Waikato Regional Council Annual Tax Update Year to 30 June 2019

By Phil Fisher & Josie Goddard
August 2019
Report: Tax
Annual Update to the Audit and Risk Committee
Tax Governance & Tax Risk Management

Introduction
Council adopted its Tax Governance Framework in 2017. It was a proactive step towards identifying and managing tax risk in order to maintain Council’s low risk profile.

A Tax Risk Management Strategy was established at the time of the Tax Governance Framework being introduced, and has now been operational for 3 full years. Council has shown its commitment to managing tax risk by achieving its strategy as set.

As part of the Tax Governance Framework, we have prepared this annual tax update as a report to Council’s Audit and Risk Committee (Committee) on progress made during the period up to 30 June 2019.

This memorandum provides:

· A summary of the more substantive tax advice Council has sought from PwC during the period 1 July 2018 to 30 June 2019.
· Commentary on tax matters currently being addressed as at 30 June 2019.
· A more general update on the wider tax environment which may affect Council, albeit kept to a high-level – refer Part Three.

Context
Council is largely exempt (not completely) from income tax. However, Council pays significant amounts of indirect taxes including:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>12 months to 31 March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST Output tax paid</td>
<td>$19,445,587.73</td>
</tr>
<tr>
<td>GST Input tax claimed</td>
<td>$13,479,949.53</td>
</tr>
<tr>
<td>PAYE &amp; Withholding tax</td>
<td>$11,354,818.81</td>
</tr>
<tr>
<td>FBT</td>
<td>$102,217.79</td>
</tr>
</tbody>
</table>
Significant work undertaken in Year to 30 June 2019

In line with Council’s Tax Governance Framework, it is appropriate to report to the audit and risk committee on significant tax issues that arose throughout the year.

Council set a Tax Risk Management Strategy for the year ended 30 June 2019, details of which can be seen in Part Two. Council has been proactive in achieving its planned strategy.

For the most part, the tax compliance of Council has been ‘business as usual’ for much of the year with the various tax returns (income tax, GST, PAYE, FBT, etc.) being filed on time and without any concerns being raised.

Relevant tax work undertaken throughout the year included Council:

- Requested assistance with the preparation and filing of the income tax return for the year ended 30 June 2018, as well as assistance in completing tax disclosure notes for the 2018 financial statements.

- Commissioning PwC to undertake an evaluation of FBT compliance, in line with Council’s operational tax strategy. The report will be delivered in draft by 12 August 2019.
  
  • Similar to prior compliance evaluations the FBT evaluation took place over two days and involved interviewing a range of personal and reviewing source documentation and calculations. The key findings of this report includes but is not limited to; an analysis of potential benefits that Council is planning to incorporate as a result of the shift to the new premises, the current FBT calculation method and the treatment of eye care benefits. Our report also discusses the FBT implications of the motor vehicle exemptions and how Council are utilising these. In summary, whilst there are a number of minor matters that need to be addressed, Council staff were engaged and well educated in FBT compliance.

In addition, to support the ongoing tax risk management, Council:

- Sought assistance on a number of ad hoc queries by utilising the PwC Tax Helpdesk to strengthen their business decisions with confirmation of the potential impact of the relevant tax issues.

- Continued to subscribe and actively use PwC’s online Indirect Tax Policies and Guides.

Council has taken a proactive approach to tax risk management in the past. This is particularly relevant given the increased focus by Inland Revenue on tax governance and the tax control framework. It is important to continue to keep this focus moving into the future. To develop this focus we have included the future tax management strategy in accordance with Council’s current tax governance framework – refer Part Two.
Report:
Tax Strategy
Year to 30 June 2022
## Tax Strategy

Current Proposed Strategy to 30 June 2022

<table>
<thead>
<tr>
<th>Tax services</th>
<th>Achieved strategy</th>
<th>Future strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Financial year ending 30/6/2018</td>
<td>Financial year ending 30/6/2019</td>
</tr>
<tr>
<td>Tax helpdesk facility</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Access to online taxation policies</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Tax compliance reviews undertaken</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• GST</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• PAYE/withholding taxes</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>• FBT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• MyTax Strategy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax return independently reviewed</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Tax disclosure notes independently reviewed</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Tax agency – income tax</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>External advice sought on major tax issues</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Tax training provided to staff</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Report: Tax Developments
Tax Developments
A brief overview of relevant tax developments over the year.

Other relevant points of note that will impact Council include:

• Inland Revenue continues to encourage public sector organisations to be tax compliant. One of the standard questions when Inland Revenue review any organisation is whether there has been an independent assessment of tax compliance, and if so, to request any reports issued. We note that the increasing focus of the BCP programme (used for large Corporates) has been on the employment taxes and GST, with a significantly reduced focus on income tax matters.

• Inland Revenue’s ongoing internal transformation has caused disruption to usual services. Clients are noting refunds automatically being swept from one tax type to meet a tax payment in another account. This is sometimes occurring prior to a due date. This is frustrating and time consuming to rectify often requiring multiple communications with Inland Revenue. We encourage clients to ensure all MyIR account balances are reconciled as a final step in the compliance process. We recommend that this reconciliation occur at least monthly.

• Once the Inland Revenue transformation project is fully operational we can expect to see the results of their ability to see significantly more data about each taxpayer. The final step in the Transformation journey is for individuals to receive pre-populated accounts. While there have been some such accounts issued this year, we expect from 31 March 2020 that all individuals will be issued with these. We are encouraging our clients to ensure they are comfortable that their Payday filing transitions have been successful by applying analytical tools across their payroll data. Ideally employers would identify any risk areas before employees are given their first pre-populated accounts.

• The Tax Working Group issued its final report in February 2019. The Government is currently considering the recommendations made. The most significant recommendation was the proposed introduction of a capital gains tax which has now officially been rejected by the Government.

• Inland Revenue kilometre rate methodology updated in operational statement OS 18/01: “Commissioner’s statement on using a kilometre rate for business running of a motor vehicle”. The statement introduces a two tier system and different rates for petrol/diesel, hybrid and electric vehicles. Further evolution of this two-tier approach are currently being considered. Mileage rates are set by Inland Revenue and published on their website and updated annually. https://www.ird.govt.nz/topics/income-tax/day-to-day-expenses/vehicle-running-costs/kilometre-rates-for-business-use-of-vehicles-2018-2019-income-year

• Donee organisations must now be either on Schedule 23 of the Income Tax Act 2007 as approved donee organisations or listed on the charities register in a move to ensure greater transparency of donations tax credits. This could impact local authorities income tax positions.

• Inland Revenue recently confirmed that local authorities should not account for GST on rates in relation to Council owned residential properties. We suggest revisiting how Council’s are approaching the GST for rates on residential properties it owns to ensure the correct GST treatment is applied. If Council has historically accounted for output tax in relation to rates on residential property, we recommend quantifying the refund and considering claiming the refund in a subsequent GST return (subject to thresholds below), or filing a voluntary disclosure.
Broader Tax Developments
A brief overview of relevant tax developments over the year.

Other broader tax developments include:

• From 1 July 2019 a local authority who is a member of a Tax Consolidated Group will no longer receive all of the benefits of being in a Tax Consolidated Group. Whilst local authorities will remain eligible to be members of Consolidated Tax Groups, from 1 July 2019 dividends derived by a local authority from a CCO that is member of a Consolidated Tax Group will no longer be excluded income for income tax purposes ie such dividends will have to be included in the calculation of taxable income of the Consolidated Tax Group. Effectively this means that dividends paid by a CCO to a local authority will be subject to income tax post 1 July 2019, although imputation credits can be attached to those dividends. Other non-dividend income such as interest, rental income, management fees etc that are paid between the tax CCO and parent local authority will continue to be ‘ignored’ where a consolidated tax group exists. This is potentially a ‘temporary’ change, with a more fulsome review of local authority taxation to be undertaken by Inland Revenue.

• From 1 April 2020 Donee Organisations are required to be listed with Charities Services in order for donors to be able to claim tax credits for donations made to them. QB 19/10 was also released clarifying the requirements of a donee organisation to establish and maintain a fund under s LD 3(2)(c) of the Income Tax Act 2007. The consultation reference for this item was PUB00337.

• Payday Filing went live 1 April 2019 requiring employers to submit PAYE returns within 2 days of a payday.

• Interpretation Statement IS 18/07: “Goods and services tax — zero-rating of services related to land” was released December 2018. The interpretation statement concerns 1 April 2017 amendments to the Goods and Services Tax Act 1985. The amendments relate to the circumstances in which services related to land can be zero-rated under s 11A(1)(e) and (k).

• Interpretation statement IS 18/04: “Goods and services tax – single supply or multiple supplies” updates and replaces IS 17/03: “Goods and services tax – single supply or multiple supplies”.

• IRD Numbers required on all property transactions Supplementary Order Paper (SOP) No 248 to the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill (114-2). The SOP includes a proposal that will require all buyers and sellers of property to provide their IRD number as part of the transaction process. Previously, those buying or selling a main home did not have to provide an IRD number.

• Regulations have been issued providing for how errors in an employer’s employment income information for a payday may be corrected. Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 (LI 2019/62) were notified on 28 March 2019.

• Standard Practice Statement SPS 19/02 — Voluntary disclosures has been released by Inland Revenue with application from 27 March 2019. It replaces SPS 09/02 and follows the 2018 consultation document, ED0201.

• IS 19/01: Income tax — application of schedular payment rules to non-resident directors’ fees The Interpretation Statement considers the situations in which tax must be withheld from directors’ fees paid to non-residents. This includes a discussion of when directors’ fees paid to non-residents are considered to have a New Zealand source. The Interpretation Statement then goes on to consider when and how much tax must be withheld and paid to the Commissioner, if withholding is required from directors’ fees paid to a non-resident.
Broader Tax Developments (cont’d)
A brief overview of relevant tax developments over the year.

- Research and Development tax credit scheme introduced. The 15% tax credit is available from the beginning of the 2019/20 income year for income tax payers.
- GST on low value (under $1,000) imported goods rules will apply from 1 December 2019. GST will apply at 15% on what will be known as “distantly taxable goods” and offshore sellers, marketplaces and re-deliverers who exceed the GST threshold (NZD$60,000) will be required to register for GST.
- The criteria for self-correction of errors in later income tax, FBT or GST returns been replaced with a combination of a monetary threshold and materiality threshold. Taxpayers now have the option of correcting an error in a subsequent return, provided it is not material and the purpose isn’t to delay the payment of tax, when the error results in a difference of tax to pay that is equal to or less that the lower of:
  - $10,000 of tax; and
  - 2% of the taxpayers annual gross income, or GST output tax.

Local Government relevant matters

- PwC undertook some research recently into urbanisation. Whilst focussed around the 6 largest centres in New Zealand, it is an interesting read and provides some food for thought. A further article in the New Zealand Herald discussing the comparison in discretionary income between Auckland and Napier after factoring in housing and transport costs is also worth noting. Links below.
  
  

- Infrastructure Funding - The Government is currently investigating means by which large infrastructure projects can be funded where local authorities have funding constraints. This is an ongoing piece of work and brings into spotlight the limited means by which local authorities can currently generate revenue.

- Local Government Funding Inquiry - The Productivity Commission released their draft (and rather lengthy!) report – the briefer summary can be found at the following link. Submissions can be made on the draft report before the end of August, and a final report is due to be issued by 30 November 2019. The Department of Internal Affairs conducted workshops with over 60 councils to review the operation of the Local Government Financial Management System and were intending to feed the insights from those workshops into their response.
  
  https://www.productivity.govt.nz/inquiry-content/3819?stage=3

- The Wellbeing Budget has been the most recent output following some increased focus of the government in this area. Whilst there are a number of criticisms being imposed, and this is very much the start of a journey, this will be a key focus of this government, and is naturally of relevance to local government given the four key Wellbeing pillars of the Local Government Act

- Tax Policy have invited us to an open discussion on the tax framework for local government. Whilst it may be some time before any conclusions are reached, and legislative changes enacted, this is consistent with their previously signalled review of the income tax legislation as it applied to local government.
Key recommendations with regards to the New Zealand tax system:

- **Capital gains tax**: Extend the existing coverage of taxing capital gains. Eight of the 11 members of the TWG favoured a broad capital gains tax that would apply at full income tax rates, on realisation (sale or other disposal) of an asset and with no allowance for inflation. This has now been ruled out by the Government and will not go ahead.

- **Environment taxes**: In the short term, expand the coverage and rate of the Waste Disposal Levy, strengthen the Emissions Trading Scheme (ETS) and advance the use of congestion charging. Strengthening the ETS would involve all emissions (including from agriculture) facing a price. Tax instruments that address water pollution and the extraction of water from rivers, streams and aquifers, are also discussed.

- **Company tax**: No plans to alter the company tax rate or move away from the imputation system.

- **Personal income tax**: Consideration was given to raising the bottom income tax threshold (currently $0 - $14,000) to $20,000 or $30,000, and potentially combining this with an increase in the second marginal tax rate (currently 17.5%) to 21%.

- **Retirement savings**: Encourage greater participation in KiwiSaver for low-income earners through various measures, including refunding the ESCT for KiwiSaver members earning less than $48,000, increasing the member tax credit from 0.50 to 0.75 per $1 of contribution and reducing the PIE rates for KiwiSaver funds,

- **Digital services tax**: Be ready to implement a digital services tax to if a critical mass of other countries move in that direction and New Zealand’s export industries are not materially impacted.

Other possible areas earmarked for reform are changes to the loss continuity rules for start-ups, bringing back depreciation deductions on buildings if capital gains tax is extended, expanding deductions for ‘black-hole’ expenditure, and concessions for nationally significant infrastructure projects.

The full report can be found at: [https://taxworkinggroup.govt.nz/resources/future-tax-final-report](https://taxworkinggroup.govt.nz/resources/future-tax-final-report)

Thank you