KPMG

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Regular commentary from our experts on topical tax issues

Issue 1

PAYE and investment income reporting & employee share scheme Tax Bill introduced

Snapshot

The new **Tax Bill** contains:

- New rules for determining the timing and amount of employee share scheme benefit income and its deductibility for employers.
- New rules for reporting employee income and PAYE information by employers and investment income by banks, PIEs and other investment income payers. These changes support Inland Revenue's Business Transformation.
- Various other changes, including a discretion for Inland Revenue to issue IRD numbers to non-residents without requiring a NZ bank account if the Commissioner is satisfied with the applicant's identity.

The Bill will need to be enacted by 31 March 2018. This year's election may make that timetable challenging. However, it is likely that it will be met. Any assessment of the operative dates of proposed rules which apply post enactment should take this likely timetable into account.

Hundreds of pages of draft legislation, commentary, accompanying documents and analysis means there is much to work through

The Bill's centrepiece is a new framework for PAYE and investment income reporting to support Business Transformation

The Bill will therefore impact all business

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What are the key changes in the Tax Bill?

Taxation of employee share schemes

Employees

The Tax Bill introduces new timing and quantification rules for benefits paid in relation to "employee share schemes" (a newly defined term). These new rules do not apply to schemes where employees pay market value for the shares, where the shares are at risk and there is no protection against falls in share value.

If the new rules apply, income arises at the earlier of when:

- The shares are transferred to a non-associate or cancelled for consideration; or
- They own the shares in the same way as any other shareholder. That is, the shares are held free of restrictions, such as risk of forfeiture, or when any protection against a fall in the value of the shares ceases. Events that have no real risk of occurring or are of no real commercial significance are ignored.

The taxable income is established on that date. It is equal to the value of the shares less any payment made by the employee.

Employers

Under the new rules:

- Employers will receive a deduction equal in amount and timing to the employee's taxable share benefit.
- Deductibility for costs of running an employee share scheme (other than exempt schemes) and costs associated with bonuses to fund employee share purchases will continue.
- Available subscribed capital will be created equal to the deduction to the employer (including for the company issuing the shares, if not the employer).

Exempt schemes

The existing widely-offered share purchase scheme exemption is being replaced with the following criteria:

- A $5,000 annual cap on the total value of shares and a $2,000 annual cap on the discount employers can provide. The most an employee can spend on the shares will therefore be $3,000 per annum.
- If there is a "minimum spend" requirement for employees to acquire the shares, this must be no more than $1,000.
- At least 90% of full time employees must be eligible to participate in the scheme, with the qualification period to participate no longer than 3 years.
- Loans to employees to acquire the shares must be interest free and payable in instalments. (The current 10% notional interest deduction will be removed.)
- Employees must hold the shares for a minimum three year period.

Application date and transitional rules

The new rules will generally apply to benefits which are paid after 6 months following enactment of the Tax Bill.

Employee income and PAYE reporting

The current reporting of employee income and PAYE information by employers will change from 1 April 2019 (or from 1 April 2018 for early adopters):

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- Employers will need to provide employee income and PAYE information on a payday basis, replacing the current monthly and twice monthly employer monthly schedule requirements.
- The frequency of PAYE payments will remain unchanged, although there will be scope for this timing to be changed in future by Order in Council.
- Employers using payroll software (or payroll intermediaries) will need to provide the information within two working days after payday in a prescribed electronic format. Employee share benefits will be reportable 20 days after receipt.
- Employers with annual PAYE and employer superannuation contribution tax totalling $50,000 or less will be able to file manually within seven working days after payday. A grace period is also proposed for new employers to implement appropriate payroll systems.
- Current IR56 taxpayers will need to provide their employment income information monthly, within seven days of month end.
- For new employees, identity details including date of birth, contact details, IRD number, tax code and KiwiSaver information will need to be provided by employers electronically. This can be sent in advance of the first payday, for validation by Inland Revenue.
- The process for correcting PAYE errors will be set out in new Regulations (which will be subject to consultation prior to being made).
- The subsidy for using payroll intermediaries will cease from 1 April 2018.

Investment income reporting

Under new investment income reporting rules from 1 April 2020 (or 1 April 2019 for early adopters):

- Interest and dividend payers will need to provide investment income information electronically by the 20th of the month following payment to Inland Revenue. Those making payments exempt from withholding tax will need to provide information yearly by 20 April (or monthly at their preference).
- The information will include, name, contact details, IRD number, date of birth (if held), the tax rate applied, amount/type of investment income, tax withheld (and credits attached), and for PIEs whether the fund is a retirement scheme.
- Multi-rate PIEs will need to report investors' Prescribed Investor Rate details six monthly to Inland Revenue.
- Until the new monthly reporting rules apply, existing year-end reporting will need to be completed by 15 May (rather than 31 May).
- A new non-declaration RWT rate of 45% will apply for interest income from 1 April 2018, while new investors in multi-rate PIEs will need to provide their IRD number. The PIE will need to close the account if the IRD number is not notified within six weeks of account opening.
- An electronic database of RWT exempt investors will be maintained by Inland Revenue. Payers of investment income will need to validate recipients' status against this database.
- Annual withholding certificates will only need to be provided to recipients who have not provided their IRD number.

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- There will be the ability to self-correct withholding tax errors in the same year (or in the following tax year if below $2,000 or 5% of the payer's withholding tax liability, whichever is higher).

Other

The Tax Bill also:

- Treats shares received as result of de-mergers of certain ASX-listed Australian companies as not giving rise to a taxable dividend.
- Gives Inland Revenue the discretion to issue IRD numbers to non-residents in cases where there is no NZ bank account if the Commissioner is satisfied with the applicant's identity.
- Clarifies that a trustee's personal or body corporate capacity is separate from their trustee capacity.
- Contains a number of "remedial" amendments, including to the employee allowances, PIE and CFC rules.

Our initial thoughts

Another monster Tax Bill with hundreds of pages of **draft legislation**, **commentary**, **cabinet reports** and **regulatory impact analysis** to work through. It will therefore take time. However, this is not one only for the tax policy purists.

Employee income and investment income reporting impacts

The centre piece is a new employee income and investment income reporting legislative framework to support Inland Revenue's Business Transformation. These changes alone will affect every business. They have been previously consulted on and the draft legislation does not dramatically deviate from the original proposals.

While their respective start dates – 1 April 2019 and 2020 – may seem a long way away, business needs to start working through what the future payroll and withholding systems requirements may involve. Being an election year, there is every possibility that the Tax Bill may not be enacted until late 2017 or even early 2018. The final shape of the rules may be uncertain for a few months yet. However, we expect the key "building blocks" to be unchanged (including if there is a change of Government):

- **For employers** – what are the systems and payroll impacts of moving to payday reporting and disclosing additional employee information, such as date of birth to verify identity with Inland Revenue?
- **For NZ banks and dividend payers** – the investment income reporting proposals will lead to nearer "real time" reporting of investor, income and withholding tax information to Inland Revenue. A higher default rate will also need to be factored into existing RWT systems. How will the new investment income reporting sit alongside your FATCA, Automatic Exchange of Information (AEOI) and Anti-Money Laundering customer due diligence and reporting? Are their opportunities to rationalise your processes?
- **For PIEs** – provision of an IRD number will become a critical interaction, as the new rules will prohibit a PIE taking on new investors without one. This will have implications for both fund providers (i.e. systems being able to flag the absence of an IRD number within six weeks of on-boarding) and investors (how the new requirements are communicated to them). NZ's implementation of AEOI (to the extent a PIE is subject to those rules) may help as it imposes self-certification of tax status on new investors, including taxpayer identification numbers.

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Employee share scheme tax rule impacts

Regular taxmail readers will be aware that this has been an area of concern for some time for Inland Revenue. Its concern is that employee remuneration in the form of share awards is presently being undertaxed.

The proposal is to defer the taxing point until the very latest date at which unhindered economic ownership of the shares vests, thereby effectively taxing any movement in share value up to that date. Existing schemes will need to be reviewed for the impact of these new rules, particularly changes to the taxing point, if any.

On a positive note, employers will generally be able to claim a deduction for costs associated with share awards, but only to the extent of the taxable employee benefit amount.

The effect on employee share purchase schemes, existing members, new members and new awards will all need to be carefully worked through.

Other

The ability for IRD to issue a NZ tax number without evidence of a fully-functioning (verified) NZ bank account is overdue and welcome. The original intent of the bank account requirement was to verify non-residents transacting NZ land. The practical outcome has been to make it difficult for all non-residents to comply with their NZ obligations. Guidelines on when the Commissioner's discretion will be applied will be needed.

Legislatively distinguishing between personal/corporate capacity and a person's capacity as a trustee is a needed clarification. While this addresses the direct impact of the *Concepts 124* and *Staithes* decisions, they do not address the wider issue of those Courts raising arguments not raised by the disputants.

The Tax Bill, under the heading "remedial items", also contains a range of measures some of which are arguably policy changes deserving of greater prominence and consideration.

For further information

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