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

Tax Counsel Office
Inland Revenue
PO Box 2198
Wellington 6140

Our ref 21872410_1

1 May 2023

Dear Susan and Amanda

PUB 00464 Deductibility of software and a service (SaaS) configuration and customisation costs

Thank you for the opportunity to comment on the draft interpretation guideline PUB00464 (draft guideline) regarding the deductibility of costs a taxpayer incurs in configuring or customising "(C&C") application software as part of a software as a service ("SaaS") arrangement.

We appreciate the Tax Counsel Office devoting resource to undertake the analysis regarding how the current tax law applies to SaaS C&C costs, following the 2021 change in accounting interpretation. We agree with the analysis in the draft guideline, based on the current legislation and (where applicable) NZIAS 38. In particular, we support the conclusion that under the current legislation, SaaS C&C costs should depreciable (either as depreciable intangible property or fixed life intangible property) or deductible (if the requirements of section DB 34 of the Act are met), thereby removing the risk of "black hole" expenditure.

However, we note that the analysis in the draft guideline is complex and taxpayers incurring SaaS C&C costs will need to undertake a detailed analysis of both the tax rules and relevant accounting standards to determine the appropriate tax treatment for each SaaS contract, resulting in potentially significant compliance costs for some taxpayers. We also have some concerns with the resulting tax outcomes, from a tax policy perspective.

Our concerns include, that the current legislative position:

- Requires a complex analysis of NZIAS 38 if a taxpayer is applying section DB 34 of the Act, including determining which paragraphs of the relevant accounting standard apply to the expenditure that has been expensed for financial reporting purposes.
- Gives different tax outcomes depending on whether the C&C activities are undertaken in-house, by the SaaS provider, or by a third-party contractor (as this will determine whether section DB 34 of the Act can apply). While this outcome derives from the application of NZIAS 38, this nevertheless seems anomalous from a tax policy perspective.

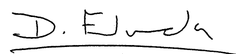
© 2023 KPMG, a New Zealand partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.
Document classification: KPMG Confidential

- Also gives differing tax outcomes depending on whether or not a taxpayer is required to report under IFRS (i.e., generally taxpayers that do not report under IFRS would not apply NZIAS 38 and therefore would not be able to apply section DB 34 of the Act).
- Requires the separate tracking of C&C expenditure and analysis of each contractual arrangement to determine whether section DB 34 of the Act applies or whether there is depreciable intangible property ("DIP") or fixed life intangible property ("FLIP").
- Gives a nonsensical tax outcome, depending on whether there is DIP or FLIP. For instance, if the contractual term is 5 years, the SaaS arrangement will not be FLIP and therefore the software depreciation rate will apply to C&C costs (i.e. 50% DV or 40% SL). If the contractual term is 3 years, the SaaS arrangement will be FLIP and the costs must be depreciated over a 3-year period (so effectively a 33.3% SL rate applies). From a tax policy perspective, it does not make any sense that the tax depreciation period should be shorter for contracts with a longer term.

To reiterate, we are supportive of the interpretation of the current rules in the draft interpretation guideline. However, given the wider concerns above, in our view the treatment of SaaS costs should be referred to Inland Revenue Policy and Regulatory Stewardship ("PaRS") to review the current tax policy settings with a view to simplifying the position and potentially codifying the treatment of SaaS C&C expenditure.

If you have any questions regarding this submission, please do not hesitate to contact us.

Yours sincerely



Rachel Piper
Partner

Darshana Elwela
Partner