KPMG Centre
18 Viaduct Harbour Ave
PO Box 1584
Auckland 1140
New Zealand
T: +64 9 367 5800

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Cross-border workers: issues and options for reform
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
Wellington

By email: policy.webmaster@ird.govt.nz

26 November 2021

Dear Sir or Madam

**Cross-border workers: issues and options for reform**

We welcome consideration of the matters raised in *Cross-border workers: issues and options for reform - An officials' issues paper* (the "issues paper") and are pleased to be able to make a submission. We are generally supportive of the proposals raised in the issues paper, subject to our detailed submissions which are aimed at further improving the workability of the rules. However, we note the following:

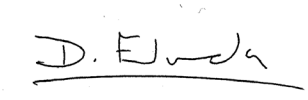
- The proposed territorial approach to employer tax obligations should be reworked such that foreign employers are deemed to have "sufficient presence" in New Zealand, unless they fall below certain thresholds.
- There is inconsistency of approach in relation to Non-Resident Contractors Tax ("NRCT"), which continues to apply extra-territorially, notwithstanding this is collected via the PAYE system.

We note that Inland Revenue's *Draft Operational Statement ED0223* ("ED0223") released earlier in the year has also caused considerable uncertainty around the obligations for foreign employers. Given the likely legislative track for the changes proposed in the issues paper appears to be a 2022 Tax Bill, for enactment in 2023, Inland Revenue's operational position in the interim needs to be made clear.

We have organised our submissions into appendices based on the chapter, topic and proposals suggested in the issues paper.

We are, as always, happy to discuss our response and trust that it is helpful. Please do not hesitate to contact us; Rebecca Armour on 09 367 5926, Darshana Elwela on 09 367 5940 or Nick Cooke on 09 363 3695.

Yours sincerely



**Darshana Elwela**
Partner

**Rebecca Armour**
Partner

## Appendix 1: PAYE issues

**Proposal 1: Enable more flexible PAYE arrangements for employees included on a shadow payroll**

We agree that the PAYE arrangements for employees included on a shadow payroll need to be made more flexible, due to the current reporting provisions being unrealistic and difficult for employers to apply in practice.

*Identification of shadow payrolls on payroll submissions*

We understand that Officials intend to restrict the availability of flexible PAYE arrangements to employees on a shadow payroll. To enable the monitoring of this restriction, employers would be asked to identify shadow payrolls as part of their employment income information reporting ("payday PAYE filings"), thereby triggering identification of shadow payrolls in Inland Revenue's system.

As Officials will be aware, there are flexible PAYE arrangements for employees on a shadow payroll already in place. These rules came into effect 1 April 2019 with the introduction of payday PAYE filing and they allow a 20-day deferral for recognising the payday for filing purposes.

Whilst implemented with good intentions, the current rules fail to recognise the complexity of operating a shadow payroll, specifically the time which it can take employers to obtain the necessary information to undertake accurate PAYE reporting.

Inland Revenue's *myIR* system is currently unable to separately recognise shadow payrolls as part of payday PAYE filing. This means that to rely on the current flexible PAYE arrangements, employers must calculate and input the deferred pay date, often meaning it will fall into a subsequent PAYE period to which it relates, causing a permanent shift in PAYE reporting periods. Otherwise, employers face the automatic application of interest and penalties for late filing.

These failures have been a source of frustration for employers and tax advisors alike. We therefore welcome the extension of the current arrangements to allow more flexibility in shadow payroll reporting. However, we strongly recommend increasing the capability of *myIR* to separately recognise shadow payroll reporting.

*Catch-up and trailing payments*

Allowing employers to make catch-up payments of PAYE, FBT and ESCT without incurring interest and penalties is a step in the right direction.

However, the 28-day time limit to make the catch-up payments is insufficient and practically would make very little difference for any employer who finds themselves in this situation. Instead, we recommend the time limit is extended to at least 56-days, to give employers greater opportunity to obtain the information necessary to complete accurate PAYE reporting and payments. Again, updating *myIR* capability is critical to making this work in practice.

Also, as FBT is collected via a different mechanism, this will need to be considered further. Due to the nature of the FBT return and payment process, we would suggest that it would be more practical to allow employers to simply include details of the fringe benefits and pay catch-up payments of FBT when filing the subsequent return.

Finally, there is a question as to how Inland Revenue will monitor whether employers have *"taken reasonable measures to manage their employment-related tax obligations"*. Practically, we see no way for this requirement to be verified by Inland Revenue. We assume it is intended

that employers would simply need to self-assess that this criterion is met, albeit with the risk of a negative outcome in the event of an audit or risk review, if that is not the case.

*PAYE flexibility: options*

The PAYE flexibility solution needs to be easy to understand and practically administer and flexible enough that it allows employers to complete accurate PAYE reporting.

We agree that the creation of a standalone PAYE arrangement for cross-border employees is likely to exacerbate administration and compliance costs for employers. In-year square ups are therefore supported, although we recommend that the time limit for these be increased to at least 56-days for the same reasons mentioned above.

We understand Officials are also happy for any "final" square-up adjustments to be made via the employee's tax return. Officials should consider:

- How would these adjustments be made in the employee's tax return. That is, whether they should be included in the "employment income" box, "other income" box or a box specifically created for these adjustments?
- Whether including income which has not suffered tax at source could push the individual into the provisional tax regime.
- Whether interest may accrue on any terminal tax payment which seems unfair given the intention of these proposals.

These issues could be addressed through a more practical arrangement, such as allowing employers to perform both in-year and post-year square-ups, without any time limit. That would ensure employers have both the flexibility and time to complete accurate PAYE reporting, which then does not need to be adjusted via the employee's tax return. The employee can then simply file their return using the gross income and PAYE amounts as disclosed in *myIR* (which will be based on the amounts reported to Inland Revenue by the employer). This is our preferred approach, if the objective is to allow the greatest flexibility.

**Proposal 2: Repeal of the PAYE employer bond provision**

We agree with the repeal of the PAYE employer bond provision on the basis that it is rarely used in practice.

**Proposal 3: Introduce a threshold or other measures clarifying when PAYE, FBT and ESCT obligations are deemed to arise**

*Territorial approach to employer obligations*

We note that the issues paper references the "territorial approach" and *ED0223* in which the territoriality principle is explained. In our submission in response to ED0223, we were of the view that a full consultation on the territoriality principle's application is required before ED0233 can be finalised in its current state. This remains our view.

We have attached a copy of our submission to ED0223 for your information. We have not attempted to replicate all our points raised in that submission here. However, in summary, we consider that:

- The Income Tax Act 2007 ("the Act") has extra-territorial application in that it applies to non-residents, whether there is a connection to New Zealand or not (the "universal approach").
- The scheme of the PAYE rules necessarily applies to a non-resident employer as that is necessary for an employee to have an obligation, if an employer does not comply.

- Enforceability is a separate question from whether a tax obligation arises. If the application of the universal approach is not enforceable against the employer, it is enforceable against the employee.

On this basis, as well as on other supporting factors as explained in our submission, ED0223's starting point appears to be incorrect. However, given the ongoing uncertainty created as a result of ED0223, Inland Revenue's operational position needs to be considered as a matter of priority to give certainty to business. Particularly, as the changes in the issues paper which support the ED0223 position are unlikely to be legislated prior to 2023.

Despite our reservations with regards to the analysis in ED0223, we outline our thoughts as to the proposals raised in the issues paper below:

We note that as proposed, a non-resident employer will be deemed to have a "sufficient presence", and therefore New Zealand employer tax obligations, only if the sufficient presence test thresholds are met. This starts from the position that foreign employers will be outside the New Zealand employer tax net, unless the relevant tests are met. In practice, this may be a difficult test for non-resident employers to apply to determine whether they have PAYE and other employer tax obligations.

A better outcome would be for the sufficient presence test to be applied in reverse. That is, a non-resident employer should be deemed to have sufficient presence in New Zealand, and therefore subject to NZ employer tax obligations, unless all the below conditions are satisfied:

- They have less than NZD500,000 of gross employment-related taxes:
- They have less than 5 employees present in NZ (regardless of tax residence):
- They do not have a trading presence, such as carrying on operations and employing a workforce for the purpose of trade:
- They do not otherwise have a fixed or permanent establishment in New Zealand:
- They are not performing contracts in New Zealand with employees who are present for more than 183 days:
- They do not have an address for service in New Zealand

If a non-resident employer is unable to satisfy all the above conditions, the non-resident employer should have an obligation to report and pay PAYE. This removes the ambiguity of the "sufficient threshold" test creating additional tax compliance obligations. Instead, they would be within the New Zealand employer tax net, unless they can show otherwise.

If the non-resident employer can satisfy all the above conditions, the current provisions of the Act which allow for the collection of PAYE from employees (see below) would apply.

**Proposal 4: Clarify employee responsibilities for discharging PAYE, FBT and ESCT obligations**

*IR56 taxpayers*

We agree that it is currently unclear that the law requires employees to file and pay PAYE as IR56 taxpayers when an employer fails to do so. We support the clarification of both the law and guidance in this regard. However as mentioned above, we do not necessarily agree that a non-resident employer has no obligation to do so. Instead, we believe enforcing that obligation extra-territorially may be the real issue.

In any case, we note that as IR56 taxpayers, employees need to conduct their own PAYE reporting, often using their payslips (which may be denominated in foreign currency) to calculate

their New Zealand taxable employment income. As such, it would be useful for Inland Revenue to publish more detailed guidance which employees could use to assist in this process (including guidance on topics such as acceptable exchange rates, etc.).

*Double taxation*

There are also complications for employees. For example, the potential for double taxation. We are aware of some jurisdictions, particularly in Asia, requiring their employers to withhold tax on employment income, even when made to an employee who is New Zealand tax resident and is performing the services here. This is notwithstanding New Zealand's Double Tax Agreements ("DTAs") generally allocating the primary taxing right to the jurisdiction where the services are performed.

This leaves New Zealand based employees in a precarious situation of having to pay tax in both jurisdictions and being unable to claim a foreign tax credit in New Zealand.

Similar issues can be seen where the non-resident employer meets its employer reporting obligations in New Zealand and so accounts for tax in both the foreign jurisdiction and New Zealand. A foreign tax credit would be denied in New Zealand on the basis the income is New Zealand sourced under the relevant DTA. Worse still, the non-resident employer must gross-up the employee's salary in New Zealand to account for the foreign tax paid (i.e., PAYE is due on the foreign tax grossed-up as well as the usual salary). This represents an excessive cost to the non-resident employer and is an unequitable outcome.

While we recognise there is the Mutual Agreement Process ("MAP") process to resolve DTA double taxation issues, in practice this can be time consuming and costly for individual employees (and/or their non-resident employers) to follow. And with the trend towards remote working arrangements, we see this increasingly becoming a tax policy issue that will need to be addressed by New Zealand.

We therefore request that consideration is given to these issues as a policy matter.

*Extension to the collection of FBT and ESCT*

We agree that the legislation applying FBT and ESCT in cross-border employment tax scenarios is unclear. The issues paper proposes that the tax treatment of FBT and ESCT is equalised with that of PAYE income. That is, if a payment is made by a non-resident employer on which New Zealand tax is payable by the employee (regardless of whether there is a withholding obligation by the employer), FBT would apply to any non-cash benefits and ESCT would apply to cash contributions to an employee's superannuation or KiwiSaver scheme.

We agree with the approach in principle, to ensure consistency of tax treatment for employees of NZ and non-resident employers. The practical difficulty with this is the lack of a mechanism for FBT and ESCT collection. There is currently no IR56 equivalent for either FBT or ESCT. Further, consideration will also be needed about how these tax liabilities can be funded by the employee, if there is insufficient cash to pay the tax.

**Proposal 5: Expressly permit the transfer of PAYE, FBT and ESCT obligations to a related New Zealand entity**

We agree that often a local entity will assume the responsibility for discharging employer-related tax obligations of cross-border workers. Although as Inland Revenue notes, failures in communications can cause delays in this reporting process occurring.

Like flexible PAYE arrangements for shadow payrolls, any notification obligation needs to be simple. We recommend *myIR* capability is increased for this accordingly.

The requirement for the local entity to have "joint and several liability" for the tax obligations of the non-resident employer is unnecessary. We note that specific protection arguably already

exists in subpart HD of the Act, as the local entity will be effectively acting in an agency capacity for the non-resident employer (the "principal").

To us, the related NZ entity would be operating in a similar role to a PAYE intermediary. Under those rules, the employer retains sole responsibility for PAYE compliance. We see no reason for deviating from that principle.

## Appendix 2: NRCT issues

As a general comment, and a matter of principle, it is not clear to us why NRCT is not subject to the same territoriality considerations as PAYE and related employer tax obligations. The collection mechanism for NRCT is the PAYE system. That is, if New Zealand's employment tax obligations do not extend extra-territorially, unless there is sufficient presence, the same principle should apply to NRCT.

Notwithstanding this, we make the following observations and recommendations in relation to the NRCT proposals.

### Proposal 1: Change the day-count and monetary NRCT withholding thresholds to a "single payer" requirement

We agree with the stated concerns regarding the practical ability for payers to apply the current "all circumstances" view when determining whether NRCT should be deducted. We support a "single payer" approach to applying the NRCT rules, as this should alleviate the relevant issues.

### Proposal 2: Introduce a non-resident contractor reporting requirement

We understand that the purpose behind the proposal to introduce enhanced non-resident contractor reporting is to manage the perceived integrity risk if the "single payer" approach is adopted. Primarily, this reporting obligation would include sufficient details to allow Inland Revenue to identify the payee, should enforcement be required.

We expect that, in most cases, the details required by Inland Revenue are likely to be collected when on-boarding a contractor, similar to those required for new employees. On that basis, we do not anticipate significant issues for employers in collecting this information. However, care needs to be taken to minimise the compliance cost from any additional NRCT reporting requirements.

*Simplification of threshold tests*

Under the proposed "single payer" approach, we believe the current threshold tests should be workable. However, we would welcome further discussion on how these thresholds could be further simplified.

### Proposal 3: Improve the flexibility of NRCT in some circumstances by expressly permitting: (i) retroactive exemption status; (ii) broad exemption status, and (iii) catch-up payments

As with shadow payroll reporting, we generally agree that the application of NRCT via the payroll system needs to be made more flexible, mainly due to the current difficulties when applying NRCT in practice.

*Separate NRCT tax code*

Currently, payers are required to withhold NRCT at the appropriate rate and show the tax code as "WT". The WT tax code applies to withholding taxes on schedular payments generally, rather than specifically to NRCT.

We agree with the proposal to introduce a specific NRCT tax code, allowing Inland Revenue to identify NRCT and distinguish it from other withholding taxes.

*Catch-up payments of NRCT*

Allowing payers to make catch-up payments of NRCT without incurring interest and penalties is a step in the right direction.

However, again, the 28-day time limit to make catch-up payments is insufficient and would make very little difference for any payer who finds themselves in this situation. Instead, we recommend this is extended to at least 56-days, which should give payers more time to obtain the information necessary to complete accurate NRCT reporting and payments. Again, updating *myIR* will be critical to making this work in practice.

With regards to how Inland Revenue will monitor whether payers demonstrate that they have *"made reasonable enquiries or [taken] reasonable steps to confirm the thresholds"*, this is likely to be difficult to verify in practice. Again, like employer tax obligations, we assume payers will simply need to self-assess that this criterion is met, and will run the risk of a negative outcome in the event of an audit or review if that is not the case.

*Exemption certificates*

Our recent experience of obtaining NRCT exemption certificates is that it can often take months for Inland Revenue to process relatively straightforward applications. We are therefore pleased to see that Inland Revenue is open to reviewing and modernising this process.

Furthermore, retroactive application of exemption certificates is a welcome change as this is a common problem for payers from having to manage withholding obligations in the interim.

We also agree with the proposal for certificates to apply more broadly. Specifically, they should cover all activities by the contractor and should be issued for longer than the current 12-month period.

We recommend that where certificates are being issued based on a good tax compliance history, certificates should be issued for a period of longer than 2-years (we recommend 5 years), expiring on the earlier of:

a) 5 years from date of issue;

b) When the non-resident contractor fails to file an income tax return on time; or

c) The non-resident contractors' circumstances change such that they are required to inform Inland Revenue that they are no longer eligible for an exemption.

*Alternatives to exemption certificates*

We agree that non-resident contractor self-certification of their exemption status will not necessarily simplify compliance, although it would mitigate payers' risk, provided they can reasonably rely on any self-certification.

We agree that a searchable online register of active NRCT exemptions may assist payers in discharging their obligations. It would also mitigate payers' risk while still requiring non-resident contractors to interact with Inland Revenue to confirm their NRCT exempt status.

While we are supportive of this proposal in principle, there are a few practical issues with how such a register would operate.

Firstly, we note the current RWT exemption register does not contain any identity details of exempt persons, only the person's IRD number and the end date for the exemption. It is not clear whether similar "anonymisation" would be acceptable for NRCT purposes. (A key difference is that RWT exempt status is generally limited to non-natural persons, whereas there is no such limitation for non-resident contractors.) To protect the privacy of non-resident contractors that are individuals, we believe the use of other identifiers like that used for Inland Revenue's RWT exemption register will be necessary. This brings into question how a NRCT exemption register could be made to work in practice.

Secondly, Officials do not expect to include non-resident contractors on such a register other than on ground of a good tax compliance history. This means any register would operate

alongside the current NRCT exemption certificate application process for other grounds. We expect the operation of two systems simultaneously may impact Inland Revenue's ability to operate either system efficiently, further decreasing Inland Revenue's responsiveness and exacerbating current issues while leading to potential confusion amongst non-resident contractors and payers.

**Proposal 4: Enable a "nominated taxpayer" to establish a good compliance history basis for NRCT exemption and to discharge tax obligations**

We anticipate the use of a nominated taxpayer to obtain an NRCT exemption certificate may be attractive to some non-resident contractors, although again the requirements for "joint and several liability" seems unnecessary, particularly given the protections in subpart HD of the Act.

**Proposal 5: Repeal the non-resident contractor's bond provision**

We agree with the repeal of the non-resident contractor's bond provision on the basis that it is rarely used in practice.

## Appendix 3: Technical and remedial measures

### Proposal 1: Taxing contributions to foreign superannuation schemes and sickness, accident and death benefit funds under PAYE

We agree that subjecting contributions to foreign superannuation schemes to FBT can result in double taxation. Allowing PAYE to be deducted instead may go some way to alleviating this issue.

Further, applying a different tax policy to one group of taxpayers (cross border-workers) compared to everyone else complicates the taxation regime and leads to further uncertainty.

However, this will mean that the tax burden for these benefits will potentially be shifted from the employer to the employee, if an IR 56 taxpayer, presenting the employee with a tax bill without necessarily the cashflow to fund it.

### Proposal 2: Trailing payments and FBT

We welcome Inland Revenue's clarification that trailing payments should only trigger an FBT liability to the extent the benefits relate to the time spent working in New Zealand.

### Proposal 3: Shadow payrolls recognition of income

We disagree with the proposal to amend the shadow payroll rule so that income would be recognised when paid. The current operation of the rules is necessary to ensure consistency between PAYE filings and the employee's income tax return position. Otherwise, a mismatch would arise.

For example, if the actual payment is made on 25 March 2022, under the newly proposed rule this would be taxable to the individual in the year ended 31 March 2022 and should be included in their 2022 tax return. However, for PAYE filing purposes the income can be reported alongside other salary/wage income in the April 2022 PAYE period, which falls in the year ended 31 March 2023. As the information reported under PAYE filing informs individuals' gross income details in *myIR*, this will not accurately reflect the amount of employment income which must be recognised by the employee in their 2022 tax return.

We therefore recommend that the operation of this rule be left as is, particularly given that Inland Revenue has benefited already from the current rule due to the increase in income tax rates which came into effect from 1 April 2022. If the rule was amended, employees would not be afforded the same benefit on any future decrease in income tax rates, removing any notion of equity in the tax system.

### Proposal 4: Non-resident contractors' threshold tests do not apply to non-resident entertainers

We welcome clarification in the legislation that the day-count and monetary threshold tests do not apply to non-resident entertainers.