

C O R P O R A T E S C O N T A C T

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Less Taxing Tax Initiatives

Inland Revenue has been working on a number of tax simplification measures for individuals and businesses that were outlined in the Less Taxing Tax discussion document released in September 1999.

Changes to late payment penalties

Legislative amendments have been made to S139B of the Tax Administration Act 1994. The new rules around penalties and instalment arrangements will apply on 1 April 2002. The aim is to reduce the penalties imposed on taxpayers who pay just a few days late and ensure that they are not over penalised.

The key changes are:

- Staggered application of the initial late payment penalties.
An initial late payment penalty of 1% is imposed the day after the due date for payment and a further 4% initial late payment penalty is imposed 7 days after the first initial late payment penalty imposition.
- No incremental late payment penalties imposed on debt under an arrangement.

A 1% incremental late payment penalty will not be imposed provided the taxpayers have met their monthly obligations.

These changes are in line with Inland Revenue's strategic direction and demonstrate the department's commitment to good service as outlined in the Charter.

What taxes will these changes affect first?

The staggered application of the initial late payment penalty will apply to taxpayers who have taxes that are due to be paid on or after 1 April 2002, in particular the following:

- Income tax returns for 31 March 2001 (clients of agents)
- GST returns for 31 March 2002
- PAYE returns for 15 March and 31 March 2002

The non-application of incremental late payment penalties will apply to all arrangements that will be entered into on or after 1 April 2002. The authority to cancel late payment penalties under Section 183B of the Tax Administration Act 1994 will also be repealed from 1 April 2002.

What further changes are coming up?

A discussion document, "Taxpayer Compliance, Standards and Penalties: a review", was released in August 2001 which included a proposal to completely replace the debt and hardship rules. The proposed changes are aimed at correcting deficiencies in the current legislation and provide guidance to both Inland Revenue and taxpayers on the appropriate treatment of a person in debt. These will bring forthcoming changes to the way the department will administer its debt recovery.

If the proposed legislation is passed, the changes will apply to tax that is outstanding as at 1 July 2002. We will provide information about any further changes in the next Corporates Contact.

New ACC earner levy rate

From 1 April 2002 the ACC earner levy rate will increase to 1.2 cents (GST-inclusive) in the dollar. The current rate is 1.1 cents (GST-inclusive). The annual maximum earnings on which earner levy is payable has increased from \$85,795 to \$87,185. From 1 April 2002 earner premium will be known as earner levy.

This change is included in the tax tables, which apply from 1 April 2002.

Compliance and Penalties Regime

The Compliance and Penalties Regime contained in Part IX of the Tax Administration Act 1994 has now been in effect for some time. This regime is designed to encourage taxpayers to comply voluntarily with their tax obligations, but also to ensure that penalties for breaches are imposed impartially and consistently.

Each case affecting Corporates customers is carefully considered before deciding whether or not a penalty applies. The most common shortfall penalty imposed is for lack of reasonable care. Corporates has set up a Consistency Committee in Auckland and Wellington that reviews the application of the regime to Corporate clients.

The Committee has noted some trends emerging in the types of errors being made by Corporates clients. It is timely to draw these to your attention.

There have been several instances of errors occurring where temporary contract staff have been employed, and the contract staff have made errors due to their lack of familiarity with the system. Special care needs to be taken where contract staff are used.

A major element of taking reasonable care for a Corporates client is to have appropriate systems in place to reasonably ensure that tax returns are accurate, and all obligations met. Where there is not a proper system of checks and reconciliation's this will automatically raise a question of whether reasonable care was taken. Often we are told that systems will be improved, however the issue is whether the systems that were in place were adequate.

One check that should always be in place is a 'reasonableness' check of the major components, for example considering whether an amount shown as GST outputs is reasonable in comparison with other periods and known factors affecting the period in question. Clients are leaving themselves open to potential penalties where no 'reasonableness' check is done.

Sometimes an argument is raised that there is no revenue loss when a broad view of the tax base is taken. The Compliance and Penalties Regime looks at compliance by the taxpayer concerned, and no revenue loss is not a relevant factor for consideration.

Several times there have been problems because the tax affairs of Corporates clients are prepared offshore. In these circumstances the Corporate has a duty to ensure that the overseas agent is properly aware of the tax obligations in New Zealand.

Section 141 of the Tax Administration Act 1994 provides for offsets and/or consequential adjustments to be made where there are multiple shortfalls in one tax type and period, or consequential adjustments to other tax types or associated persons.

From time to time we receive requests for remission of interest along with an explanation of a tax shortfall. The only situation identified to date where interest will be remitted is where an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance.

Questionnaires

Corporates Segment has for some time now been using taxpayer questionnaires. Our intention is to make greater use of questionnaires to assist compliance by businesses within the Corporates Segment. The questionnaires may take one of several forms. The most common will be where Inland Revenue seeks certain information or explanation e.g. "Please provide details of all transactions where an arm's length price was not used". Most questions will focus on areas that the department sees as potential risks or where we require certain information.

A second type of questionnaire is more in the form of a checklist e.g. "Have you made adjustments for" This type is more of a self-audit questionnaire.

Questionnaires will often be issued as part of a project. Following analysis of the responses, you may receive additional questions, some perhaps a visit to validate the information and in some cases an investigation. Many will need no further follow-up.

Some of the advantages of the questionnaire include:

- greater coverage by Inland Revenue of potential risk issues and enable industry comparisons;
- in contrast to investigations, the time and compliance costs is minimal for both the taxpayer and the department;
- assistance in evaluating compliance by providing extra information to that provided in tax returns;
- provides Inland Revenue with a level of comfort about the accuracy of tax returns; and
- they allow current information to be collected.

The questionnaire may also be a tool for taxpayers to review their systems and procedures to ensure tax compliance.

The questionnaires will mainly target potential risk issues, but in others it may be used to enable coverage where taxpayers are spread throughout New Zealand. The questionnaires will specify the response date. Where there is no response, when one is required, Inland Revenue will issue a formal request.

The questionnaire is not "notification of an audit or of a pending audit", in terms of the shortfall penalty legislation. Taxpayers are entitled to file a voluntary disclosure if, when completing the questionnaire, they identify things that are not correct.

Transfer Pricing

The Corporates Segment has a strong focus on transfer pricing. Corporates investigators routinely evaluate company compliance in this area, to ensure New Zealand is receiving its fair share of tax from cross-border associated party transactions. In particular, companies posting low profits (especially losses) or transacting with tax haven associates should expect very close scrutiny.

Transfer pricing documentation is central to the process of justifying and explaining pricing of cross-border transactions. A company's main purpose in preparing and maintaining documentation should be to place itself in the position where it can readily demonstrate to Inland Revenue that its transfer prices are consistent with the arm's length principle.

There is no explicit statutory requirement to prepare and maintain transfer pricing documentation. However, if a company's documentation inadequately explains why its transfer prices are considered to be consistent with the arm's length principle, Inland Revenue is more likely to audit those transfer prices in detail. The lack of adequate documentation may also make it difficult for the company to rebut an alternative arm's length transfer price proposed by Inland Revenue.

Companies should not rely solely on transfer pricing documentation compiled some years ago. Regular re-evaluation of both the facts and your transfer prices to determine that they are, and remain, arm's length is advisable. Is your company now performing different functions or assuming new risks? Is your bottom-line profit result still commercially realistic? Has there been a major change in your line of business that impacts significantly on prices or profitability? Indeed, are last year's comparables still truly comparables?

Remember, it is the responsibility of local management to ensure the company's transfer prices are in accordance with the arm's length standard. If Inland Revenue makes transfer pricing adjustments, the quality of your documentation will be a key factor in determining the extent to which penalties might apply.

Electronic Commerce Guide

A Guide to Tax Consequences of Trading over the Internet has just been released on the Inland Revenue web site www.ird.govt.nz/library/ecommerce. It covers general issues in a question and answer format, Income Tax and GST specific issues and details Inland Revenue's involvement internationally particularly with OECD. The author would be interested in any feedback you have in terms of content and useability of the information. You are invited to respond to gary.morton@ird.govt.nz

General Insurance Reserving Industry Guidelines

The General Insurance Reserving Industry Guidelines set out the approach taken by Inland Revenue Corporates Segment, Insurance Sector, to the calculation of reserves for general insurance.

The industry guidelines have effect from the 2002/03 income tax year.

The key points of the industry guidelines are:

1. The approach is to follow the Financial Reporting Standard No 35 where it is consistent with the income tax legislation.
2. The Unearned Premium Reserve is generally calculated by apportioning gross premiums on a daily basis. Alternative methods may be accepted. Acquisition costs and reinsurance premiums are not required to be netted off against gross premiums.
3. An insurer may deduct a reasonable estimate of the outstanding claims incurred and not paid at the end of an income year. For insurance business (other than Accident Insurance where section DK 5 applies):
 - (a) The policy benefit amount and the direct claim settlement costs are incurred in the income year in which the insured event occurs;
 - (b) Indirect claim settlement costs should not be included in the estimation of the insurer's OCR;
 - (c) Any deductible unexpired portion of direct claims settlement costs at the end of an income year are to be included in gross income.
4. Third party recoveries and salvages can be effected through the OCR claim process without being separately reported as trading stock or bad debts.

The complete guidelines can be obtained from www.ird.govt.nz/aboutir/structure/corps/gir-industryguidelines.html

Emails

Inland Revenue is receiving an increasing number of email messages from customers as the use of the internet for business and communication becomes more popular.

Over the past few months we have noticed that more and more of these contain viruses. Although we have checks in place to protect the tax system, we would like to remind you to keep your virus protection software and procedures up to date to minimise the risk of your desktop becoming infected. This will protect your business records.

Trans-Tasman triangular tax discussion document

The Trans-Tasman triangular discussion document was released recently by New Zealand Finance and Revenue Minister Michael Cullen and Australian Treasurer Peter Costello.

Triangular taxation occurs where Australian shareholders in a New Zealand company operating in Australia are unable to access Australian-sourced franking credits, with the same problem applying in reverse for New Zealand shareholders in Australian companies operating in New Zealand.

The mechanism under consideration is one that allocates both Australian franking credits and New Zealand imputation credits to shareholders in proportion to their ownership of a company.

The discussion document is available in electronic format at www.taxpolicy.ird.govt.nz or www.treasury.gov.au, submissions close on 3 May 2002.

Requirements for Non-Resident Contractors simplified

Withholding tax requirements for non-resident contractors who come to New Zealand to work for short periods each year have been simplified.

Payments to non-resident contractors are subject to a 15% withholding tax, unless the contractor holds a certificate of exemption from tax in New Zealand. Non-resident contractors – or their employers – must apply for this exemption even if they are exempt from paying tax in New Zealand. For example, if the non-resident is from a country with whom New Zealand has a double tax agreement that exempts the contract activity being undertaken.

From 1 April 2002, non-resident contractors will no longer be required to apply for a certificate of exemption from withholding tax if they are:

- eligible for relief under a double tax agreement; and
- present in New Zealand for less than 62 days in aggregate in any 12-month period.

More information is available in Tax Information Bulletin, Volume 14 No 3.

Contact details for enquiries are as follows:

Telephone (04) 802-6056
Fax (04) 384-5883
email nr.contractors@ird.govt.nz

Requests to amend FBT fourth quarter or annual returns for the year ended 31 March 2001

If you elected the 64% option on your fourth quarter or annual FBT return for the year ended 31 March 2001, and then requested a reassessment to use the multi-rate option, which was declined, you should now resubmit your request.

A change in policy means that we will now allow requests for reassessments to use the multi-rate option when the 64% option was previously used. As we are unable to identify those employers who may be affected, we are asking you to resubmit your request in writing.

FBT filers' prescribed interest rate for loans

For the quarter beginning 1 January 2002 the prescribed rate of interest for calculating the fringe benefit value of low-interest loans to employees is 6.70%. This is a decrease from the previous quarter's rate of 7.19%.

Are you Connected?

Version four of the Tax Agents' CD Rom was issued to Tax Agents in the first week of April 2002. The Tax Agents' CD Rom is included in the new Are you connected? (IR 780) pack. This pack combines the CD Rom, Electronic Interfaces (IR 788) pamphlet and How to Contact Inland Revenue (IR 709) pamphlet.

The IR 788 is a new pamphlet that contains the CD Rom instructions and short descriptions of Inland Revenue's other electronic services including E-File, ir-File, Inland Revenue's website, INFOexpress and StationeryXpress.

The IR 709 contains our contact information. These details have been included for Tax Agents to give to their customers so non-Tax Agents do not phone the Tax Agents' line.

The CD Rom contains over 400 key Inland Revenue publications, including tax returns and guides. This service is intended for tax agents, corporates or solicitors, but is available to any taxpayer that wishes to order one. This can be ordered by requesting the IR 780 through INFOexpress, StationeryXpress or by phoning us. Please note that this ordering procedure has changed from previous years.

Any queries regarding the CD Rom can be emailed to agentcd@ird.govt.nz