".

In concluding that the arrangement amounted to tax avoidance, the Court relied on a variety of contemporaneous correspondence, comprising e-mails and letters/memoranda, which recognised tax efficiency as a stated goal of the arrangement. By contrast, the Court did not appear to consider in great depth a number of non-tax purposes/reasons for the arrangement, such as cash accumulation and retention benefits, foreign tax, lower fixed-interest-rate funding, New Zealand (i.e., local) dollar-denominated funding, and an improved debt-to-equity ratio. While it is perhaps understandable for the Court to have regarded the non-tax purposes/reasons as not being unique to the arrangement itself, it is interesting that the Court appeared to take issue with tax *efficiency* as a stated goal; as this is a not unreasonable (and not uncommon) objective - among others - for a world-wide corporate group's treasury function to achieve in establishing cross-border acquisition funding.

One curious aspect of the Court's judgment is its conclusion that the Note was "to all intents and purposes" a *mandatory* convertible note, that Frucor was always going to discharge its debt by issuing the Shares, and that the arrangement was therefore a "dressed-up" subscription for equity. This analysis does not appear to give much weight to the fact that, during the term of the arrangement, the Bank would have an enforceable right to repayment in cash (and would rank as a creditor ahead of equity) if Frucor became insolvent; i.e. it was (presumably) highly unlikely that the Bank would have allowed the Shares to be issued to discharge the debt in the event of Frucor's insolvency. That is consistent with Frucor's observation that it recognised a $204,421,565 liability in relation to the Note under *International Financial Reporting Standards*, with which it was required to comply to ensure that its financial statements were a true and fair representation of its assets and liabilities. It is therefore not invariably the case that conversion of the Note into equity was a foregone conclusion, or that the arrangement would have been at all times, in substance, a subscription for equity.

As such, it is difficult to differentiate the arrangement from a forward purchase agreement for equity, in relation to which completion is deferred and the issuer is deemed to incur interest on the basis that the arrangement is a financial arrangement. This position was submitted by Frucor as a fall-back. However, the Court found that such an outcome was not reasonable in the context of a wholly-owned corporate group. Contrary to Muir J's view, the Court appeared to readily reject Frucor's submission, and instead considered that the Shares did not have any value when issued to the Parent, as the Parent was Frucor's sole shareholder (i.e., the Shares did not alter the Parent's economic interest in Frucor).

To some extent, it is disappointing that that submission was not more fully analysed by the Court in the light of the Court's finding that the Shares validly discharged Frucor's debt to the Bank; and particularly given that debt is regularly capitalised in the context of a wholly-owned corporate group without any objection from the Commissioner. Thus, the Court's finding of tax avoidance appears to be predicated on the arrangement being a "dressed-up" subscription for equity *from the outset*. But, unless Frucor's insolvency was truly unfeasible, that does not appear to aptly characterise the arrangement.

Counteracting the Tax Advantage

Citing *BNZ Investments v Commissioner of Inland Revenue*, Frucor submitted that, because the Commissioner must only reconstruct a tax avoidance arrangement so as to counteract any tax advantage, it is necessary to identify the "base level" deduction that would have been allowed in any event. Given that the Note was issued in order for Frucor to repay a $144 million loan from Danone Finance, Frucor's view was that if the arrangement had not been entered into, its debt-to-equity ratio would have remained about the same. As such, Frucor submitted that there was no real "tax advantage" for the Commissioner to counteract.

However, citing its judgment in *Alesco New Zealand Limited v Commissioner of Inland Revenue*, the Court concluded that the Commissioner was not required to consider that Frucor might have entered into an alternative arrangement. As such, the tax advantage was the $66 million interest deduction claimed over the life of the arrangement when, as a matter of commercial and economic reality, only $11 million of the deduction truly related to interest.

On the one hand, this aspect of the judgment is difficult to criticise based on the literal words of section GB 1 of the Act, pursuant to which the Commissioner "may have regard to" an alternative arrangement.

However, the Court's finding does seem punitive, given that Frucor arguably did not obtain a deduction which, but for the arrangement, would not have existed. The arrangement yielded a similar tax outcome to an ordinary shareholder loan: in fact, interest on the original Danone Finance loan (which was refinanced by the Note) was greater than the $11 million resulting from the Court's finding. The approach is also difficult to reconcile with McGechan J's judgment in BNZ Investments, in which he stated:

"... I have no doubt [section GB 1] is intended to counteract tax advantages obtained out of avoidance, but not otherwise. **Where tax advantages are increased through avoidance which would have existed in any event, it is that increment above base level which is to be counteracted, not the legitimate base level itself**. That is all the preservation of the tax base - the purpose of the section - requires".

[emphasis added]

Unfortunately, the Court did not directly address the validity of this principle from BNZ Investments. If the Court did not consider it is only the "increment above base level which is to be counteracted" it would have been helpful for the Court to expressly state this.

Shortfall Penalties

Finally, the Court concluded that the threshold for an "unacceptable tax position" shortfall penalty - which applies when a taxpayer is not "about as likely as not to be correct" - can be described as "whether there is substantial merit in [the taxpayer's] argument" or "whether the taxpayer's argument would be seriously considered by a court. To that end, the Court endorsed the Supreme Court's conclusion in *Ben Nevis* that the use of the word "about" in the threshold for shortfall penalties made it clear that a 50% prospect of success is not the standard. In finding that Frucor was not liable to shortfall penalties, the Court appeared to be influenced by the fact that Muir J not only regarded Frucor's argument as deserving of serious consideration, he also "explained in a careful, closely reasoned and comprehensive judgment why he was persuaded it was both factually and legally correct".

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Snapshot of recent developments

Tax legislation and policy announcements

OECD Tax Policy Reforms 2020

The Tax Policy Reforms 2020 report tracks the tax policy developments over time and provides an overview of the latest tax reform trends for OECD countries. It identifies major tax policy trends emerging before COVID-19 but includes a special feature which takes stock of the tax and broader fiscal measures introduced by countries in response to the pandemic, from its outbreak to June 2020. The report shows that initial government COVID-19 responses focused on providing income support to households and liquidity to businesses, and the responses were then expanded. Most recent measures suggest that the recovery phase will be supported by expansionary fiscal policy in several countries. With countries facing such high levels of uncertainty, policy agility will be key and targeted support measures should be maintained to avoid scarring effects. Once recovery is well underway, governments should shift from crisis management to more structural tax reforms. In addition, the rising pressure on public finances as well as increased demands for fairer burden-sharing should also provide new impetus to reach an agreement on digital taxation.

Inland Revenue statements and guidance

GST and agency interpretation statement

On 7 September 2020, Inland Revenue released public consultation item *PUB00327: Goods and Services tax – GST and agency.* This draft interpretation statement considers whether a person is acting as an agent or as a principal for the purposes of the Goods and Services Act 1985. It is primarily concerned with the application of sections 60(1) and (2) and identifies features that indicate when an agency relationship will exist in relation to a supply. Submissions close on 20 October 2020.

Liquidation question we've been asked

On 9 September 2020, Inland Revenue released an item for consultation *PUB00366: First step legally necessary to achieve liquidation when a liquidator is appointed.* The draft clarifies that the first step legally necessary to achieve liquidation in a long-form liquidation (being the appointment of a liquidator) is not the same for a short-form liquidation. In a short-form liquidation, a resolution by shareholders, board of directors or another overt decision-making step is required. Submissions close on 21 October 2020.

Land for the compulsory zero-rating rules

On 23 September 2020, Inland Revenue released a public consultation item PUB00381 – Do certain supplies wholly or partly consist of land for the compulsory zero-rating (CZR) rules? This draft Questions We've Been Asked concludes the following types of supplies (which wholly or partly consist of land) will be subject to CZR rules:

- the sale of transferable development rights;
- the sale of standing timber;
- the sale of a purchaser's interest in a binding sale and purchase agreement for land, even if it is conditional.

In comparison, the statement concludes that the following supplies do not consist of land for the CZR rules:

- the sale of a purchaser's interest in a non-binding sale and purchase agreement for land;
- and the grant of a licence to use land.

The deadline for submissions is 3 November 2020.

Tax treatment of cryptoassets

On 8 September 2020, Inland Revenue updated its guidance on the tax treatment of cryptoassets in New Zealand to clarify how the income tax rules apply. Essentially, cryptoassets are treated as a form of property for tax purposes, and so the proceeds from selling, trading or exchanging cryptoassets are broadly taxable. The guidance defines "cryptoassets", sets out the tax treatment for individuals and businesses who are buying, selling and mining cryptoassets, the effect of tax residency status on cryptoasset income, the PAYE and fringe benefit tax issues when providing cryptoassets to employees, record keeping obligations and how to calculate net income to include in tax returns.

GST and Leaky Homes Financial Assistance Scheme

On 21 September 2020, Inland Revenue issued a Commissioner's Statement *CS 20/05 – GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment (MBIE) under the Leaky Homes Financial Assistance Package (FAP).* The Commissioner considers that a payment made under the FAP scheme from MBIE to a body corporate is not a payment in respect of any actual supply of goods and services made by the body corporate in return for that payment. However, the Commissioner considers that these payments are in the nature of a grant or subsidy from the Crown under section 5(6D) of the Act and therefore are deemed to be in response to a supply from the body corporate. As a result, these payments are subject to GST. A GST registered body corporate which receives such payments is therefore obliged to include the GST component in its GST return and to pay for any net GST output tax. A body corporate which is not registered (and not liable to be registered) for GST will not be obliged to account for GST.

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

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