TaxMail

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Regular commentary from our experts on topical tax issues

Issue 1

Tax governance high on IRD's agenda

Snapshot

Inland Revenue has formally launched its **2015/16 Multinational Enterprises Compliance Focus guide**.

This latest version updates the 2013/14 document. It provides insights into Inland Revenue's monitoring of all New Zealand businesses. This includes the Commissioner's view of:

- Tax governance and control structures.
- Compliance with international tax regimes, including transfer pricing, cross-border financing and controlled foreign company ("CFC") rules.
- Responses to Base Erosion and Profit Shifting ("BEPS") developments, both in New Zealand and internationally.

A checklist of key risk items to consider is attached to this taxmail. If you have answered "No" or "Don't Know" to any of the items, please contact your KPMG advisor for assistance.

The 2015/16 Compliance Focus for Multinationals emphasises the role of good tax governance in mitigating tax risk

All Boards are expected to set the appropriate tax tone from the top

If you do not have a documented tax strategy and tax risk control framework expect IRD to ask why (with greater scrutiny as a result)

Contact us

Tony Joyce
Partner, Tax
T: +64 4 816 4512
E: tjjoyce@kpmg.co.nz

John Cantin
Partner, Tax
T: +64 4 816 4518
E: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

Why should you care?

It's not just for big business

The document is important and relevant to all New Zealand businesses. This includes New Zealand's many private companies, particularly those with complex arrangements or group structures.

Inland Revenue is becoming increasingly sophisticated in its risk profiling. It expects taxpayers to have a similar appreciation of tax risk. The Basic Compliance Package is to include a further 300 foreign owned groups with NZ turnover of $30 million or more.

We expect greater tax transparency, not less. It will apply to more and more New Zealand businesses as Inland Revenue's Business Transformation takes shape.

What are the key risk areas?

Tax Governance

The loudest message is the importance of tax governance. The expectation is that Boards take greater ownership of, and responsibility for, setting the taxation strategy and direction.

This includes having a satisfactory tax control framework ("TCF") and endorsing a set of overarching principles around tax.

The OECD's **Principles of Corporate Governance** and **Guidelines for Multinational Enterprises** articulate the key ingredients of an effective TCF. A TCF is critical for all businesses, not just large ones. The detail and specifics will depend on the particular circumstances of the entity and the industry in which it operates.

Inland Revenue is also strongly encouraging Boards to endorse the OECD's Business & Industry Advisory Committee's ("BIAC's") **Statement of Tax Principles** in setting the right tone from the top.

Our take

The Commissioner has laid down her absolute minimum expectations of Boards, which is to routinely consider the following:

- Is there a documented tax strategy and has it been kept up to date?
- Have effective systems, procedures and resources been put in place to manage tax risks and, if so, is a clear statement made in the annual report to that effect?
- Is annual reporting sufficiently transparent such that all stakeholders have the capacity to analyse and effectively interpret the information on taxes paid?

For the first time that we can recall, the Commissioner is actively encouraging Boards to publicly disclose tax-related information. This includes a reconciliation between cash tax paid and accounting tax expense, and an explanation of major differences.

This is already happening in Australia. Australia's Board of Taxation has published a voluntary tax transparency code for medium and large business. The Australian Taxation Office is required to publish limited tax return data for listed and certain privately owned companies.

These point to the potential consequences of not heeding Inland Revenue's "guidance" on tax governance:

- The introduction of similar tax transparency rules to Australia's. The Australian experience is that businesses need to develop a strong tax narrative. Otherwise, there is the risk of misunderstanding by the media and wider community of tax return data published in isolation. Given overseas and local experience, this potential should not be underestimated.

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Tony Joyce
Partner, Tax
T: +64 4 816 4512
E: tjjoyce@kpmg.co.nz

John Cantin
Partner, Tax
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- A higher perception of tax risk with correspondingly greater and more frequent risk review or audit activity by Inland Revenue. While not expressly stated, that is the clear inference and our experience in other countries, including Australia, where similar tax authority expectations exist.

On governance, we expect the adoption of TCFs and tax principles will become best practice. Tax reporting should already be a regular agenda item in Audit & Risk Committee meetings for larger businesses. For others, including many medium-sized businesses, it is time to step up. Greater tax transparency is no longer a nice to have but a necessity. Brands and reputations are on the line for companies and their Board members.

Those who overlook tax do so at their own peril. Now, more than ever, different stakeholders will be interested in how a business manages its tax position and complies with the tax laws of the countries in which it operates.

Proactively providing greater transparency, and ensuring your relationship with tax authorities is positive, will result in greater "dividends" to your shareholders over the long term.

How we can help

Unsure whether tax governance in your organisation is best practice? KPMG's **Tax Barometer** is designed specifically to allow Boards and Management to understand how tax strategically sits within their organisation and develop appropriate tax governance frameworks. It also measures whether Boards' expectations of Management for managing tax are understood and being met.

Business Transformation

Inland Revenue's Business Transformation project is now well and truly underway. The key business tax and GST/PAYE legislative and administrative reforms will be implemented within a 2017-19 timeframe.

Our take

It is clear that better use of information and technology to assess risk is a high priority for Inland Revenue. This is not surprising. The sizeable investment in Inland Revenue's administration of the tax system requires some payback.

The changes are aimed at business providing to Inland Revenue more information, more often, in a format that can be easily matched and monitored. Better use and analysis of commercial and financial data in real time should result.

This data will also be shared with overseas tax authorities, under information sharing agreements, and likewise overseas data shared with Inland Revenue. It is therefore important that foreign and New Zealand multinationals are mindful of this and are able to respond appropriately.

International Tax

Transfer pricing features prominently as a risk area. This is closely tied to a number of the OECD BEPS initiatives in relation to which New Zealand has been an active contributor.

The profitability of wholesaler/distributor arrangements and supply chain re-structures (i.e. shifting of functions away from NZ) are particular areas of focus. Similarly, interest rates and fees/charges for related-party funding are under scrutiny.

Issues identified with CFCs include whether they are in fact NZ tax resident and common errors when applying the active business and passive income tests.

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Tony Joyce
Partner, Tax
T: +64 4 816 4512
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Our take

Businesses that do not maintain contemporaneous transfer pricing documentation will be exposing themselves to significant tax risk. Tax authorities around the world are competing for their share of the global tax pie. Inland Revenue makes the point that its support of New Zealand businesses' foreign tax positions, in disputes with foreign tax authorities, relies on good quality information.

A Government discussion document next year on New Zealand's response to the OECD BEPS interest limitation recommendations has been signalled. We understand this will consider "deficiencies" with the current thin capitalisation rules. It may also consider the case (or not) for a UK or Australian-styled Diverted Profits Tax.

Action points for Government and Inland Revenue

The document puts the focus on business to take a principled approach to tax planning and compliance, including documenting and justifying the positions taken. The BIAC Statement of Tax Principles asks businesses to take a co-operative approach to managing their tax.

A consequence is that Inland Revenue needs to be equally well focused on helping businesses to comply. It needs to work with business to solve their compliance issues.

The metric of *$X* of tax for every dollar of audit spend is a simple test for Government spending and Inland Revenue time. This encourages audit activity, the "ambulance at the bottom of the cliff" approach, as a solution.

While audit activity is important for those not prepared to comply, it is not the appropriate means to resolve practical and technical problems for those that are compliant (the vast majority of businesses). Equal, if not greater, focus on the "fence at the top of the cliff" is required.

The correlation between Inland Revenue educating and working with business and revenue outcomes is less obvious. This requires innovative thinking. Otherwise, business will be frustrated by Inland Revenue's inability to deliver its side of the implied bargain.

Relatedly, good quality policy and legislation is required. Businesses can only easily apply legislation which is clear and based on sound principles.

Action points for business

There is much in the new Compliance Focus Guide for all businesses to consider. The attached checklist summarises some of the key risk areas. How do you measure up?

If you are unsure where your organisation sits when it comes to tax governance best practice, need help with your tax governance strategy, or would like to discuss any of the other Inland Revenue compliance focus areas, please contact us.

Tony Joyce
Partner, Tax (Governance)
Wellington
Phone: +64 4 816 4512
Email: tjjoyce@kpmg.co.nz

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kpmg.com/nz
twitter.com/KPMGNZ

Your Compliance Focus Checklist

Tax Governance and Strategy	
The approach to tax (tax strategy) and tax risk (TCF) is documented and up to date	Yes / No / Don't Know
Board and Management have a clear understanding of the business's tax profile and this is aligned	Yes / No / Don't Know
Tax compliance is on time, accurate and issues are reported to the Board	Yes / No / Don't Know
The tax positions on unusual and significant transactions are well understood and appropriately managed	Yes / No / Don't Know
Board/Management can effectively explain differences between the Effective Tax Rate and company rate (28%) and between accounting tax expense and cash tax paid	Yes / No / Don't Know
Business Transformation (BT)	
GST/PAYE/withholding systems can cope with increased and more frequent reporting to Inland Revenue under BT	Yes / No / Don't Know
There is a high level of confidence that the data that will be sent to Inland Revenue is accurate	Yes / No / Don't Know
BEPS	
Cross-border charges and transactions are properly documented and explained for New Zealand's tax rules (e.g. transfer pricing / CFCs)	Yes / No / Don't Know
Cross-border related party funding is at arms-length rates	Yes / No / Don't Know
The NZ and global supply chain is well understood and explained	Yes / No / Don't Know
Transactions/structures that may be subject to NZ BEPS responses (e.g. hybrid financial instruments/entities and the NZ thin capitalisation position) are well understood	Yes / No / Don't Know
Business as usual	
The following can be explained to stakeholders: · Tax losses · Differences between financial reporting and tax treatments · High/unusual tax credits or any large tax benefits · Variances between years	Yes / No / Don't Know

This compliance checklist is to help you understand the key tax risk areas of focus for Inland Revenue

It is important that business has well documented tax policies to rebut Inland Revenue enquiry and scrutiny

If you have answered "No" or "Don't Know" to any of the items, please contact your KPMG advisor