

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

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Our risk review process for large enterprises: Behavioural rating

Staff are completing the 2006 risk reviews for large businesses and notifying taxpayers of the results. For the first time, businesses subject to a comprehensive risk review are being given a detailed explanation of their tax behaviour ratings.

Our perception of the group's attitude towards its tax risk position is measured by looking at a number of behavioural factors. A high rating indicates that a high level of risk has been determined for that particular factor.

The summary below provides an overview of how the behaviour ratings can be interpreted. In most cases there will be a greater likelihood of audit activity from Inland Revenue if behavioural factors have been rated in the high risk category.

Interpreting Inland Revenue's behaviour ratings

Inland Revenue's behaviour ratings for large businesses can be interpreted as follows:

Tax planning – the approach taken when undertaking tax planning.

- Low risk:* Our perception is that a conservative approach is taken towards tax planning.
- Medium risk:* Our perception is that a proactive approach is taken towards tax planning.
- High risk:* Our perception is that an aggressive approach is taken towards tax planning.

Level of cooperation – whether information requests are complied with and Inland Revenue is kept fully informed.

- Low risk:* A very good level of cooperation exists.
- Medium risk:* Cooperation is acceptable in most instances.
- High risk:* A number of instances of non-cooperation have occurred.

General tax compliance – the extent that tax return and payments obligations are fully met.

- Low risk:* A very good level of general tax compliance exists.
- Medium risk:* General tax compliance is acceptable in most instances.
- High risk:* A number of failures have occurred.

Tax management – the extent of tax risk management policies and controls.

- Low risk:* Our perception is that very good tax risk management exists.
- Medium risk:* Our perception is that tax risk management is generally satisfactory.
- High risk:* Tax risk management is below Inland Revenue's expectations.

Errors – whether the group "gets it right first time". Errors disclosed voluntarily are looked at more favourably than those identified by audit.

- Low risk:* Rarely makes errors.
- Medium risk:* Errors have occurred but they have not been significant.
- High risk:* Makes errors frequently or significant errors have occurred.

Effective tax rate – Inland Revenue's calculation of the New Zealand tax payable for the group relative to its accounting profit, compared to the statutory tax rate.

- Low risk:* A rate consistent with or greater than the statutory tax rate.
- Medium risk:* A rate slightly lower than the statutory tax rate.
- High risk:* A low or very low effective tax rate (including groups with current year tax losses).

Corporate governance – the extent of directors' focus on tax matters as a normal corporate governance procedure.

- Low risk:* A high level of attention to tax matters.
- Medium risk:* A moderate level of focus.
- High risk:* A lack of adequate focus on tax matters.

New Zealand international financial reporting standards: Our compliance approach

In September, Inland Revenue and Treasury officials released a paper on the tax consequences of adopting international financial reporting standards (IFRS). That paper considered the tax policy issues that could arise from the adoption of IFRS. Submissions were due on 20 October and they were being reviewed at the time this article was written. Legislation changes are expected to be included in a Bill introduced in mid-2007.

Over the next 12 months our compliance focus will be targeted towards early adopters who file their 2006 income tax returns under IFRS. Approximately one-third of the country's largest 200 corporate groups are expected to be 2006 adopters.

There will be four steps to our compliance approach:

1. Monitoring

Staff are monitoring notes in financial accounts which will have a tax impact. We are also monitoring tax payment changes for large businesses. If you experience significant provisional tax changes for your first year of adoption, your account manager may contact you to establish the reasons why.

Reviewing IFRS tax adjustments, particularly in the year of adoption, will be important for risk assessment. **If you are preparing tax returns for a 2006 adopter we would like you to separately identify IFRS adjustments in the tax adjustment schedule.**

Although you are not compelled to make this disclosure, it will potentially save you time as it could avoid further enquiries being made by our investigators.

2. Enquiries and risk reviews

For some of our largest early adopters we may request system walk-throughs before or after tax returns are finalised. Our main focus will be to understand what checks, reviews and reconciliations were undertaken by the tax team in the year of adoption. For example, have you reconciled adjustments made to shareholders' funds, to ensure taxable income is not under or overstated? Expect to be asked what issues you identified and how you resolved them.

We will also be interested to know whether you identified errors relating to past tax returns when you prepared your first tax return under IFRS. Work papers may be examined as part of our 2007 risk reviews.

If you adopt IFRS in the 2006 income tax year and make the decision to defer some transitional adjustments to the 2008–09 income year, we would prefer to review these adjustments now rather than wait until the 2009 income tax returns are filed.

3. Investigations

We anticipate that investigations will occur where issues are not satisfactorily resolved during our risk reviews.

4. Public statements

We plan to publish a checklist for early adopters on the Inland Revenue website by the end of the year. Responses could be either filed with the tax adjustment schedule in the year of adoption, or provided during selected risk reviews. An updated checklist is likely to be published later in 2007.

If you have any feedback about this article you can contact our Risk and Intelligence team directly at risk&intelligence@ird.govt.nz

Aligning GST and provisional tax payments

New legislation was passed in April 2006 to improve the timing and frequency of tax payments.

Over the next two years, we'll be aligning the due dates for GST and provisional tax payments, and introducing a new option to calculate provisional tax.

Aligning the due dates for payments will make it easier for businesses to pay GST and provisional tax payments, as these will be paid at the same time.

These changes may also help businesses with their cash flow by aligning the payment of provisional tax more closely to when their income is earned.

Keep an eye on the Inland Revenue website over the coming months to keep up-to-date with these changes.

Inaugural survey provides a picture of large enterprises

During June, 100 large businesses were surveyed by Colmar Brunton as part of our first large enterprises survey. The results have now been analysed and show areas where businesses are happy with the service from Inland Revenue, and areas for improvement.

“This survey represents the start of a journey in helping us to better understand the needs of large businesses as taxpayers,” says Tony Morris, Assurance Manager (Large Enterprises). “The results give us a good picture of what matters to large businesses, which will assist us in improving our service.

“Thank you to those large enterprises who took the time to participate in the survey. Your input was valued and has contributed to the development of an action plan to address areas requiring improvement.”

The survey focused on six key areas: relationship management, investigations, correction of errors, voluntary compliance, tax minimisation, and the tax environment.

Relationship management

93% of survey participants rated having a specific person to contact at Inland Revenue as “important” to “extremely important”.

“We recognise that large enterprises value the account management role offered to them. We are committed to ensuring that all companies currently with an account manager will continue with that same account manager, going forward,” says Tony.

“Account management is the day-to-day management of a customer’s dealings with Inland Revenue, particularly with technical correspondence and communication.”

Investigations

Large businesses surveyed felt that the reason businesses were selected for an investigation was because “Inland Revenue perceived there to be risks they wish to examine”.

52% of all survey participants now do something different as a result of their most recent investigation.

Survey participants were asked to rate how Inland Revenue staff handled different aspects of the investigation. Staff were rated high on:

- being professional in their dealings with the business
- treating the business consistently with how they treat other taxpayers
- their technical competence and tax knowledge
- keeping the business well informed throughout the audit process
- giving the business an opportunity to express their views before a NOPA is issued
- advising the business prior to the issue of a disputes document.

Participants also signalled a number of areas we could improve:

- ability to investigate in-depth significant risk issues
- ability to resolve issues fairly, reasonably and according to the law
- requesting appropriate and relevant information
- ability to identify additional significant tax risk areas during the audit
- completing the audit within a reasonable timeframe.

“We have identified a number of ways we can improve investigation timeframes,” says Tony Morris. “This includes setting timeframes for each stage of the investigation and ensuring those timeframes are regularly reviewed. We are also placing an emphasis on keeping taxpayers informed of expected timeframes throughout the investigation.”

Correction of errors

95% of large businesses make a voluntary disclosure when a major tax irregularity is found. For a minor error 60% make a voluntary disclosure.

75% of large enterprises said the key factor they consider when deciding whether to make a voluntary disclosure is their obligation to pay the correct amount of tax.

“We are pleased with the number of large businesses who indicated they have made use of voluntary disclosures to ensure a correct tax position.

“A number of businesses surveyed expressed concern that making a voluntary disclosure impacted our risk rating of large enterprises adversely. This is not the case. Overall, voluntary disclosures are viewed as a positive step to demonstrating good compliance.”

Voluntary compliance

Survey participants told us that we had the most impact on voluntary compliance by:

- respecting their confidentiality and privacy
- providing them with tax information bulletins and guides
- applying the law consistently and equitably.

Tax minimisation

The answers to the series of questions about tax minimisation showed that large enterprises make corporate decisions for commercial reasons. Tax implications are only part of that decision. It was stressed that the tax manager's job is to balance cost versus risk.

“We understand the importance of having an investigator who understands the commercial reality for large businesses. We are looking to increase investigator awareness and understanding of the diverse nature of commercial pressures that impact on businesses operating in New Zealand and globally,” says Tony.

“We also hope to show the link between taking a risky tax position and ensuing investigation activity in our compliance strategy and future risk assessments.”

The tax environment

41% of large enterprises have a board member specifically responsible for tax matters. 50% have a written tax risk policy or strategy.

Overseas-owned large enterprises tended to have a greater emphasis on managing their tax processes than those that are New Zealand owned.

“There are a number of options for us to explore. We could learn from the Australian Taxation Office's focus on governance. We could also look to develop programmes to examine the drivers of business decision making.”

Changes at Inland Revenue

As you may have heard, Inland Revenue is undergoing an internal restructure. This has been driven by the need to meet the growing demands of new social policy initiatives and a more complex and diverse customer base. We believe the changes will help us become more agile and responsive to new and changing expectations, and will help us deliver on our outcomes effectively and efficiently.

The restructure has seen the development of five new internal business units:

- **Assistance** provides integrated, cost-effective customer contact, including debt management
- **Assurance** helps increase voluntary compliance and deter non-compliance. This group has responsibility for investigations, debt collection and enforcement, technical advice and risk assessments.
- **Customer Insight** has a dedicated focus on customer groups. This group represents the voice of the customer within Inland Revenue.
- **Customer Operations** manages customer processes which do not require person-to-person contact.
- **Design** provides specialist design skills and implements new policy initiatives.

As part of the restructure we are looking at how best to share information with corporate organisations in the future. This will be the final issue of *Corporates Contact*. We welcome your thoughts about what works for you, what information has been useful in the past, and the best way to deliver this information. If you have any feedback or suggestions please email them to the *Corporates Contact* editor at corps.contact@ird.govt.nz

Inland Revenue's Corporates Segment has been providing information about tax to corporate organisations through *Corporates Contact* since 1998. It has been a medium through which Inland Revenue has been able to share the impact and implementation of legislative changes, highlight common errors, and share risk areas identified through investigations.

Inland Revenue and GST numbers: Update

In the March edition of *Corporates Contact* we alerted you to the fact that the availability of valid Inland Revenue and GST numbers for future issue was decreasing rapidly and that we would be adding a zero to all eight figure numbers to make all Inland Revenue and GST numbers nine figures long.

After consultation with business, key stakeholders, banks and other government departments, we have come up with a second design solution. Consequently, we will be introducing an extended nine figure range to work alongside the current eight figure range.

This solution will mean:

- previously, a valid number was greater than 10-000-000 and less than 99-999-999
- now a valid number will still be greater than 10-000-000 but less than 999-999-999.

For example:

- all current eight figure numbers remain unchanged (12-345-678)
- new customers will be issued with a nine figure number (123-456-789).

The extension of the current range was chosen as it will provide customers with continuity. All Inland Revenue systems will be able to accept and receive eight and nine figure numbers from April 2007. Inland Revenue will start issuing nine digit Inland Revenue and GST numbers from April 2008 if the eight digit number range is not depleted before then.

To be compliant, your software/systems must accept the extended nine figure range as well as the existing eight figure range from April 2007. We have been working with software developers and payroll providers for over a year to ensure their annual updates are now compliant.

Important information to remember:

- We will be able to accept both eight and nine figure numbers from April 2007.
- Inland Revenue will issue nine digit numbers from April 2008 if the current number range is not depleted before then.
- Over time, all Inland Revenue and GST forms will be updated to show nine boxes and you may need to provide staff with advice on how to complete an Inland Revenue form with nine boxes—leave the first box blank.
- Some software providers' products may need to have a zero added when entering an employee's number to the front of the current eight figure number. Your provider should alert you to this when they send an update, upgrade or patch.
- If your company has an eight figure GST number you can continue to display this on any invoices that you produce. Should you set up a new company or subsidiary and a nine figure GST number is issued this will need to be displayed.
- If you store other GST numbers, eg contractors, you will need to ensure that you are able to take up to nine figures.

You can email additional enquiries or questions, to the project team at number.extension@ird.govt.nz

KiwiSaver: A new work-based savings initiative

In September 2006 Parliament passed legislation with the aim of making it easier for New Zealanders to save, particularly for retirement.

As employers you will have a key role with KiwiSaver. While KiwiSaver is voluntary for employees from 1 July 2007, all new employees aged 18 to 65 years will be automatically enrolled—unless they opt out (or are specifically excluded from automatic enrolment).

Inland Revenue has been actively working with employers and employer groups to work through design and implementation issues to ensure the processes are workable and costs to employers are minimised. From late 2006, we will be sending you more information about the initiative, including what you'll need to do and when.

Key features of the initiative which will impact on you are:

- Inland Revenue will provide a comprehensive information pack for you to give to your new employees who qualify for automatic enrolment, or existing employees who decide to opt-in by providing you with a KiwiSaver deduction notice.
- For employees that are subject to automatic enrolment, contributions will start from their first pay and will continue unless they opt out.
- You will deduct KiwiSaver contributions from your employee's gross pay and send this to Inland Revenue along with PAYE.
- You will be required to advise Inland Revenue of each new employee's name, IRD number and address who are subject to automatic enrolment or have opted-in via a KiwiSaver deduction notice. These details will be sent in with your Employer Monthly Schedule. You will only be required to provide the information that the employee gives you.
- Accept any employee's opt-out notice and advise Inland Revenue that the employee has opted out. Refund any contributions deducted that have not been on-paid to Inland Revenue.
- You may choose a KiwiSaver scheme for your employees to become members of, if the employee does not choose their own scheme. The scheme will need to be open to all new permanent employees. Inland Revenue will need to accept your choice of scheme.
- You will be able to make contributions on behalf of your KiwiSaver employees. These will be exempt from specified superannuation contribution withholding tax (SSCWT)—capped at the lesser of the employee's contribution or 4% of the employee's salary and wages.
- Once a member has been in KiwiSaver for a year they can take a contributions holiday. Inland Revenue will notify you and you will be required to stop making KiwiSaver deductions. Inland Revenue and/or the employee will advise you when to start or stop making deductions.
- You will not be expected to provide financial advice to your employees and the legislation backs you up on this.
- The Government Actuary can exempt employers with existing registered superannuation schemes from having to automatically enrol new employees provided the existing scheme:
 - is portable
 - open (in practice) to all new permanent employees
 - has a total combined employer/employee rate of at least 4%
 - employer contributions that count towards the contribution rate of 4% vest within five years.

The exemption also applies to defined benefit schemes that meet the first bullet point above and provided that it accrues benefits at a minimum rate of 4% of the employee's salary or wages.

- Existing registered superannuation schemes have the option of:
 - continuing to be a registered superannuation scheme
 - converting to KiwiSaver as long as it complies with certain requirements
 - establishing a KiwiSaver scheme under an umbrella trust within their existing scheme under their existing trust deed.

You might want to talk with your provider about your options if you have an existing superannuation scheme.

For further information go to www.ird.govt.nz/kiwisaver

In brief

New rules for foreign trusts

New disclosure and record keeping rules for foreign trusts were introduced on 1 October 2006.

If you represent a foreign trust and know these rules apply to you, a *Foreign trusts disclosure (IR 607)* form must be completed for each foreign trust you administer.

If you are not sure if you are affected, the article in our *Tax Information Bulletin Vol 18, No 5 (June 2006)* should help clarify your position.

If, after reading the article, you have any further questions, please email them to competent.authority@ird.govt.nz

A reminder about annual disclosure and filing requirements for controlled foreign companies and foreign investment funds

We'd like to remind you that any taxpayer with an income from or control interest in a foreign company or foreign investment fund, not exempted under the international tax disclosure exemption, is required to disclose that interest. Inland Revenue monitors compliance in this area to ensure that required disclosures are filed and the calculations are correct. Penalties may be applied if the required disclosures are not filed with Inland Revenue.

If you've indicated that you have held rights in a foreign company or foreign investment fund by ticking "yes" in Box 34 on the *2006 Income tax return Companies (IR 4)*, it is important that you attach the disclosure to the return form. If you e-file your income tax return, these disclosures must be submitted to Inland Revenue at the time of filing. We are investigating whether these disclosures could be electronically filed in the future. If you have any comments or suggestions please let our Risk and Intelligence team know by emailing risk&intelligence@ird.govt.nz

Uncertain about your tax interpretation?

Don't forget, if you want to reduce exposure to potential shortfall penalties when you file your next income tax return, you can file a *Statement in support of a tax interpretation (IR 282)* with your return form. The IR 282 disclosure gives you the benefit of a 75% reduction in potential shortfall penalties for any unacceptable or abusive tax positions. You can find more information about this under "Forms and guides" on the Inland Revenue website.

Correction to FBT article

The article about changes to fringe benefit tax (FBT) in the June 2006 issue of *Corporates Contact* incorrectly stated: "Employers now have the choice of calculating the FBT payable based either on the vehicle's tax book value, or its cost price. Employers who choose the tax book value option will be required to apply the calculation method to all vehicles owned or leased."

This should have read: "Employers who choose the tax book value option will be required to apply the calculation method to **that** vehicle, whether it is owned or leased."

From the editor

Disclaimer

Corporates Contact seeks to comment generally on topical tax issues relevant to large corporates. While every attempt is made to ensure that the law is correctly interpreted, articles are intended to be a brief overview only and are not a full commentary or analysis of the law. The examples provided are not intended to cover every possible factual situation.