

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

N U M B E R T W E N T Y E I G H T ~ D E C E M B E R 2 0 0 5

Risk areas identified as part of risk review process

In the September 2005 issue of *Corporates Contact* I discussed our risk review process, including what was involved and how the results would help the taxpayers and Inland Revenue. The risk review process for our largest taxpayers has now been completed and the results have been analysed, highlighting some significant risk areas we will be monitoring and developing appropriate risk responses for in the coming year.

These include:

- **International Financial Reporting Standards (IFRS)**
Early adopters of IFRS are now starting to disclose the financial effects via reporting disclosures. Understanding transitional year tax filing disclosures and tax adjustments will be a significant issue for us when the 2006 tax returns are filed.
- **Financing expenses paid to non-resident associates**
In 2006 we will be reviewing a number of taxpayers for the rates of interest, guarantee fees and financing costs, to ensure that excessive rates are not being paid.

We are also continuing to focus on the four risk areas referred to in the June 2005 edition of *Corporates Contact*. These relate to related party financing into New Zealand (that is, nil coupon optional convertible note funding from foreign associates), intangible property structuring, asset valuations and allocations for depreciation, and foreign dividend withholding payment structures.

In addition we will continue to actively monitor Inland Revenue data for the whole of our corporate taxpayer base in a number of areas, such as imputation balances, income tax losses, conduit tax relief and foreign dividend withholding payments.

I believe that if we expect taxpayers to voluntarily comply with their tax obligations, it is only right that we share with them the risks we have identified or perceive to exist.

With the holiday season almost upon us I want to take the opportunity to wish you and your staff a safe, happy and restful festive season and best wishes for 2006.

Spyros Papageorgiou
Group Manager
Corporates

Deductibility of at risk pay clarification

We received some feedback about the deductibility of at risk pay, an issue that was mentioned in the September 2005 issue of *Corporates Contact*. The important thing to remember is that just because year-end performance pay is paid to employees within 63 days of the year-end, it does not itself qualify as expenditure incurred in that income year. It must be demonstrated that the taxpayer was definitively committed to the expenditure on or before year-end.

If events take place after the year-end that give rise to liability—such as an appraisal process that has subjective elements—then generally the expenditure is incurred in the later income year, notwithstanding the link back to the income year just ended. Basically, the test is one of whether the employer has a legal obligation to pay, as at balance date. In the case of *CIR v Glen Eden Metal Spinners Ltd (1990)*, the court looked at the commitment that existed at the balance date.

Foreign tax exemptions for branch operations of grey list companies

With Australia, as part of its international reforms, further increasing the scope of its branch profits exemption, it seemed timely to remind taxpayers of part B of schedule 3 of the Income Tax Act.

Should a grey-list controlled foreign company apply any of the listed preferences in the calculation of its home country tax liability, it is a tax concession grey-list CFC and is required to attribute its income or loss. The attributed income or loss, however, is simply the taxable income or loss calculated in the country of residence with the benefit of the concession excluded. Full branch equivalent calculations are not required.

The first of the listed preferences is:

Any exemption from income tax for income derived from business activities carried on outside the country.

This means that if an Australian controlled foreign company has foreign branch operations that are not subject to Australian income tax, it is a tax concession grey-list CFC and must attribute its income or loss to the New Zealand taxpayer with an income interest in the CFC.

For example, Australian company, owned 100% by New Zealand company, has \$100 taxable income in Australia but also has exempt foreign branch profits of \$100. Australian company is a tax concession grey-list CFC and New Zealand company has attributed CFC income of \$200.

As set out in paragraph 16.5 of the *Tax Information Bulletin Appendix D—Controlled Foreign Companies Vol 2 No.3 (October 1990)*, this tax exemption includes income tax exemptions that may also arise as a result of a double tax agreement between the grey-list country and another jurisdiction.

Review highlights common reasons for tax shortfalls

A review undertaken recently into why tax shortfalls are occurring has revealed a number of common themes that explain why companies are failing to ensure the correct tax position is taken.

Systems issues

- New computer systems have not been correctly set up or adequately tested.
- Computer systems imported from overseas have not been adapted for the New Zealand tax system, for example, imported systems may not correctly account for GST.
- Changes to computer systems have had unforeseen consequences or may not have been adequately tested before implementation.

Staff issues

- New staff, or high staff turnover, are commonly cited as a contributing cause of the tax shortfall (particularly in GST cases). Often it appears that the new person has not been adequately supervised/trained and has not followed the system or has missed a step in the system.
- A check for reasonableness or an independent review has not been carried out, allowing for obvious errors to get through.
- Staff absences and lack of a backup person is also commonly attributed as the cause of a tax shortfall.

PAYE

- Bonus or lump sum payments and settlements are often not accounted for, as these are handled by the HR department and not communicated to the payroll division due to confidentiality issues.

NRWT

- Issues surrounding non-resident withholding tax and royalties. The wide scope of amounts liable to have NRWT deducted is often not appreciated. Recent errors include use of trademark/intellectual property use.

Tax shortfalls on most taxes and duties are subject to shortfall penalties (a percentage of the tax shortfall) so it is in your best interest to ensure the correct tax position is taken.

If you become aware that there is a tax shortfall arising then this should be disclosed as soon as possible. Our booklet, *Putting your tax returns right (IR 280)*, sets out how to make a voluntary disclosure and the benefits of making a voluntary disclosure.

High wealth programme brings in millions of extra tax dollars

Nearly \$36 million worth of additional tax has been identified, assessed and paid during the past year, thanks to Inland Revenue's high wealth individual programme.

A further \$102 million has been assessed and is under dispute, while another \$100 million in potential tax risks has also been identified and is under active examination.

The high wealth programme is designed to draw together a range of initiatives to improve both compliance and Inland Revenue's understanding of leading-edge commercial tax planning approaches, including national and international business and investment structures, and financing products.

The programme is co-ordinated by the Corporates Segment's High Wealth Individuals Unit, which gathers information and undertakes risk analysis. The research and analysis is allowing Inland Revenue to gain a better understanding of high wealth individuals, their business and financial affairs, and tax planning techniques.

The initial focus has been on 100 individuals and the entities controlled by them. In general, those involved tend to be associated with highly complex structures. The average number of associated entities is 37, and the highest number of entities associated with one individual is 155.

Individuals under scrutiny in the high wealth individuals programme have generally been co-operative. This programme is about ensuring that this group is aware of their tax obligations, helping them meet those obligations, and ensuring they are aware of the consequences if they choose not to comply. We want to ensure they are paying their fair share of tax on time, every time.

Common tax risks identified include:

- residency – determining the country where the high wealth individual and their entities are to be taxed
- trusts – use of such vehicles to divert taxable income
- management fees – payments to loss-making associates
- disposal of assets – businesses selling “investment” assets
- property dealings – examining capital/revenue issues
- lifestyle assets – luxury assets being shown as business assets, together with the costs
- tax losses – entering in arrangements that generate tax losses
- transfer pricing – transferring profits to associated offshore entities
- avoidance schemes – entering into schemes specifically designed to avoid tax, such as the *Trinity scheme*.

Business obligations with unclaimed money

Unclaimed money is funds left untouched for six or more consecutive years in financial institutions and businesses.

Most of the forgotten and abandoned money comes from deposits left in financial institutions such as insurance proceeds, and also includes unclaimed funds such as cheques or wages.

Initially it is the responsibility of the institution holding the funds to make every effort to locate the proper owner of the money. If they cannot locate the company or individual, under the Unclaimed Monies Act 1971 the funds are required to be paid to Inland Revenue.

The Act applies to all companies, banks, building societies, insurance offices, money-lenders, auctioneers, real estate agents, accountants, sharebrokers and motor vehicle dealers that hold defined classes of unclaimed money.

Companies need to consider if they have amounts that are unclaimed money and to ensure that systems are in place to pay the money to Inland Revenue at the appropriate time.

For more information about the process for financial institutions and businesses to pay the money to Inland Revenue, check out the article in the *Tax Information Bulletin Vol 5, No 7 (December 1993)*.

The 2005 unclaimed money list has recently been published. There are 5,049 names on this year's list and the average amount unclaimed is \$947.30. The largest single amount of unclaimed money owed to a company or individual is \$76,528.16.

Please direct all enquiries to: Unclaimed Monies, BusinessDirect, Inland Revenue, PO Box 895, Wellington.

A look at filing patterns for 2004 income tax returns

As at 30 September 2005 Inland Revenue's Corporates Segment had received a total of 5,722 income tax returns for the 2004 year with 4% still outstanding.

The bulk of returns were, as can be expected, *Income tax return companies (IR 4)*, with a total of 4,608 returns filed (see figure 1).

FIGURE 1

Corporates income tax returns by receipt date

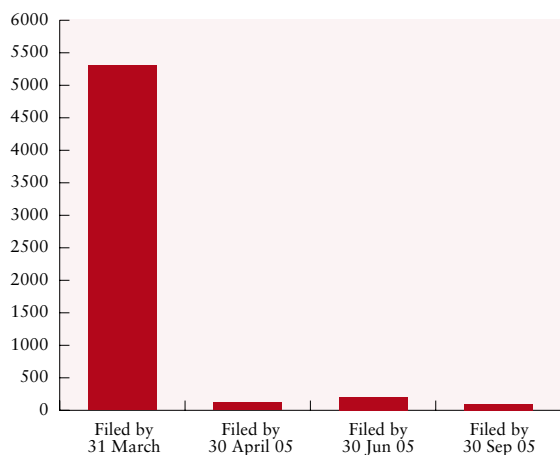
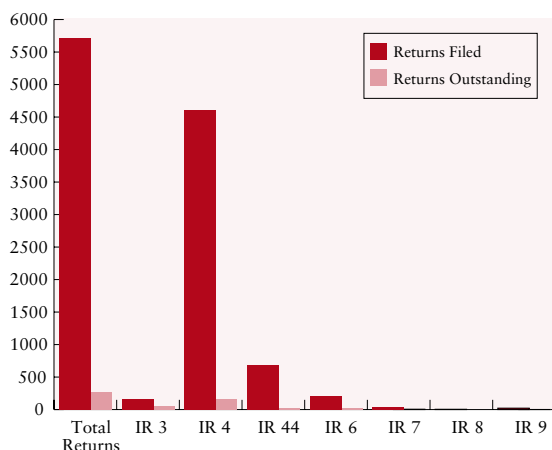


FIGURE 2

Corporates 2004 income tax returns



It is pleasing to see that most corporate taxpayers filed by 31 March (see figure 2).

Filing on time, and preferably before the due date, has a number of advantages:

- you get faster service—we have more time before the due date to process your return, we get a backlog at 31 March which is quickly followed by the personal tax summary season
- it is less likely that your refund will be held up for an *Annual imputation return including dividend withholding payment account return (IR 4J)*
- payments can be sorted out to minimise use-of-money interest issues
- tax pooling payments can be advised earlier so accounts don't go into the Inland Revenue debt/arrears system
- inter-company offsets can be arranged earlier
- from a risk-assessment point of view, we are more likely to examine the return earlier and, if there are questions, to ask them then. This has the benefits that the records are current and the people with the institutional knowledge are available, compared to some time later
- completing the return as part of the year-end company procedures is efficient in terms of the information being current, compared to completing the exercise later and having to refamiliarise yourself with the data.

Tax agents' EOT running out for filing 2005 income tax returns

The remaining extension of time due date for 2005 returns for agents is 31 March 2006.

If it is looking like your return will not be filed on time we suggest you write to the Team Leader Business Services advising of the reason. An application to be placed on the "D" list, must be in writing, it cannot be done over the phone. In order for your application to be processed and noted in our system by 31 March, we advise you send your letter so it reaches us before Friday 24 March 2006.

In brief

Refund by cheque

We often get phone enquiries when a valid bank account is provided for income tax refunds, but a manual cheque is issued instead. If you, or your tax agent, complete the *Company income tax return (IR 4)* and tick box 30F (refund by cheque) this will override all future refund requests for that tax year. So, if you have a reassessment at a later stage for a refund, this will still be paid by cheque rather than to your bank account. To avoid this, please ensure box 30F is not ticked if you have a valid bank account loaded for income tax returns.

Depreciation guides

Companies must claim depreciation for fixed assets used in business that have a useful lifespan of more than 12 months. Inland Revenue has three guides that explain depreciation and the rates to use.

Depreciation – a guide for business (IR 260) contains an overview of depreciation and how it works, however it does not include the depreciation rates.

General depreciation rates (IR 265) sets out the general and provisional depreciation rates, both diminishing value and straight line that apply for assets acquired on or after 1 April 1993.

You can also use our online calculators to find the rate for your asset and calculate the amount to claim.

For depreciation rates for assets acquired on or before 1 April 1993 please see our guide, *Historic depreciation rates for assets acquired before 1 April 1993 (IR 267)*. This guide is only available in electronic format.

You can request copies of the IR 260 and IR 265 by calling INFOexpress on 0800 257 773.

Updating your organisation's structure

To assist us to maintain an up-to-date list of your organisational group structure, please let us know of any changes, such as when you have a new subsidiary, a holding company, joint venture, or when there are cessations such as amalgamations, strike offs etc. Changes can be notified as they happen, or you can advise us annually, for example by 31 March when tax returns are filed.

International Financial Reporting Standards

The United Kingdom, Europe and Australia required certain companies to adopt International Financial Reporting Standards (IFRS) for accounting periods commencing on or after 1 January 2005. Companies in New Zealand with parent companies in the United Kingdom, Europe or Australia have largely adopted the new reporting standards from that date, and the remaining New Zealand companies are required to adopt the standards for accounting periods commencing on or after 1 January 2007. Inland Revenue is monitoring the introduction on both policy and operational fronts.

From the editor

If you have any suggestions for future topics in *Corporates Contact*, please send an email to Corps.Contact@ird.govt.nz

If you would like to register to receive, or stop receiving, *Corporates Contact*, please either subscribe or unsubscribe through the [newsletters and bulletin](#) area of our website.

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.