

# Cross-border workers: issues and options for reform

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*An officials' issues paper*

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*Prepared by Policy and Regulatory Stewardship, Inland Revenue*

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Cross-border workers: issues and options for reform – an officials’ issues paper

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# CHAPTER 1

## Background

- 1.1 The overarching objectives of the Government include accelerating New Zealand’s economic recovery and laying the foundations for a better future. As New Zealand is a small economy, to advance these objectives it is likely there will be increased demand from businesses based in New Zealand to obtain workers with specialist skills from abroad. Conversely, many New Zealanders will seek opportunities to live and work overseas. The tax arrangements for internationally mobile workers can be complex and impose compliance costs on businesses and/or the individual worker.
- 1.2 The ongoing COVID-19 pandemic has disrupted work and travel patterns. It has also highlighted the role of technology in enabling cross-border work arrangements. The pandemic has accelerated existing trends affecting how, when and where people work. Technology, such as artificial intelligence, and the greater use of contracts for the supply of personal services will be increasingly important drivers in the future.
- 1.3 Against that background, and in light of concerns raised with officials, it is timely to review the tax obligations that apply to the payers of cross-border workers to ensure they remain fit for purpose.
- 1.4 The purpose of this officials’ issues paper is to outline domestic technical tax and policy issues that arise for businesses bringing workers to New Zealand where those workers are either employees or non-resident contractors (in this paper collectively referred to as “workers”). The focus of this paper is on the payer’s employment-related tax obligations.
  - Employers are obliged to withhold tax under the Pay as You Earn (PAYE) system and pay fringe benefit tax (FBT) and employer’s superannuation contribution tax (ESCT), where applicable.
  - Payers of non-resident contractors are obliged to withhold non-resident contractor’s tax (NRCT) from contract payments.

These tax obligations were introduced in the latter half of the 20th century. Although the obligations serve different purposes, it is useful to review them together in light of the changing world of work.

- 1.5 The system of collecting tax from the payer via withholding is long-established. This system reduces the compliance burden overall by removing from each payee the obligations to pay and report tax and placing those obligations on the payer. The withholding tax system minimises the risk of non-compliance, smooths the payment of tax for both the payee and the government, and supports other aims, such as the accuracy of the transfer system – for example, Working for Families payments.
- 1.6 Arguably, employees working in New Zealand for a non-resident employer (whether as a remote worker, a business traveller or on assignment to a New Zealand employer) and non-resident contractors who are working in New Zealand

are in different circumstances to local employees and contractors. These different circumstances may mean a different policy approach is justified.

- 1.7 From a policy perspective, one consideration is whether an ultimate tax liability exists for the payee in New Zealand. Another consideration is whether withholding taxes enable the risk of non-compliance to be managed. The final consideration is whether better provision, and use, of information can play a role in promoting tax compliance.
- 1.8 This paper outlines potential policy options for addressing issues faced by payers with a view to improving certainty, efficiency and fairness in the tax system. Some potential solutions are proposed for consideration, and suggestions for other potential solutions are invited.
- 1.9 Many of the issues that have been brought to our attention are a mixture of policy and operational matters. Purely operational issues have been excluded from this paper.
- 1.10 For the avoidance of doubt, this paper does not consider the tax treatment of people working in New Zealand under the Recognised Seasonal Employer scheme. Nor does it include situations in which an employee working in New Zealand constitutes a permanent establishment of a non-resident employer. In addition, issues affecting New Zealanders working abroad are not considered.
- 1.11 It is also important to note that the pandemic has challenged the fitness of the current double tax agreement tests for employees and others who work across borders. It is not yet clear when, or even whether, a new international consensus will emerge. Although we understand that other countries also see some merit in looking at these rules, officials do not consider it necessary to wait for any international processes before reviewing New Zealand's domestic settings.

## Glossary of helpful terms

<b>Assignment</b>	An <i>assignment</i> is an arrangement between the legal employer (the <i>home country employer</i> ) and another employer (the <i>host country employer</i> ) that the employee works for the <i>host country employer</i> while remaining an employee of the <i>home country employer</i> . This arrangement is particularly common within corporate groups. Also called a <i>secondment</i> .
<b>Home/host country</b>	The <i>home country</i> is the country the employee was sent from. Typically, they will have been a tax resident in the <i>home country</i> before the <i>assignment</i> , but this is not always the case. The country they are assigned to work in is the <i>host country</i> .
<b>Remote worker</b>	The employee's workplace is not their employer's main workplace; for example, they may normally work from home rather than the employer's office.
<b>Shadow payroll</b>	A payroll that records details of the employee's remuneration for the purposes of the <i>host country</i> revenue authority.
<b>Short-term business traveller</b>	A worker whose activities in the <i>host country</i> will typically be of limited duration – fewer than 183 days in any 12-month period. Also called a <i>short-term business visitor</i> .

- Split-pay/split-paid** A person who receives elements of their remuneration package from the *home country employer* and elements from the *host country employer*.
- Tax equalisation** As tax rates differ between countries, *tax equalisation* is an approach that ensures a worker is neither advantaged nor disadvantaged by accepting an *assignment* to a particular country. The employee and *home country employer* agree net pay on a “neither better nor worse off” or “stay at home” basis. The *home country employer* deducts a hypothetical *home country* tax from the employee’s remuneration, excluding any components that are paid purely because of the *assignment*. The *home country* and *host country employers* are responsible for the payment of tax due to the respective revenue authorities, as per the terms of the *assignment*.
- Trailing payments** A payment received after the end of an *assignment* but relating to the *assignment* period; for example, a bonus.

## Summary of issues, options and proposals

- 1.12 Officials are seeking public feedback on the issues set out in this paper. Table 1 summarises the issues, options and proposals.

**Table 1: Summary of issues, options and proposals**

Chapter and topic	Issue	Option/proposal
2 – PAYE issues	<ol style="list-style-type: none"> <li>1. The current PAYE, FBT and ESCT system is inflexible.</li> <li>2. It is not always clear when PAYE, FBT or ESCT obligations arise.</li> </ol>	<p>Five proposals are discussed:</p> <ol style="list-style-type: none"> <li>1. Enable more flexible PAYE arrangements for employees included on a shadow payroll.</li> <li>2. Repeal of the PAYE employer bond provision.</li> <li>3. Introduce a threshold or other measures clarifying when PAYE, FBT and ESCT obligations are deemed to arise.</li> <li>4. Clarify employee responsibilities for discharging PAYE, FBT and ESCT obligations.</li> <li>5. Expressly permit the transfer of PAYE, FBT and ESCT obligations to a related New Zealand entity.</li> </ol>

Chapter and topic	Issue	Option/proposal
3 – NRCT issues	<ol style="list-style-type: none"> <li>1. The NRCT withholding threshold tests require consideration of facts unconnected to the contract.</li> <li>2. The current NRCT system is inflexible.</li> <li>3. The exemption process requires modernisation.</li> </ol>	<p>Five proposals are discussed:</p> <ol style="list-style-type: none"> <li>1. Change the day-count and monetary NRCT withholding thresholds to a “single payer” requirement.</li> <li>2. Introduce a non-resident contractor reporting requirement.</li> <li>3. Improve the flexibility of NRCT in some circumstances by expressly permitting:               <ol style="list-style-type: none"> <li>(i) retroactive exemption status</li> <li>(ii) broad exemption status, and</li> <li>(iii) catch-up payments.</li> </ol> </li> <li>4. Enable a “nominated taxpayer” to establish a good compliance history basis for NRCT exemption and to discharge tax obligations.</li> <li>5. Repeal the non-resident contractor’s bond provision.</li> </ol>
4 – Technical and remedial issues.	Other technical or remedial changes are required to various rules in the Income Tax Act 2007 and the Tax Administration Act 1994.	<p>Four proposals are discussed:</p> <ol style="list-style-type: none"> <li>1. Tax contributions to foreign superannuation schemes and sickness, accident and death benefit funds under PAYE.</li> <li>2. Amend the FBT rules to clarify that trailing benefits are only taxed where they relate to time spent working in New Zealand.</li> <li>3. Amend the shadow payroll rule so that income is recognised when paid.</li> <li>4. Clarify that the day-count and monetary threshold tests for non-resident contractors do not apply to non-resident entertainers.</li> </ol>

1.13 Subject to submissions on the issues paper and other government priorities, any proposals to be taken forward will be included in a future tax bill.

### **Making a submission**

1.14 Submissions are invited on the options and proposals outlined in this issues paper. Submissions proposing alternative solutions are also welcomed.



- 1.15 Submissions should include a brief summary of the submitter’s major points and recommendations. They should also indicate whether it is acceptable for officials from Inland Revenue to contact submitters to discuss the points raised, if required.
- 1.16 The closing date for submissions is **19 November 2021**.
- 1.17 Submissions can be made:
- by email to [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz) with “Cross-border workers: issues and options for reform” in the subject line, or
  - by post to:  
  
Cross-border workers: issues and options for reform  
C/- Deputy Commissioner, Policy and Regulatory Stewardship  
Inland Revenue Department  
P O Box 2198  
Wellington 6140
- 1.18 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of responses on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Please clearly request to withhold your response if you consider that any part of your submission should properly be withheld under the Act.



## CHAPTER 2

### PAYE, FBT and ESCT

- 2.1 Systems similar to Pay As You Earn (PAYE) are found in many countries. Withholding from employment income ensures efficient tax collection at source, and the provision of timely and accurate information enables better administration of the tax and transfers system as a whole.
- 2.2 PAYE withholding tax was introduced in New Zealand with effect from 1 April 1958. The PAYE system streamlined the collection of taxes from individuals' salaries or wages and ensured that the amount collected is broadly accurate. As a result, individual taxpayers who only earn employment income do not normally need to pay a substantial amount of tax on their gross income after the end of the tax year. Further taxes have since been applied to other components of employee remuneration:
- Fringe Benefit Tax (FBT) applies to specified benefits provided by an employer to an employee, such as private use of a vehicle, contributions to a superannuation scheme or private medical insurance, or a loan.
  - Employer's Superannuation Contribution Tax (ESCT) applies where the employer makes cash contributions to a superannuation fund or KiwiSaver scheme for the benefit of its employee(s).
  - Non-Resident Contractors Tax (NRCT), which is included in the PAYE system, is discussed in chapter 3.
- 2.3 Two other important payments are collected via the PAYE system: Accident Compensation Corporation (ACC) earners' levy and KiwiSaver contributions. Both serve distinct policy purposes and are governed by their respective Acts.<sup>1</sup> These payment obligations do not necessarily follow the general tax treatment of an individual's remuneration. For example, income that is not liable to, or is exempt from, New Zealand tax (for example, where a double tax agreement applies) may still be liable for ACC earners' levy. KiwiSaver similarly provides its own code defining the circumstances in which contributions are due and the person liable to contribute. Queries raised with officials about the treatment of these payments are not within the scope of this paper.
- 2.4 Since the introduction of PAYE, changes in the ability of individuals to travel and businesses' needs for specialised skills have driven growth in the numbers of persons who work outside their home country. Employees who work in New Zealand, whether for a New Zealand or a non-resident employer, are subject to New Zealand income tax unless they qualify for an exemption. The tax due on their income is collected by the PAYE system.
- 2.5 Feedback gathered by Inland Revenue indicates that the application of the PAYE system to employees whose employer is not resident in New Zealand requires

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<sup>1</sup> These are the Accident Compensation Act 2001 and the KiwiSaver Act 2006.

clarification and greater flexibility. Non-resident employees are not always comparable to local employees, which may justify a different policy approach.

- 2.6 New Zealand's PAYE, FBT and ESCT rules are strictly applied. Where an employee does not meet the conditions for an exemption and the employer has not deducted or paid the relevant amounts, the employer is deemed to have breached their employment-related tax obligations from the first day of the employee's presence in New Zealand (sometimes called "day one"). The employer must then take steps to correct the tax payment and the tax reporting requirements that support the PAYE system.

### **Summary**

This chapter:

- reviews the existing day-count tests for exemption
- suggests introducing a more flexible PAYE, FBT and ESCT system for employees on a shadow payroll
- suggests the PAYE employer bond provision be repealed
- considers the introduction of a threshold to clarify when a non-resident employer is subject to the PAYE, FBT and ESCT rules
- proposes that an employee of an employer with no New Zealand presence be liable to account for FBT and ESCT
- proposes clarification of the circumstances in which an employee should account for their own PAYE, FBT and ESCT, and
- considers providing an explicit ability for non-resident employers to transfer their PAYE, FBT and ESCT obligations to a related New Zealand entity.

### **Day-count tests for exemption**

- 2.7 A person who comes to work in New Zealand for a short period of time may be exempt from New Zealand income tax either under domestic law or under a double taxation agreement. Under the Income Tax Act 2007, the exemption is available where the employee spends 92 or fewer days in New Zealand in a 12-month period.<sup>2</sup> Under a double taxation agreement, the threshold is 183 or fewer days in a 12-month period.<sup>3</sup> Both exemptions are subject to specified conditions being met in addition to the day-count test. Concerns have been raised that these tests are not fit for purpose.
- 2.8 Examples provided to us by tax advisors and New Zealand businesses that demonstrate the problem include:

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<sup>2</sup> Section CW 19 of the Income Tax Act 2007.

<sup>3</sup> See Article 15 of the OECD Model Tax Convention. The test varies depending on the relevant double taxation agreement.

- an unforeseen delay to a project, perhaps caused by equipment failure or weather, resulting in the employee spending additional time in New Zealand, and
  - employees spending extra days in New Zealand unbeknown to the employer, for example, a holiday spent in New Zealand.
- 2.9 Officials are also aware that a breach may occur where communication failures mean the necessary tax arrangements were not put in place in time. Where the day count has been breached, the employer is required to correct the tax position from the first day the employee was present in New Zealand. This means the employer incurs additional compliance costs. The employer is also potentially subject to shortfall penalties and use of money interest. Whether a shortfall penalty is imposed will depend on the facts and circumstances of the particular case and whether the employer has taken reasonable care.<sup>4</sup>
- 2.10 Officials are of the view that the day-count tests remain appropriate.
- The domestic exemption aims to relieve very short-term business visitors from disproportionate compliance costs. This aim is balanced against ensuring that New Zealand-sourced income is taxed where business trips are longer or more frequent.
  - Double taxation agreements are bilateral arrangements that grant favourable treatment on a reciprocal basis. There is no compelling reason to expand this 183-day exemption to non-treaty partners.
- 2.11 It should also be noted that the exemptions are not simply day-count tests. In both cases, the exemptions are only granted subject to meeting additional conditions – in particular, that the person is chargeable with tax in their country of residence.
- 2.12 However, officials agree that the correction process can be complex and time-consuming. We understand that the compliance costs incurred can be disproportionate to the amount of tax involved. In light of these concerns, officials are interested in exploring options for greater PAYE flexibility.

### **Flexible PAYE arrangements**

- 2.13 The PAYE system seeks to capture the income tax due while imposing the lowest practicable compliance and administration costs. In New Zealand, the PAYE rules apply to every payment of PAYE income. “PAYE income payment” is a defined term encompassing salary, wages and other specified payments.<sup>5</sup> Officials recognise that it is not always practical to collect PAYE from the income of cross-border employees under normal arrangements and, therefore, enabling greater PAYE flexibility for such employees is desirable. This is despite no change in the underlying policy that PAYE, FBT and ESCT obligations arise from the first day of the employee’s presence in New Zealand.

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<sup>4</sup> Section 141A of the Tax Administration Act 1994.

<sup>5</sup> Section RD 3 of the Income Tax Act 2007.

- 2.14 Officials favour permitting employers who have employees subject to shadow payroll arrangements to operate PAYE, FBT and ESCT on a more flexible basis during the tax year. Flexibility recognises:
- the additional complexity of payment and reporting arrangements where remuneration is delivered abroad
  - the role of tax equalisation and similar arrangements that provide the employee with a guaranteed net income, and
  - the desirability of simplifying the process for “catch-up” and other one-off payments.
- 2.15 Officials intend to restrict the availability of flexible PAYE arrangements to employees on a shadow payroll. Without making a distinction between local and shadow payrolls, the PAYE system could not be appropriately administered. Employers would be asked to identify shadow payrolls on their employment income information form to trigger identification of shadow payrolls in Inland Revenue’s systems. Where cross-border employees are paid from an ordinary New Zealand payroll, the normal rules should apply.
- 2.16 Officials are interested in any practical concerns that could arise, whether PAYE flexibility should be extended to a wider class of cross-border employees and, if so, who and in what circumstances.

#### ***“Catch-up” and trailing payments***

- 2.17 A flexible PAYE arrangement should permit catch-up payments if an employee has breached the day-count threshold in circumstances where the employer reasonably believed an exemption would be available. The introduction of a catch-up facility would not result in income arising in the period before the breach being exempt from New Zealand tax (see example 1). Once the threshold was breached, the exemption could not apply. PAYE, FBT and ESCT would be due and should be calculated from the first day of presence in New Zealand.
- 2.18 Where a breach of the day-count tests was remedied under flexible PAYE arrangements, penalties and interest would not apply provided the breach was remedied in a specified timeframe and the employer had taken reasonable measures to manage their employment-related tax obligations. Reasonable measures would be demonstrated where the employer has robust processes in place to manage their tax obligations. This could include the employer:
- taking tax advice relating to the assignment
  - asking questions about the employee’s New Zealand connections before the assignment – for example, prior presence in New Zealand
  - keeping records of the assignment, including any review, business travel or other arrangements for working in New Zealand
  - monitoring employee time in New Zealand by timesheets or other method, and
  - taking prompt action to discharge tax obligations when the employee’s circumstances change.

- 2.19 Officials propose that the period for correcting the situation should be 28 days from the employer first becoming aware the day-count threshold has been breached. Officials propose that the time when an employer “first becomes aware” the threshold has been breached would be the earlier of the time when the employer knows the threshold has been breached and the time when the employer expects the threshold to be breached.

**Example 1**

Estella, a Brazilian tax resident, comes to NZ on a ten-week assignment (70 days) to work on a construction project. A New Zealand company manages the project and takes responsibility for the employees. At the outset of Estella’s assignment, it is anticipated that the 92-day exemption under New Zealand domestic law will apply. New Zealand does not have a double taxation agreement with Brazil.

Unfortunately, two weeks after Estella’s arrival, the project managers are told that equipment necessary to complete the work Estella is undertaking will be delayed arriving in New Zealand. This delay means that Estella’s time in New Zealand will extend to 14 weeks (98 days). At this point, the New Zealand company expects the threshold to be breached so it puts Estella on the shadow payroll. A catch-up PAYE payment for the first two weeks is made, and PAYE is applied thereafter.

- 2.20 Officials also anticipate that PAYE flexibility should enable the capture of trailing payments on shadow payrolls, such as bonuses.

***PAYE flexibility: options***

- 2.21 Flexible PAYE arrangements would make a beneficial treatment available to employers of cross-border employees. This treatment would need to be balanced against integrity concerns. Officials have therefore considered options that meet those concerns.

***Option 1: PAYE arrangement***

- 2.22 Historically, some tax advisors have favoured the model adopted in the United Kingdom. Under “modified PAYE arrangements”,<sup>6</sup> employers enter into an agreement with HM Revenue & Customs (HMRC) to operate payroll on an estimated basis for eligible employees. The agreement is subject to a number of conditions. These include that:

- the employer must tax equalise the employee’s general earnings (for example, salary, bonus and the cash equivalent of any non-cash benefits in kind)
- tax will be calculated on a grossed-up basis, and
- the employer must undertake an in-year review<sup>7</sup> of the reported compensation to capture any material changes.

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<sup>6</sup> HM Revenue & Customs. (2021). HMRC internal manual - PAYE Manual. *PAYE82002 - PAYE operation: international employments: EP appendix 6: modified PAYE in tax equalisation cases.*  
<https://www.gov.uk/hmrc-internal-manuals/payee-manual/payee82002>

<sup>7</sup> The initial calculation and in-year review must include a “best estimate” of the earnings for each eligible employee: including salary, cash bonus and non-cash benefits. Typically, changes in values (such as pay increases), changes in benefit values, or actual bonus amounts are captured in the in-year review.

Under a modified PAYE arrangement, final adjustments to the compensation items and values, and the associated gross-up, can be made in each employee's self-assessment tax return.

- 2.23 Making PAYE flexibility subject to conditions may promote the integrity of the arrangement and deter potential abuse. In the UK, a breach of the conditions may result in an agreement's termination. Notably, HMRC reserves the right to cancel an agreement where:

“... significant and/or regular underpayments of income tax on employment income have arisen in respect of employees' self-assessment returns and in the opinion of HMRC that tax ought to have been accounted for in the calculation of estimated PAYE ...”

- 2.24 The creation of a stand-alone PAYE arrangement for cross-border employees has merit, but on balance, officials do not prefer the creation of a New Zealand equivalent to modified PAYE arrangements. We note that this approach potentially entails greater costs for set-up, ongoing compliance and administration. We are interested in whether submitters agree with our conclusion, and if not, we invite suggestions as to the conditions that should apply to an equivalent New Zealand scheme.

#### *Option 2: In-year square-ups*

- 2.25 The second option officials have considered is allowing in-year square-ups via the PAYE system. This would allow employers additional time to accurately capture all compensation items for each employee on the shadow payroll. The employer would then report these items and make a “catch-up” tax payment. This is similar to the PAYE flexibility for breaches of the day-count test discussed above, but in addition to day-count breaches, it would apply to all compensation adjustments (for example, salary increases or changes in the remuneration package).

- 2.26 Officials consider each catch-up payment should occur no later than 28 days from the employer first becoming aware of the need to adjust or report the employee's remuneration. Final adjustments would be made via the employee's self-assessment tax return.

#### *Views sought*

- 2.27 Officials seek views on the advantages or disadvantages of the above two options and any conditions that should apply if PAYE flexibility were adopted. In particular, we are interested in the implications for reporting and paying FBT and ESCT.

- 2.28 Some businesses have expressed an interest in year-end/“Month 12” calculations. Officials are concerned that this option could result in integrity risks, including less accurate calculation of tax during the income year. We are interested in understanding whether, if one of the above two options is adopted, there is still interest in a year-end process.



## Bonds given by employers of certain non-resident employees

- 2.29 The PAYE employer bond provision<sup>8</sup> applies if, at the time of PAYE withholding:
- it cannot be determined if the payment will be exempt income for the employee under either domestic law or a double taxation agreement, and
  - the employer or PAYE intermediary applies to the Commissioner of Inland Revenue and provides a bond or other security for the amount that would otherwise be withheld.

If the Commissioner accepts the bond or security, the employer or PAYE intermediary is released from the obligation to withhold.

- 2.30 A review of existing arrangements shows the PAYE bond mechanism is rarely used. With a greater availability of flexible PAYE arrangements, officials anticipate the bond would no longer be required and propose its removal.

### Questions for submitters

- Should PAYE flexibility be available to a wider group of employees than those on shadow payrolls? If so, which other groups of employees should be included?
- Do you see any practical issues or concerns in permitting PAYE flexibility? For example, what would be the impact on split-paid employees?
- Which option to increase PAYE flexibility do you prefer and why?
- Do you support removal of the PAYE employer bond requirement?
- Do you have any other comments?

## The territorial approach to employer obligations

- 2.31 Draft operational statement *ED0223 – Non-resident employers’ obligations to deduct PAYE, FBT and ESCT in cross-border employment situations*<sup>9</sup> (the draft OS) clarifies that a non-resident employer that is subject to New Zealand’s laws is obliged to comply with New Zealand’s PAYE requirements.<sup>10</sup> This is commonly described as a territorial approach. Whether the employer is “subject to New Zealand’s laws” is determined by assessing whether the employer has a “sufficient presence” in New Zealand.
- 2.32 Whether an employer has a sufficient presence in New Zealand will turn on the facts and circumstances of the particular case. The factors to be considered are outlined in the draft OS at paragraphs 7–13. Guidance is also given by way of

<sup>8</sup> Section RD 23 of the Income Tax Act 2007.

<sup>9</sup> Available at <https://www.taxtechnical.ird.govt.nz/en/consultations/draft-items/expired-items/ed0223>

<sup>10</sup> The draft OS is reproduced in the appendix to this issues paper.

examples in the draft OS. The draft OS will be finalised following receipt of submissions on this issues paper.

- 2.33 Consultation undertaken in relation to the draft OS revealed that some submitters viewed the sufficient presence test as vague and uncertain. They seek a threshold test to help identify when an employer’s presence would be deemed sufficient.
- 2.34 Officials accept that a threshold that deems the employer to be liable to discharge employment-related tax obligations could provide additional clarity. However, we do not intend that a threshold should replace analysis of a sufficient presence. Instead, we propose the threshold support the analysis: that is, where the threshold was met, regardless of whether the employer had a sufficient presence, the employer would always have an obligation to apply the PAYE, FBT and ESCT rules.
- 2.35 Where an employer did not have a sufficient presence and did not meet the threshold, they would not have an obligation to apply those rules. However, an employer that established they had no obligation would still be able to choose to assume responsibility for discharging employment-related tax obligations.
- 2.36 Officials are interested in submitters’ views on whether a clear threshold that demonstrates a “sufficient presence” is desirable. If yes, then officials propose the threshold should be the lower of:
- \$500,000 of gross employment-related taxes per current tax year,<sup>11</sup> or
  - five employees present in New Zealand (including full- and part-time employees, whether they are tax resident in New Zealand or not).

We are also interested in whether other measures would provide greater certainty.

- 2.37 Officials note that a threshold could cause employers to drop in and out of the obligation to apply the rules as circumstances changed. We therefore suggest that once an employer was in the PAYE system, they would remain in the system until they:
- made alternative arrangements, such as using a local payroll provider
  - arranged with a related New Zealand entity to discharge the obligation, or
  - no longer needed to make employment-related tax payments.
- 2.38 If a threshold were introduced, a supplementary rule would be included to support the integrity of the threshold and apply it across employees of non-resident associated persons.
- 2.39 Where the threshold was not met and no New Zealand entity was willing to accept the PAYE and other tax obligations (as described below), the obligations would be imposed on the employee, who would need to register as an employer and report and pay taxes to Inland Revenue under an IR56 arrangement (see paragraphs 2.45 to 2.48).

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<sup>11</sup> This aligns with the monthly payment amount stated in section RD 4(2) of the Income Tax Act 2007.

## **FBT and ESCT obligations**

- 2.40 FBT is imposed on an employer who provides certain categories of benefits to its employees. These benefits are excluded income for the employee, meaning that they are not included as assessable income in the employee's annual gross income. FBT is a tax borne and paid by the employer and not the employee.
- 2.41 ESCT is imposed on an employer who makes cash contributions to an employee's superannuation or KiwiSaver scheme. The cash contributions are excluded income for the employee; that is, the contributions are not taxable to the employee.
- 2.42 A consequence of the territorial approach to PAYE is that a non-resident employer who does not meet the sufficient presence test has no liability for either FBT or ESCT. It follows that there is a discrepancy between the treatment of employers who are resident in New Zealand, or have a presence in New Zealand, and those who are neither present nor resident.
- 2.43 We assume that FBT is being paid by non-resident employers, consistent with the view expressed in the 1995 Tax Information Bulletin.<sup>12</sup> However, the draft OS has highlighted that the law concerning the application of FBT and ESCT in cross-border employment scenarios is not as clear as it could be. We are proposing to clarify that treatment.
- 2.44 Officials propose equalising the tax treatment of resident and non-resident employers, and their employees, so that FBT and ESCT is paid regardless of the employer's presence in New Zealand. This would align these taxes with PAYE and mean that the obligation would transfer either to a New Zealand entity or to the employee. The transfer of employment-related tax obligations is discussed below.

## **Remote workers: employee obligations**

- 2.45 Improvements in technology have enabled more employees to take advantage of working in a place distant from the workplace provided by their employer. Depending on the work performed, an employee who works remotely may not undertake activities that give rise to a presence for the employer in New Zealand.
- 2.46 Officials seek to clarify that where an employer does not have a sufficient presence in New Zealand to give rise to New Zealand employment-related tax obligations, the employee working in New Zealand is required to discharge the PAYE obligation. As discussed above, officials intend to extend the tax obligation to include FBT and ESCT. This extension would apply to remote workers who are required to account for and pay PAYE.
- 2.47 Officials note that the law requiring an employee to assume responsibility for the obligations is not clearly expressed, and it makes no direct reference to employees of a non-resident employer. It also does not connect clearly to the mechanism under which PAYE payments are collected directly from employees. This mechanism is

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<sup>12</sup> Inland Revenue. (December 1995). FBT on benefits provided in NZ to employees of non-resident employers. *Tax Information Bulletin*, volume 7 (no 6), (p. 8). <https://www.taxtechnical.ird.govt.nz/tib/volume-07---1995-1996/tib-vol7-no6>

for an employee to register and arrange to pay taxes on their own account as an IR 56 taxpayer.

- 2.48 The term “IR56 taxpayer” is an administrative tool that is described as being “used to identify workers who are required to pay their own taxes (PAYE) on their wage or salary but are not self-employed.”<sup>13</sup> Officials propose clarifying that employment-related tax payments (PAYE, FBT and ESCT, as applicable) must be made under IR 56 arrangements where a non-resident employer does not have a sufficient presence in New Zealand.

As outlined above, in these circumstances the employer would be able to choose to assume these tax obligations.

**Example 2**

Pip is an employee of Magwitch Ltd, a Singapore-based company. Pip is the head of Magwitch Ltd’s research and development division. Pip lives in New Zealand and is a New Zealand tax resident. His role is based in the Singapore office, and Pip is frequently required to visit countries in the Asia-Pacific region. To reduce his time away from his family, Pip works 95 days a year from his New Zealand home.

Magwitch Ltd has a New Zealand subsidiary, Gargery (NZ) Ltd.

***Assume Magwitch Ltd has a sufficient presence in New Zealand***

Assume that Pip’s activities in New Zealand give rise to a sufficient presence in New Zealand for Magwitch Ltd to be subject to employment-related tax obligations under the draft OS. A sufficient presence could arise where, for example, Pip is undertaking activities that further Magwitch Ltd’s business, separate to Gargery (NZ) Ltd’s business activities. This could include entering contracts with suppliers for other group companies or establishing a branch of Magwitch Ltd in New Zealand. In this scenario, Magwitch Ltd would have a liability to pay New Zealand employment-related taxes. Magwitch Ltd would have to register as an employer in New Zealand and pay the employment-related taxes due in respect of Pip’s activities.

***Assume Magwitch Ltd does not have a sufficient presence in New Zealand***

Assume that Pip’s activities do not give rise to a sufficient presence in New Zealand for Magwitch Ltd. This could be the case, for example, where Pip’s New Zealand business days consist of meeting with local managers at Gargery (NZ) Ltd in performance of his role as division head or are days spent working from home on activities for the benefit of Magwitch Ltd’s wider group. In this scenario, Pip would be responsible for the payment of the employment-related taxes as an IR56 taxpayer.

- 2.49 Officials do not think it is appropriate to extend the proposals to increase PAYE flexibility (see paragraphs 2.13 to 2.28) to IR56 arrangements. This is because the administrative flexibility would not be available to other New Zealand taxpayers who make payments under IR56 arrangements. Once the arrangement has been established, both local and cross-border employees assume a similar compliance burden.
- 2.50 Officials considered whether a cross-border employee should pay New Zealand income taxes under self-assessment, rather than via the PAYE system. However, adopting this approach would mean it should be made available to IR56 taxpayers generally. This is a wider proposition than the changes affecting cross-border

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<sup>13</sup> Inland Revenue. (March 2021). *IR56 taxpayer’s handbook - IR356* (p. 5). <https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir300---ir399/ir356/ir356-2021.pdf>

workers discussed in this paper. Self-assessment also does not adequately cater for the discharge of FBT and ESCT obligations. As such, officials do not believe self-assessment is appropriate.

### **Ability to transfer employment-related tax obligations to a New Zealand entity**

- 2.51 Many different arrangements can be made for employees working in cross-border situations. Often employees come to work for New Zealand entities on an assignment, and the local entity is responsible for the discharge of the employment-related tax obligations. In other cases, there may not be a formal arrangement for the employee even though they are, in practice, working for the New Zealand entity. Officials think that, regardless of the formal arrangement, where the employee is working for the New Zealand entity, it is appropriate for the New Zealand entity to discharge the non-resident employer's employment-related tax obligations.
- 2.52 In other circumstances, an employee may be present in New Zealand in circumstances where their work is only for the benefit of their home country employer. This is common in short-term or remote-working scenarios. If that work does not constitute a sufficient presence in New Zealand for that non-resident employer, the employer does not have PAYE, FBT or ESCT obligations.
- 2.53 In practice, the New Zealand entity may agree to assume responsibility for the non-resident employer's tax obligations. This is a practical solution that minimises compliance costs, as there is no need for the non-resident employer to establish and run its own New Zealand payroll. Officials are of the view that where the New Zealand entity is related to the non-resident employer, such as by being a group company, it is appropriate for the related entity to discharge the employment-related tax obligations.
- 2.54 An alternative model could be to provide for an automatic transfer of the obligations to a New Zealand entity. Automatic transfer would ensure that, in any case where a related entity existed in New Zealand, the obligation was enforceable against the New Zealand entity. However, officials are aware of examples where failures in corporate communications have meant a New Zealand entity was not able to make timely tax arrangements. This is particularly the case where the employee is in New Zealand either solely performing the business of the home country employer or on a short-term basis. In these circumstances, an automatic transfer could be unfair.
- 2.55 Officials think the practice of transferring employment-related tax obligations should not be compulsory. However, to aid transparency, we propose that a New Zealand entity that accepts the obligations should notify Inland Revenue that the obligation has been transferred and that the entity is acting as agent for the non-resident employer. Where the obligations have been transferred, the home country employer and the New Zealand entity would have joint and several liability for tax compliance.
- 2.56 Officials are interested in submitters' views on the desirability of optional transfers of the employment-related tax obligations to a New Zealand entity and issues that might arise.

### **Example 3**

All facts are as stated in Example 2.

#### ***Assume Magwitch Ltd has a sufficient presence in New Zealand***

In this scenario, although Magwitch Ltd has a liability to pay New Zealand employment-related taxes, responsibility can be transferred to Gargery (NZ) Ltd to make the tax payments and comply with reporting requirements.

#### ***Assume Magwitch Ltd does not have a sufficient presence in New Zealand***

In this scenario, Magwitch Ltd does not have a liability to pay New Zealand employment-related taxes. If there was no related New Zealand entity, Pip would need to register and make employment-related tax payments under an IR 56 arrangement. However, as a related entity exists, the obligations can be transferred to Gargery (NZ) Ltd.

In both scenarios, if Gargery (NZ) Ltd agrees to accept the obligations, it would have to notify Inland Revenue that it was acting as agent for Magwitch Ltd. Gargery (NZ) Ltd would then include Pip on either the local payroll or a shadow payroll, as appropriate.

### **Questions for submitters**

- Should the PAYE obligation for non-resident employers have a threshold test? If so, is a threshold of the lower of:
  - \$500,000 of gross employment-related taxes per current tax year, or
  - five employees present in New Zealand appropriate?
- Do you consider it appropriate to transfer PAYE, FBT and ESCT obligations to a New Zealand entity?
- What problems or issues do you see, if any, with the transfer of the obligations?
- Do you have any other comments or suggestions?

## CHAPTER 3

### NRCT

- 3.1 The obligation to comply with PAYE requirements falls on the payer of the income. Where the payee is a non-resident contractor, the person who pays the income is required to withhold non-resident contractors' tax (NRCT), a schedular tax, from the contract payment. NRCT (formerly non-resident contractors' withholding tax) is collected via the PAYE system.
- 3.2 Payers of non-resident contractors face similar issues to those faced by employers of cross-border employees (outlined in chapter 2). These include lack of communication between the parties concerning the non-resident contractor's presence and/or activities in New Zealand and unforeseen delays to projects. In addition, specific issues exist for NRCT.
- 3.3 NRCT was introduced in 1982 for "contract projects" (typically large-scale construction projects). From 1990, NRCT was widened to include all contracts for service. The underlying purpose of this regime was to manage "flight risk" – contractors who departed New Zealand having completed their work and collected payment but having not paid the New Zealand tax due.
- 3.4 NRCT, by its nature, is more complex than employment-related PAYE. NRCT encompasses the performance of services by the non-resident contractor and the supply of personal property or services by other persons. Further, NRCT was introduced and expanded in response to specific concerns about the integrity of the New Zealand tax base, whereas employment-related PAYE obligations serve a range of purposes. NRCT is intended to be a robust withholding obligation.
- 3.5 Unless a contract payment is exempt, the payer is required to withhold NRCT, generally at 15%, from each contract payment. While NRCT is included in the PAYE system, it can apply to contracts in which both payer and contractor are non-resident and only the activity takes place in New Zealand. There is no intention to extend the territorial approach to NRCT, as this would exclude the payer from the withholding obligation. Further, NRCT is an interim, not minimum or final, tax — the non-resident contractor has its own tax filing requirement that gives effect to the final tax position.

#### **Summary**

This chapter:

- seeks views on potential modifications to the existing thresholds
- suggests introducing a more flexible NRCT system
- proposes improvement to the exemption certificate system, and
- proposes the non-resident contractor's bond provision be repealed.

## **NRCT withholding thresholds**

- 3.6 Contract payments are “schedular payments”, as defined by law. However, contract payments are carved out of that definition – and therefore exempt from withholding – in two circumstances:
- Where the non-resident contractor is present in New Zealand for 92 days or fewer in a 12-month period and is entitled to full relief under a double taxation agreement.
  - Where total payments to the non-resident contractor are \$15,000 or less in a 12-month period.

### ***“All circumstances” view vs “single payer” view***

- 3.7 When determining if the exemption from withholding is available under either of the above thresholds, the payer must consider (as applicable) all the days of presence of, or all the contract payments made to, the non-resident contractor in a 12-month period. This means the payer must consider matters unrelated to the contract payment in question (for example, work performed for another payer or holidays). In effect, this is an “all circumstances” view.
- 3.8 New Zealand businesses have raised concerns that the “all circumstances” view is difficult to comply with in practice, as they must rely on the non-resident contractor to disclose full information. In addition, the payer bears the costs of non-compliance if the conditions of the exemption are breached.
- 3.9 Given the underlying policy seeks to manage flight risk, it is appropriate for the payer to be required to withhold where they are not certain an exemption is available. However, it is possible to simplify and clarify the withholding obligation.
- 3.10 Officials consider that the “all circumstances” view of the thresholds imposes an excessive compliance burden on the payer. It is more appropriate to apply a “single payer” view to the thresholds. This would mean the payer would only need to consider the thresholds relating to their contract with the non-resident contractor. The “single payer” view should include related payers, such as members of a consolidated group.
- 3.11 To manage the integrity risk, officials favour improved reporting by payers of their non-resident contractors to Inland Revenue. This would mitigate the information imbalance that currently exists between payers, non-resident contractors and Inland Revenue. In our view, the report would include sufficient payee details to identify the payee should enforcement be required. At a minimum, this would be the payee’s name, New Zealand or home country address, and New Zealand IRD number or foreign tax identification number (as applicable). The reports would be required on the 15th of each month, with the first due 15 days after the end of the month in which the first payment was made to a non-resident contractor.
- 3.12 Officials are interested in whether payers would have difficulties in reporting this type of information to Inland Revenue. If so, what issues arise and what could be made easier?



### ***Simplification of threshold tests***

- 3.13 The existing thresholds have not changed since 2003, and officials understand interest in simplifying these tests exists. However, there are challenges to reform of both thresholds.
- The basis on which the day-count exemption is available may vary between double taxation agreements, according to the particular terms of the agreement. This is a potential obstacle to simplification and consistency.
  - At its current level, the monetary threshold represents a low risk of tax loss and operates as a tax integrity measure. Any increase in this threshold would represent additional potential revenue loss in cases of non-compliance.
- 3.14 Officials have considered whether simplifying the threshold tests is desirable. The most straightforward change would be to remove the thresholds, with the result that the payer would not have a withholding obligation only where the non-resident contractor has exempt status. Removal of the thresholds would make NRCT obligations simpler, clearer, and more certain, but would, in effect, reinstate the legislative position that applied before the introduction of the thresholds in 2002 and 2003.
- 3.15 Officials think that, by moving to a “single payer” view and enabling greater flexibility for corrections (see below), reform of these tests is unnecessary. We are interested in whether submitters agree with this view, particularly in light of other possible changes to the NRCT regime.

### **NRCT flexibility**

- 3.16 Unless an exemption (see below) is in place, or the thresholds discussed above remove the obligation to withhold, NRCT withholding is required from each payment for the activity or service. In most cases, the contract for that activity or service precedes the first payment to the non-resident contractor. This allows time to ensure that the payer’s tax obligations will be met.
- 3.17 Although the strict requirements of NRCT are clear, we are aware that in practice unforeseen factors may impact the performance of the contract. For example, we are aware of cases where a non-resident contractor has been called in at short notice to handle an emergency. In other cases, weather, or other factors outside the payer or contractor’s control, cause project times to overrun. In these circumstances, correction is required. Under current law, the correction is made by a voluntary disclosure. We note that the private sector’s experience of the corrections process is that it can be complex and time-consuming. Further, the costs incurred can be disproportionate to the amount of tax involved.
- 3.18 Officials think the flexibility of NRCT can be improved. To achieve this, it would be necessary to distinguish NRCT withholding from other payroll withholding taxes. Officials favour a separate NRCT code to trigger this distinction in Inland Revenue’s systems.
- 3.19 We propose that where the payer can demonstrate they made reasonable enquiries or took reasonable steps to confirm the thresholds referred to in paragraph 3.6 would not be exceeded, it should be possible to make a catch-up payment and account for

the NRCT due for the prior period via ordinary NRCT filing. The demonstration of reasonable measures would be aligned to those explained at paragraph 2.18; that is, the payer should be able to show that they have robust processes for managing the NRCT obligation.

- 3.20 Provided the correction was made within a reasonable time from the date when it became apparent a threshold would be breached, the correction would be able to be made without exposure to penalties and use of money interest. We believe that 28 days from knowledge of the breach constitutes a reasonable period for correction.

#### **Questions for submitters**

- Do you support changing the withholding exemptions from an “all circumstances” requirement to a “single payer” requirement? Do you see any issues with this change?
- Do you support the introduction of a reporting obligation for payers of payments to non-resident contractors? Would you have difficulties in reporting information to Inland Revenue? If so, what issues arise and what could be made easier?
- Is further reform of the NRCT thresholds desirable? If so, what reforms would you suggest and how would any resulting integrity risks be managed?
- Do you support the proposal to enable greater NRCT flexibility by permitting corrections to be made via catch-up payments? What issues could arise from this approach?
- Do you have any other comments?

#### **Exemption certificates**

- 3.21 The threshold tests exclude payments from the definition of a “schedular payment” and, therefore, remove the withholding obligation. Where the thresholds do not provide relief, non-resident contractors are still able to ensure NRCT is not withheld on a payment made to them by obtaining an exemption for the contract payment.<sup>14</sup> The exemption is evidenced by a certificate issued by Inland Revenue. Certificates are available where the non-resident contractor meets one or more of the following conditions:

- the amount of the payment is not assessable income
- the contractor provides a bond or other security for the income tax payable on the amount (see below), or
- the contractor has a “good compliance history” in the previous 24 months that is expected to continue.

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<sup>14</sup> Section RD 24 of the Income Tax Act 2007.

- 3.22 The exemption certificate process is long-standing, and when full information is provided, the application is ordinarily processed in approximately ten days. Nevertheless, comments made by the private sector to Inland Revenue indicate that New Zealand businesses find the process can be slow and cumbersome. They have expressed an interest in a review and, where possible, modernisation of the process.

#### ***Retroactive certificates of exemption***

- 3.23 Officials favour improving the flexibility of the current exemption certificate system by providing for certificates with retroactive effect. Where an exemption certificate was issued after the date of the first contract payment, the certificate would also cover payments made before its issue date. To align with the day-count threshold test, we suggest the retroactive period be set at 92 days.

#### ***Broader certificates of exemption***

- 3.24 Currently, certificates are granted for varying lengths of time. In cases where the ground for exemption is that the amount is not assessable income, it remains appropriate to consider the issue of an exemption certificate on a case-by-case basis. However, officials favour providing that, where the certificate is granted based on a good compliance history, the exemption certificate should have a broad application – that is, it should cover all activities by that contractor and should be issued for a two-year period. This would balance flexibility with regular compliance checks.

#### ***Role of New Zealand entities***

- 3.25 Officials are interested in whether New Zealand resident entities can play a more significant role in the NRCT regime. We are aware that various business models exist in practice. For example, separate project vehicles may be created for each contract undertaken, meaning a non-resident contractor cannot show they have a good compliance history for the particular entity, despite having prior (or concurrent) presences in New Zealand in other guises.
- 3.26 Officials understand that some entities may benefit from a “nominated taxpayer” approach to meeting their tax obligations. The advantage of this approach would be that the nominated taxpayer could establish a good compliance history for the purpose of obtaining exemption certificates for related non-resident contractors. This approach could extend from NRCT matters to income tax, GST, and other tax obligations. The nominated taxpayer would need to inform Inland Revenue that it was acting as agent for the non-resident contractor(s) and would have joint and several liability for the performance of the tax obligations.

#### **Example 4**

Jaggers Inc is a US-headquartered multinational. It has a wholly owned subsidiary in New Zealand (Clarriker Ltd). Jaggers Inc, in conjunction with unrelated companies, wins a contract to undertake work in New Zealand. Jaggers Inc decides that Clarriker Ltd should be its nominated taxpayer. As Clarriker Ltd has a good compliance history, an exemption certificate is granted. Clarriker Ltd would be joint and severally liable for any New Zealand income tax obligations that arise for Jaggers Inc.

- 3.27 We are interested in submitters' views on the practical issues that may arise in connection with this proposal.

#### *Alternatives to exemption certificates*

- 3.28 Several members of the private sector have suggested to Inland Revenue that they favour alternatives to NRCT exemption certificates. Two alternatives to the current certificate process have been considered by officials.

#### *Self-certification*

- 3.29 Some New Zealand businesses have suggested self-certification of the non-resident contractor's tax status could replace the current application process.
- 3.30 Self-certification is used in the USA, and officials understand it requires the payer to:
- obtain documentation establishing the payee's entitlement to a particular rate of US tax, and
  - subject to exceptions, report to the Internal Revenue Service on each contract payment over US\$600.
- 3.31 Officials are not attracted to this option as it does not convincingly simplify administration or compliance, nor does it adequately address flight risk concerns.

#### *Register of exempt non-resident contractors*

- 3.32 Another suggestion raised is to capture details of non-resident contractors who hold exemption certificates in a searchable register. The register would be hosted on Inland Revenue's website and would identify active exemption certificates and their exemption periods.
- 3.33 Officials consider the creation of a register of entities with exempt status is a better option than self-certification, even though it may increase the compliance and administration burden. A register would enable a payer to have greater certainty that a particular non-resident contractor was entitled to be exempt from New Zealand withholding tax. A register would also:
- address the tax integrity concern – the contractor would have to interact with the tax system to establish their entitlement to this treatment, and
  - mitigate the payer's risk – whether withholding was required could be easily checked.
- 3.34 Officials consider the register should be restricted to non-resident contractors who are exempt based on a good compliance history, as this status does not rest on the assessment of any other factors. However, most exemption applications have been on other grounds – chiefly, that a double taxation agreement has relieved the income from New Zealand tax. We do not consider the double tax agreement ground as appropriate for a register. By its nature, an exemption granted on this ground is fact specific and typically for short-term, finite arrangements. There is no guarantee that an exemption granted based on a double taxation agreement would be available to any future payers (who would be the chief beneficiaries of any register).

- 3.35 The double tax agreement ground accounts for 82 percent of exemption certificates issued in the ten-year period ending 30 April 2021. As such, the proposed restriction may reduce the usefulness of a register.
- 3.36 Although records demonstrate that corporates and other commercial entities are key users of the exemption system, it should be noted that, where individual non-resident contractors are concerned, the privacy rules of New Zealand and the home country would have to be considered. Individuals might not wish to be registered due to privacy concerns, and further, the need to take another country's rules into account would increase the cost of including individual persons on the register. The alternative – a system split between a register for entities and the retention of the exemption certificate process for individuals – is not attractive in officials' view.
- 3.37 A further potential issue would be that exempt status might not have been obtained by the non-resident contractor before the first payment. This would be particularly likely for new/first-time non-resident contractors, or where the work was performed on short notice. Where this was the case, withholding would be expected, and any repayment would be via the normal process.
- 3.38 Officials seek views on the desirability of establishing a searchable register and whether it should be restricted to the good compliance history ground or if another approach to the register would make it useful. We are also interested in how a register might interact with practical business constraints. Examples of scenarios in which a register would, or would not, improve the current process are particularly welcome.

### **Bonds given by a non-resident contractor**

- 3.39 As noted above, a non-resident contractor may apply for an exemption certificate on the basis that they have provided a bond or other security for the income tax payable for a contract payment.
- 3.40 Like the bond provision for non-resident employees, officials note that this bond provision is rarely used, and therefore, they intend to repeal it. Officials anticipate that, if adopted, the proposals in this paper are likely to provide better solutions for the problems with NRCT obligations faced in practice.

#### **Questions for submitters**

- Do you support the proposals to improve NRCT flexibility by permitting retroactive and/or broader exemption certificates?
- Do you think a “nominated entity” approach would simplify NRCT and other tax obligations? What advantages and disadvantages do you see in connection with this proposal?
- Do you support the proposal to create a register of NRCT exempt entities? What issues, if any, do you see arising in connection with this proposal?
- Do you support removal of the non-resident contractor's bond?



## CHAPTER 4

### Technical and remedial measures

- 4.1 A variety of other issues that affect cross-border workers have been raised with officials. We have considered these to determine whether they are technical or remedial in nature and to identify their relative priority. We intend to address the issues in this chapter and seek feedback on these proposals.

#### Superannuation contributions: FBT liability

- 4.2 Under current rules, an employer contribution to employee superannuation is taxed in one of two ways:
- ESCT applies where the contribution is made in money to a superannuation fund or under the KiwiSaver Act 2006,<sup>15</sup> or
  - FBT applies where an employer makes a contribution to a superannuation scheme.<sup>16</sup>
- 4.3 The application of FBT extends to employer contributions to foreign superannuation schemes that resemble New Zealand superannuation schemes. However, many of our major trading partners tax superannuation contributions under PAYE-equivalent systems, with the result that unrelievable double taxation may arise.
- 4.4 In addition, comments made to Inland Revenue indicate that, although the New Zealand-Australia double taxation agreement specifically provides for the taxation of fringe benefits, compliance issues still arise. Australian superannuation contributions may be the sole reason an Australian employer files a New Zealand FBT return for Australian employees working in New Zealand who are otherwise relieved from New Zealand tax.
- 4.5 Given these concerns, officials consider that a different policy approach, applying to cross-border workers only, could be justified in this area. We propose that the obligation to pay tax for contributions to foreign superannuation schemes be made subject to PAYE rather than FBT. This change would make it clear that superannuation contributions follow the same tax treatment as salaries, wages, and other items of remuneration. We also propose that contributions to a sickness, accident, or death benefit fund should be subject to PAYE.

#### Trailing payments and FBT

- 4.6 FBT is charged on benefits provided to an employee in any quarter or income year in which the employee receives a PAYE income payment liable to income tax.<sup>17</sup> This rule poses a problem for employees receiving payments, such as bonuses or

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<sup>15</sup> Section RD 65 of the Income Tax Act 2007.

<sup>16</sup> Section CX 13 of the Income Tax Act 2007.

<sup>17</sup> Section CX 26 of the Income Tax Act 2007.

employee share scheme income, after they have left New Zealand and ceased to be a New Zealand tax resident. These trailing payments are taxable PAYE income payments, and the rule can be interpreted as subjecting benefits provided abroad, which do not relate to the period spent working in New Zealand, to FBT.

**Example 5**

Georgiana (a US national) was seconded by her employer, Skiffins Inc, to its New Zealand subsidiary from 1 January 2019 until 30 June 2021. Georgiana left New Zealand to return to the USA on 30 June 2021 and broke New Zealand tax residence on that date. Georgiana receives a company car and private medical insurance from Skiffins Inc as part of her new US remuneration package.

On 28 February 2022, Skiffins Inc paid annual bonuses for the 2021 calendar year to a number of staff, including Georgiana. The portion of the bonus paid for Georgiana's time spent working in New Zealand in 2021 (6/12ths) is subject to New Zealand tax as a PAYE income payment. This means that the US employment-related benefits (that is, the car and medical insurance) are also subject to New Zealand FBT.

- 4.7 Officials propose clarifying that, while the trailing payment itself is subject to PAYE, the receipt of a trailing payment should not trigger a liability to FBT except to the extent the benefits relate to the time spent working in New Zealand.

**Shadow payrolls: recognition of income**

- 4.8 The payday filing rules, introduced with effect from 1 April 2019, include a specific rule to cater for persons whose income is reported for New Zealand tax purposes on shadow payrolls.<sup>18</sup> The rule provides that the employee's PAYE income payment is treated as derived by the person on the 20th day following payment (the pay date). This rule was intended to allow employers additional time to collate details of the employee's income for employment income reporting purposes.
- 4.9 As currently drafted, the rule deems the pay date to be recognised for tax purposes as well as for reporting purposes. This means that the date when the income is recognised for New Zealand tax purposes has moved from the date of payment to the date of reporting.
- 4.10 Officials propose that the shadow payroll rule be amended so that the income would be recognised when paid. This would align the rule with the ordinary rules for taxing PAYE income payments. Employment income information reporting requirements and withholding tax payment dates would not change.

**Non-resident contractors' threshold tests do not apply to non-resident entertainers**

- 4.11 Interpretation Statement IS 10/04 *Non-resident contractor schedular payments* outlines that, while the term "non-resident contractor" is broad enough to include a "non-resident entertainer", these two categories should be considered separately. A referral to officials indicates that non-resident entertainers are sometimes viewed as a subset of non-resident contractors, and that the separation is not clear in the legislation.

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<sup>18</sup> Section CE 1(3B) of the Income Tax Act 2007 and section 23J(3) of the Tax Administration Act 1994.



4.12 Officials propose clarifying the legislation to confirm that the day-count and monetary threshold tests<sup>19</sup> do not apply to non-resident entertainers.

**Questions for submitters**

- Do you support the above proposals?
- Do you have any comments on the suggested changes?

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<sup>19</sup> Section RD 8(1)(b)(v) and (vi) of the Income Tax Act 2007.



## APPENDIX

### **Draft Operational Statement: Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations**

#### **Introduction**

Operational statements set out the Commissioner's view of the law in respect of the matter discussed and deal with the practical issues arising out of the administration of the Inland Revenue Acts.

This Statement clarifies the approach to take with regards to a non-resident employers' obligations to deduct PAYE, FBT and ESCT in certain cross-border employment situations.

All legislative references are to the Income Tax Act 2007 (the Act) unless specified otherwise.

#### **Application**

This statement provides general guidance to assist non-resident employers' in meeting their tax obligations regarding when to deduct PAYE, FBT and ESCT on cross-border situations. The Statement will apply from the date it is issued. However, the Commissioner will not be applying resources to examine positions taken by taxpayers prior to that date.

If you have any concerns about compliance with the tax obligations discussed in this statement, you should discuss the matter with a tax professional or Inland Revenue.

#### **Summary**

1. A non-resident employer has an obligation to withhold PAYE from a PAYE income payment made to an employee if:
  - The employer has made themselves subject to New Zealand tax law by having a sufficient presence in New Zealand, and
  - The services performed by the employee are properly attributable to the employer's presence in New Zealand.
2. A non-resident employer may have a Fringe Benefit Tax (FBT) or Employer Contribution Superannuation Tax (ESCT) liability for a benefit provided to, or a contribution made for an employee if:
  - The employer has made themselves subject to New Zealand tax law by having a sufficient presence in New Zealand, and
  - The services performed by the employee are properly attributable to the employer's presence in New Zealand.
3. There is no PAYE withholding obligation if a PAYE income payment is "non-residents' foreign sourced income" for the employee.

4. There is also no PAYE withholding obligation for a PAYE income payment made to a non-resident employee working in New Zealand if the domestic exemption in section CW 19 applies, or a Double Taxation Agreement (DTA) gives relief from source taxation such as where the employee is in New Zealand 183 days or less in a twelve-month period.

## **Discussion**

5. This Statement provides guidance on whether employers have PAYE, FBT and ESCT obligations in various cross-border employment situations.
6. The different situations involve different combinations of; the residence of the employer, the residence of the employee, and the country in which the employment services are performed.

## **Non-resident employers**

### ***Territorial limitation - Presence***

7. The PAYE rules<sup>20</sup> are intended to apply to New Zealand residents or matters over which New Zealand has jurisdiction. A non-resident may make themselves subject to New Zealand law (including the PAYE rules) by having a sufficient presence in New Zealand (Alcan<sup>21</sup> and Clark<sup>22</sup>). The nature and extent of the required presence may vary depending on the facts in each case.
8. If a non-resident employer has a trading presence in New Zealand, such as carrying on operations and employing a workforce for the purpose of trade, this would normally be sufficient for the employer to have a PAYE withholding obligation for employees they pay PAYE income payments to.
9. A sufficient presence for a non-resident employer would also include having a permanent establishment, a branch, contracts that are entered into in New Zealand and performing contracts in New Zealand with employees based here.
10. An address for service (in New Zealand) is also another indication that the non-resident employer has made themselves subject to New Zealand law.
11. A sufficient presence would not include a situation where an employee chooses (as a matter of personal preference) to undertake their employment activities in New Zealand where those activities had no necessary connection to New Zealand, and where this was the non-resident employers' only connection with New Zealand.
12. It is considered that merely having employees in New Zealand would not, of itself, constitute a presence of the employer sufficient to subject the employer to New Zealand's jurisdiction. Therefore, the degree to which an employee "represents" the employer in activities in New Zealand will be one of the things to take into account to decide whether the presence is sufficient to mean that the employer has submitted themselves to New Zealand's jurisdiction.

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<sup>20</sup> Section RD 2 of the Income Tax Act 2007.

<sup>21</sup> *Alcan New Zealand Ltd v CIR* (1993) 15 NZTC 10,125 (HC).

<sup>22</sup> *Clark (Inspector of Taxes) v Oceanic Contractors Inc* [1983] 1 All ER 133 (HL).

13. It is also considered that having a parent, subsidiary or associate would not be enough in itself to have a presence in New Zealand without something more, such as any of the factors mentioned in paragraphs [8], [9] and [10].

**Example one**

Boston Architects (BA) is an architect firm based in the USA. BA employs George who lives in Wellington. George participates in virtual meetings and completes all of his work in Wellington but as BA does not have any New Zealand clients, all the work is sent back to the US electronically.

Would BA have an obligation to deduct PAYE?

No. There would be no obligation to deduct PAYE as George's employment activities have no necessary connection to New Zealand, and the only connection to New Zealand is that George lives there.

**Example two**

George's work is highly respected and quite specialised, as he only designs schools. When there is a project to build a new school in Wellington, George is engaged (through BA) to provide his expertise and advice.

Would BA have an obligation to deduct PAYE?

No. George's expertise and advice does not require him to be in New Zealand to give it. He is not carrying on operations or employing a workforce (on behalf of BA) in New Zealand to give this advice. Although there is a connection to New Zealand while undertaking his employment activities for this project, this is not enough to impose a PAYE obligation on BA.

**Example three**

George's work on the school went well. When a new school project comes up, George is engaged (through BA) and is put in charge of dealing with the client and running the project. While some work is also done in the US, 3 more staff are hired in Wellington to help George out. It is hoped that this might be the start of more New Zealand work for BA.

Would BA have an obligation to deduct PAYE?

Yes. In this situation there is a sufficient presence in New Zealand for BA to have an obligation to deduct PAYE. George (on behalf of BA) is carrying on operations for the purpose of its business, he is entering into and performing contracts in New Zealand (on behalf of BA), and additional staff have been employed in connection with the project being undertaken in Wellington.

***Services performed***

14. Where a non-resident employer has made themselves subject to New Zealand law by having a sufficient presence in New Zealand, the extent of the non-resident employer's obligations will be limited to matters that are properly attributable to their New Zealand presence.
15. This means that if, for example, a non-resident employer carries on a business in New Zealand and pays wages to an employee who performs services that are properly attributable to the New Zealand business, the employer will have an obligation to withhold PAYE from those wages.
16. Most of the time the PAYE withholding obligations will arise where the employee is based in New Zealand.

17. However, it is possible that a New Zealand resident employee could perform services overseas that are properly attributable to the non-resident employers' New Zealand presence.
18. For example, a New Zealand resident employee may be temporarily based overseas investigating the purchase of new equipment to be used in the employers' New Zealand operations. The services of the employee would be properly attributable to the New Zealand operations and, therefore, the non-resident employer would be required to withhold PAYE from PAYE income payments made to the employee.

#### ***Section CW 19 - Amounts derived during short-term visits***

19. Under section CW 19, income that a non-resident person derives in a tax year from performing personal or professional services in New Zealand during a visit is exempt income if:
  - The visit is for 92 or fewer days (counting the day of arrival and departure as whole days).
  - The person is present in New Zealand for 92 days or fewer in total in each 12-month period that includes the period of the visit.
  - The services are performed for or on behalf of a person (which could include an employer) who is not resident in New Zealand.
  - The income is chargeable with income tax in the country in which the person is resident.
20. Exempt income is excluded from the definition of "salary or wages" and, therefore a "PAYE income payment<sup>23</sup>" is also exempt under this provision. No PAYE withholding obligation will arise for any payments described in section CW 19.

#### ***Relief given by a DTA***

21. No PAYE withholding obligation will arise for PAYE income payments where a DTA provides the employee with relief from New Zealand taxation.
22. A DTA may have the effect of denying New Zealand any taxing rights for an amount of employment income derived by a non-resident employee for employment services performed in New Zealand. This may occur if the non-resident employee is in New Zealand for in total, 183 days or less in a twelve-month period, the remuneration is paid by a non-resident employer, and the remuneration is neither borne by nor deductible in determining the profits attributable to a permanent establishment which the employer has in New Zealand.
23. Please note, the example above assumes the wording of the DTA as described, although this wording may vary slightly within different DTA's with regards to the taxing rights for employment income.

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<sup>23</sup> "PAYE income payment" is principally defined by reference to "salary or wages" which excludes an amount of exempt income (s RD 5(1)(c)(i)).

### **New Zealand resident employers**

24. An issue with regards to payments by a New Zealand resident employer is whether there is an obligation to withhold PAYE where the PAYE income payment is paid to a non-resident employee for work performed overseas.
25. It is considered that a New Zealand resident employer does not have any obligation to withhold PAYE from a PAYE income payment that is “non-residents’ foreign-sourced income”<sup>24</sup> for the employee. This is because:
  - The Core Provisions indicate that the purpose of the Act is to tax assessable income. Income tax is generally not intended to apply to non-residents’ foreign-sourced income; certainly not in the case of employment income.
  - It would be inconsistent with the purpose of the Act to impose a PAYE withholding obligation on the employer in relation to such income.

### **Employer superannuation contribution tax (ESCT)**

26. A non-resident employer who has made themselves subject to New Zealand’s law by having a sufficient presence in New Zealand, and who pays PAYE income payments, may have a liability for ESCT. Like the situation for PAYE on a PAYE income payment, the employer’s superannuation contribution would have to relate to employment services that are properly attributable to the employer’s presence in New Zealand.
27. This means that, for a non-resident employer, an ESCT liability will normally only arise when the employee is performing services in New Zealand. However, a non-resident employer could have an ESCT liability for a contribution made for the benefit of an employee working overseas, if the services provided by the employee overseas are properly attributable to the employer’s New Zealand presence.
28. A non-resident employer who has **not** made themselves subject to New Zealand’s jurisdiction has no liability for ESCT. This is so whether or not the employee is a New Zealand resident and whether or not the employment services are performed in New Zealand or overseas.

### **Fringe benefit tax (FBT)**

28. A non-resident employer who has made themselves subject to New Zealand’s jurisdiction by having a sufficient presence in New Zealand, and who pays PAYE income payments, will have a liability for FBT (subject to the discussion below). Like the situation for PAYE on a PAYE income payment, for an FBT liability to arise the provision of a fringe benefit to an employee would have to be a benefit provided to an employee in connection with the employer’s presence in New Zealand.
29. This means that, for a non-resident employer, an FBT liability will normally only arise where the employee is performing services in New Zealand. However, a non-resident employer could have an FBT liability for a benefit provided to an employee working overseas, if the services provided by the employee overseas are properly attributable to the employer’s New Zealand operations.

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<sup>24</sup> “PAYE income payment” is principally defined by reference to “salary or wages” which excludes an amount of exempt income (section RD 5(1)(c)(i)).

30. An FBT liability will also depend on other factors, including whether the employee has received a PAYE income payment in the period. Additionally, section CX 26 provides that a benefit is not a fringe benefit to the extent to which it is received in a quarter or an income year in which they derive one or more PAYE income payments, all of which are not liable for income tax.
31. A non-resident employer who has not made themselves subject to New Zealand's jurisdiction has no liability for FBT.