

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

N U M B E R F O U R T E E N ~ J U N E 2 0 0 2

Corporates segment: What do we do?

The Corporates segment is structured into sectors based on industry type and specialised taxation needs. Each sector is responsible for providing the full range of service information to our customers as well as return management, debt management and audit functions.

The sectors are:

- Banking and Finance
- Insurance and Superannuation
- Crown
- Manufacturing (including non-resident entertainers and sports people)
- Resources (including non-resident contractors)
- Services
- Special Audit

Two additional units have been established in the following areas:

- International Tax
- Computer Tax Audit

We also have a specific team that deals with corporate taxpayer **PAYE Employer Monthly Schedules**. This ensures that these schedules and any resulting issues with them are resolved as quickly as possible.

There is additional information on the individual Sectors on the Inland Revenue website at the following address:
www.ird.govt.nz/aboutir/structure/corps/

FBT for low-interest loans up

The prescribed rate of interest used to calculate fringe benefit tax for low-interest, employment-related loans has increased from 6.7 percent to 7.5 percent. The new rate applies from 1 July 2002.

Superannuation schemes, reporting taxable income

It has been noted from past errors that in some instances the taxable income of superannuation schemes has not been reported correctly. Superannuation schemes are required to report accounting income under Financial Reporting Standard 32 (FRS 32) including the change in the net current value of the schemes assets during the period as either income or an expense.

While this records both realised and unrealised movements, the unrealised component reported under FRS32 is not subject to taxation until the investment is realised. FRS 32 states if assets are sold during the period, revenues or expenses will also include the difference between the carrying amount of the asset at the beginning of the period (or when acquired, if acquired after the beginning of the reporting period) and the proceeds from the sale of the assets.

However for tax purposes, when investments held on revenue account are realised during the period, the realised gain must be calculated by reference to sale proceeds less the historical cost (not the opening carrying amount). If no adjustment is made from the accounting income then prior period gains and losses are not being brought to account for taxation.

Accordingly please ensure that revenue account realised gains or losses correctly reflect the historic cost for tax purposes.

Should you wish to discuss this item or make a voluntary disclosure in respect of past returns, please contact the Investment Desk, Banking and Insurance Sector, Corporates, Inland Revenue, Box 2871 Christchurch or phone (03) 3631 587.

Further clarification of rules for non-resident contractors

The tax-rules for non-resident contractors, in New Zealand for short periods of time, were recently simplified. From 1 April 2002, non-resident contractors who are present in New Zealand for less than 62 days in total in any 12-month period (and are exempt under a double tax agreement) no longer have to apply for a certificate of exemption.

Applying this initiative in practice

We have received a number of queries on how this initiative would work in practice. The article 'Tax simplification – reducing compliance costs for non-resident contractors' in **TIB Vol 14 No 3 (March 2002)** outlined a number of scenarios in which the new rules would or would not apply. The two primary considerations are:

(a) New Zealand presence of less than 62 days in any 12-month period

The "presence" test requires a non-resident contractor to have been present in New Zealand for a total period of less than 62 days in any 12-month period. The test takes into account prior as well as current (or proposed) presence in New Zealand.

For example, if a non-resident contractor who intends to be present in New Zealand for a period of 20 days starting on 1 June 2002, was also present for a period of 15 days in August 2001, the total time expected to be spent in New Zealand in the relevant 12-month period (from 21 June 2001 to 20 June 2002) would be 35 days. The non-resident contractor would, therefore, comply with the presence test under the new rules.

On the other hand, if the non-resident contractor expected to be present in New Zealand for a longer period – for example, from 1 June to 20 July 2002 (50 days) – then his or her total expected presence in New Zealand for the relevant 12-month period (from 21 July 2001 to 20 July 2002) will exceed the prescribed limit.

(b) Whether the non-resident contractor is exempt under a double tax agreement

New Zealand has double tax agreements with 26 countries including Australia, the United Kingdom and the United States, and agreements with several others are pending. A full list of New Zealand's double tax agreements follows at the end of this article. While these agreements generally exempt short-term non-resident contract activities in the respective countries, specific exclusions apply.

For example, if a non-resident contractor is deemed to have a permanent establishment or other fixed base in New Zealand for the purposes of conducting a contract activity, that activity is taxable in New Zealand. A "permanent establishment" is a defined term and means a fixed place of business through which the business of an enterprise is wholly or partly carried out. This can range from a branch or an office to a factory or other work-site.

Some double tax agreements also deem a permanent establishment to exist where activities are carried out in connection with the exploration or exploitation of natural resources, or if substantial equipment is used in respect of a contract being undertaken here. Our double tax agreements with Australia and the United Kingdom, for example, have an exploration/exploitation clause. The treaty with Australia also has a substantial equipment clause. Our double tax agreements with other countries, such as Japan and Canada, also have their own distinctive provisions.

Most double tax agreements also allow New Zealand to tax "royalties" derived by non-resident contractors from New Zealand. Royalties are typically defined for purposes of double taxation agreements as including, for example, payments for the supply of commercial, industrial and scientific equipment and/or certain forms of knowledge. If the non-resident contract activity involves the supply of such equipment or information, that activity is likely to be taxable in New Zealand.

Once again, not all double tax agreements are the same, and some will allow the taxation of services that would not normally be considered as royalties. For example, our double tax agreement with Canada extends to payments made in respect of the supply of scientific, technical, industrial or commercial assistance, including the provision of management services. Other double tax agreements may only tax equipment rentals if they are based on production. While this is not usually referred to in the royalty article, it is contained in the agreement's "protocols".

Obligations on non-resident contractors and their employers

It is the responsibility of non-resident contractors and their employers, when applying this initiative, to take reasonable care ensuring that the New Zealand presence test is met and in determining whether the contract activity being undertaken is exempt under a double tax agreement. If reasonable care has not been taken, resulting in a breach of the legislation and/or default of tax, Inland Revenue may take the appropriate steps to recover any tax payable and may also impose penalties and interest.

As the onus is on the payer – typically the employer – under the non-resident contractors' withholding tax rules to deduct tax where applicable, if there is a default, Inland Revenue will have to consider what penalties (and interest) should be imposed. Each case will be looked at on its merits when deciding whether if a payer has taken reasonable care. Depending on the circumstances, Inland Revenue may have to consider if a taxpayer has displayed gross carelessness, made an unacceptable interpretation of the legislation, taken an abusive tax position, or committed evasion.

Contact Inland Revenue if unsure about your obligations

The application of New Zealand's double tax agreements can be complex. Similarly, establishing the period of presence of a non-resident contractor in New Zealand may prove difficult. Circumstances may also arise which unexpectedly result in the qualification criteria being breached. If unsure of your obligations contact Inland Revenue on (04) 802 6056 (email: nr.contractors@ird.govt.nz) for further information on how this tax simplification change affects you.

Countries with which New Zealand has double tax agreements

Australia	Belgium
Canada	China
Denmark	Fiji
Finland	France
Germany	India
Indonesia	Ireland
Italy	Japan
Korea	Malaysia
Netherlands	Norway
Philippines	Switzerland
Singapore	Sweden
Thailand	Taiwan
United Kingdom	United States of America

Inland Revenue website – online services

Did you know that our website contains "online services" that allows you to send certain information such as GST registrations over the internet. There is also a facility to calculate various tax obligations e.g PAYE deductions.

We have been receiving reports of broken links and other queries from customers not being able to reach these "online services". These services require you to send confidential information so are located on the secure part of our website to prevent unauthorised interception. If you are unable to access these services, your browser and/or firewall settings may need updating. Please visit www.ird.govt.nz/otherservices/online.html for further information.

Increase in deemed rate of return for foreign investment fund interests

The deemed rate of return for foreign investment fund interests has increased from 10.29 percent to 10.46 percent for the 2001-02 income year.

The rate, which is set annually, applies to all types of investments, including interests in superannuation schemes and life insurance policies. It is based on an average of five-year government stock rates to which a margin of 4 percent is added.

Corporates Discrepancies

Analysis has been completed on the major tax discrepancies identified in tax investigations. The two tables below reflect the major type and dollar value of discrepancies. It should be noted that the discrepancies are post Adjudication and Litigation processes. The information is under generic headings, so they can represent different types of discrepancies under each heading. Regardless of this possible deficiency, they represent a good indicator for you to recognise common errors, and to ensure that checks are made to minimise the risks of falling into the same trap as some other taxpayers.

Top 9 Discrepancies by Values

	\$M
• Losses ineligible to carry forward	72
• Capital expenditure claimed	58
• Taxable income treated as capital	56
• NRWT – failure to deduct and account	40
• Group loss offsets	37
• Financial Arrangements (Accruals regime)	26
• Reserves disallowed	16
• GST – Time of Supply	15
• Loss on sale of assets not deductible	14

Top 8 Discrepancies by Cases

	No. of Cases
• GST on FBT	195
• FBT – Motor Vehicles	128
– Free/Subsidised Goods	76
– Superannuation	68
• Capital expenditure claimed	123
• Taxable income treated as capital	104
• Depreciation adjustments	101
• Failure to deduct PAYE/Withholding Tax	67

Foreign Exchange Rates

Inland Revenue has previously published the currency conversion tables every six months in the April and October issues of the *Tax Information Bulletin (TIB)*.

The foreign exchange tables (Table A mid month rates and Table B end of month rates) for the income year ended 31 March 2003 are now updated monthly on the "Online services" page on our website.

Also available on our website is an interactive overseas currency converter. It provides the mid-month (Table A) exchange rates and converts investment income from most other currencies to New Zealand dollars. From now on, we will also update this calculator each month, as the rates become available.

Please note, we will continue to publish the foreign exchange rates in the April and October issues of the TIB.

Operational statement – transfer of credits

In the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill that is currently before the house, there are provisions that will govern the transfer of excess tax to another tax type, period, or to another taxpayer. The provisions set out the effective date of the transfer that a taxpayer may elect. The earliest date that taxpayers can choose differs depending on the relationship between the transferor and transferee.

In general the provisions are proposed to apply to payments of tax made in the 2002-03 year and credits arising from assessments made after the date of enactment. The application date, as well as the substantive provisions remains subject to submissions.

Inland Revenue's current policy will apply to any excess of tax arising from assessments made prior to the date of enactment of the new legislation. If the new legislation sets an effective date prior to enactment, e.g. 2002/03 as proposed, or earlier, then past transfers will need to be revisited.

Current Policy

Inland Revenue's current policy is contained in the operational circular O/C 95/2 (plus qualifying commentary explaining the effect of changes in the legislation – since O/C 95/2 was issued).

Legislation was enacted on 24 October 2001, to allow, in certain circumstances, transfers to a period where there was no outstanding liability for tax ("a nil period").

Inland Revenue has issued further operational instructions with the effect that transfers requested before 21 April 2001 are quarantined.

To clarify further the instructions contained in OC 95/2 the following instructions have been issued to staff:

Transfers between taxpayers

These instructions are to clarify OC 95/2, the information item posted on 21 December 01 (transfers to the 2001-02 income tax year), and the flowchart and instructions prepared by the Institute of Chartered Accountants and distributed to staff on 18 January 2002.

This also expressly overrides and replaces any training that has been carried out recently on transfers.

Inland Revenue policy in respect of taxpayers considered to be in the "same economic entity" includes the following: (as stated in the operational info posted 18 Jan 2002 (transfers to the 2001-2002 income tax year)

- companies in the same group (that is, companies that are at least 66 percent commonly owned);
- a shareholder employee and company;
- partners in the same partnership;
- family members within one degree of relationship (husband/wife, parent/child); and
- a family trust and a beneficiary.

The definition follows the "associated persons" definition set out in the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill.

Where a taxpayer requests a transfer that is a transfer between taxpayers within the "same economic entity" the effective date of the transfer will be the later of:

- the payment date, or
- the day the credit is first available, usually the day after balance date or
- at the effective date requested by the taxpayer

This date is to be used for transfers between all revenues (except PAYE, child support, student loans employers account) e.g transfer between Income tax and GST, Rebates to Income tax. It also is to apply if the destination period is in arrears, a current period, future period or back period. But it does not apply to the transfer of the UOMI portion of the credit; these should be transferred at today's date.

The effective date for transfers to PAYE, child support, student loan employer's account must follow the rules set out in OC 95/2, which in general is process date.

Where a request to transfer a voluntary overpayment of provisional tax is made after the date of assessment for that year, then the earliest date that the credit is available is the day after balance date. Where the request to transfer a voluntary overpayment of provisional tax is made before an assessment has been issued for that year then the earliest date the credit is available is date of the overpayment. Note in particular where the transfer request accompanied the tax return it must be treated as being made before assessment and must be actioned before the return is processed.

For the tax years 1995-96 to 2000-01 a transfer can only be made to a period where there is no outstanding liability for tax (a nil period). If the transfer is between income tax periods and the credit arises from an assessment or reassessment issued after 21 February 2001 (Section MZ 5 (2) ITA94). Under section MZ 6 a transfer requested for excess tax arising from income derived in the 2001-02 income year can be applied to a date in a nil period that occurs after the date the excess tax is paid.

In effect a transfer between taxpayers within the "same economic entity" should be treated in the same way as a transfer within the same taxpayers account.

Transfers between taxpayers that are not within the "same economic entity" must be actioned at "process date".

This interpretation is to apply to any transfers requested on or after 21 April 2001. If any transfers have been rejected revisit the application.

Transfer Issues

If you have a request for a transfer declined, and you believe your request has been actioned incorrectly, then you need to refer the case to your Corporates account manager for review.

Recently updated publications

The following publications have recently been updated and are available from our website at www.ird.govt.nz/library or they can be ordered through INFOexpress.

Foreign dividend withholding payments guide (IR 273)

This booklet (previously an IR 274A) explains in detail:

- foreign dividend withholding payments (FDWP)
- the attributed repatriation (AR) rules, and
- the underlying foreign tax credit (UFTC) rules.

Gift duty (IR 194)

A guide to gift duty and how to pay it.

Fringe benefit tax guide (IR 409)

Explains fringe benefit tax (FBT) obligations of anyone employing staff, or companies that have shareholder-employees.

The main changes to note since the June 2001 version include:

- changes to examples & how to complete the new look returns
- introduction of a new remuneration adjustment worksheet
- options, completion and due dates for the final FBT return where employer has ceased employing staff
- late payment penalties updated to reflect recent changes.

International tax forms

The 2002 year version of the international tax forms included a change in shoulder number. Here is a list of these changes.

New shoulder number	Old shoulder number	Item name
IR 308	IR 3X	Branch equivalent tax account return
IR 408	IR 4X	Branch equivalent tax account return for companies
IR 439	IR 4H-AP	Interest in a foreign investment fund disclosure schedule (Accounting profits method)
IR 440	IR 4H-BE	Interest in a foreign investment fund disclosure schedule (Branch equivalent metho
IR 441	IR 4H-CV	Interest in a foreign investment fund disclosure schedule (Comparative value method)
IR 442	IR 4H-CVS	Multiple interests in foreign investment fund disclosure schedule (Comparative value method)
IR 443	IR 4H-DR	Interest in a foreign investment fund disclosure schedule (Deemed rate of return method)
IR 467	IR 100A	Notice of election to determine control and income interests on a daily measurement basis
IR 469	IR 100C	Notice of election to voluntarily change the method of calculating foreign investment fund income or loss
IR 477	IR 4G	Interest in a foreign company disclosure schedule
IR 478	IR 4GA	Attributed (non-dividend) repatriation worksheet
IR 479	IR 4GS	Interest in a foreign company disclosure schedule (for Schedule 3, Part A countries)