

Regulatory Impact Statement: Cross-border workers tax reform

Coversheet

Purpose of Document	
Decision sought:	Final Cabinet decision
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue
Date finalised:	25 May 2022
Problem Definition	
<p>New Zealand's employment-related tax rules are strict, with the result that they do not recognise the different compliance circumstances which arise in the context of cross-border working arrangements. There is an opportunity to modernise these rules which will minimise compliance costs and provide greater certainty for employers and payers of non-resident contractors.</p>	
Executive Summary	
<p>Cross-border work arrangements have been an issue of importance to employers and businesses for many years. New Zealand has a need to import specialist skills from abroad. In addition, traditional labour practices are changing, and improved technology has enabled remote working.</p> <p>The employment-related tax rules (Pay As You Earn (PAYE), Fringe Benefit Tax (FBT), Employers' Superannuation Contributions Tax (ESCT) and Non-resident Contractor's Tax) are precise. These rules do not adequately recognise the different compliance circumstances of employers and payers of cross-border workers. As a result, the employer or payer may be non-compliant despite their best endeavours to comply. They seek greater flexibility and certainty from the tax system. In addition, it is not always clear when a non-resident employer has a PAYE, FBT or ESCT obligation. Where the employer does not have a PAYE obligation, the current rules pass the obligation to the employee. No corresponding rules exist for FBT and ESCT. This needs to be addressed to support the integrity of the employment-related tax rules.</p> <p>Over time, private sector businesses have raised concerns with the rules with Inland Revenue. As a result, a review of the tax rules applying to cross-border workers was included on the Tax Policy Work Programme. An officials' issues paper Cross-border workers: issues and options for reform was published in October 2021.</p> <p>Public consultation indicates that the structural settings are sound. As such, the proposals do not change the rate of tax payable or the circumstances in which tax is payable. However, there is an opportunity to ensure that the rules better fit the specific circumstances which apply to the employers of cross-border employees and the payers of non-resident contractors. A package of improvements is proposed which:</p> <ul style="list-style-type: none"> • Improve the flexibility of, and/or clarify, the PAYE, FBT and ESCT and NRCT rules, and 	

- Support the integrity of the PAYE, FBT and ESCT rules.
- Make a number of remedial amendments.

These changes are broadly intended to modernise the rules to better reflect the issues that arise in connection with cross-border work and to reduce compliance costs.

The proposals will affect employers of cross-border employees, payers of non-resident contractors and the individual workers. Recognised seasonal employees are outside the scope of these reforms.

Final design of the proposals has taken stakeholder views into consideration where possible. Three proposals received feedback consistent across a number of submitters:

- The private sector sought a longer time period to correct the tax position for the employer or payer and the affected individual(s). We have increased the period from 28 days to 60 days.
- The proposal for a PAYE, FBT and ESCT threshold to support the 'sufficient presence' test for these obligations was not seen as helpful. Some submitters favoured a safe harbour and we have adopted this approach.
- The proposal to introduce an NRCT reporting requirement was viewed by the private sector as imposing a compliance cost and potentially onerous. Nevertheless, officials see this proposal as part of the overall package of NRCT reforms which will simplify the rules for payers and assist Inland Revenue to police the rules. As such, we intend to proceed with this proposal.

It is expected that some administrative systems changes are required. The changes proposed will be supported by the publication of updated guidance.

Limitations and Constraints on Analysis

Currently, the system does not distinguish between New Zealand based employees and cross-border workers – whether employees or non-resident contractors. As a result, direct sources of data are limited. However, discussions with Inland Revenue operations and private sectors businesses have been used to scope the problem and develop solutions and to provide qualitative assessments of the costs and benefits.

Responsible Manager(s) (completed by relevant manager)

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s9(2)(a)

15 June 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The reviewer considers that the information and analysis summarised in the regulatory impact statement meets the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. New Zealand introduced tax obligations relating to the employment in the latter half of the 20th century. The Income Tax Act 2007 and the Tax Administration Act 1994 impose obligations on persons who make payments subject to Pay As You Earn (PAYE) withholding tax, Fringe Benefit Tax (FBT), Employer's Superannuation Contribution Tax (ESCT) or non-resident contractors' tax (NRCT).
2. The introduction of the PAYE system streamlined the collection of taxes from individuals' salaries or wages and ensured that the amount collected is broadly accurate. The obligation to comply with PAYE requirements falls on the payer of the income. 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).
3. The latter two taxes ensure that all elements of employee remuneration are taxed on an equivalent basis.
4. 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. The withholding obligation does not arise if the contract payment is below the NRCT threshold or subject to a certificate of exemption. 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.
5. NRCT serves a different policy purpose to PAYE, FBT and ESCT. NRCT was introduced and expanded 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. It addresses 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, not minimum or final tax. The non-resident contractor has its own tax filing requirement that gives effect to the final tax position.
6. 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. The tax arrangements for internationally mobile workers can be complex and impose compliance costs on businesses and/or the individual worker.

7. The COVID-19 pandemic has highlighted the role of technology in enabling cross-border and remote work arrangements. The pandemic has accelerated existing trends towards more flexible and more remote work. For example, New Zealanders returning to New Zealand while working remotely for an overseas firm with no connection to New Zealand.
8. Given the changes in where and how people work, and the concerns raised with Inland Revenue about the rules, a review of the rules was added to the Tax Policy Work Programme.
9. If left unaddressed, it is expected that the issues faced by employers, payers and workers will continue, though they may worsen. The current rules are hard to comply with, even where the employer, payer or individual worker is trying to get it right. If flows of workers into New Zealand increase, the cost of compliance will increase. Further, leaving the problems unaddressed may make New Zealand a less desirable place for cross-border workers. In the long run, this may disadvantage New Zealand and hinder the government's economic objectives.
10. No interactions with other work programmes or regulatory systems have been identified.

What is the policy problem or opportunity?

Problem

11. New Zealand's employment-related tax rules are strict, meaning that they are narrow and inflexible when applied to cross-border working arrangements. There is an opportunity to modernise these rules which will minimise compliance costs and provide greater certainty for employers and payers of non-resident contractors.
12. The problems can be broken into three broad categories of issues:
 - PAYE, FBT and ESCT are inflexible withholding obligations and do not adequately cater for the complexities of cross-border employment arrangements. For example, where the employer or payer expected an employee to benefit from an exemption from New Zealand tax, for example under the terms of a double taxation agreement, a project delay may result in the need to pay New Zealand tax. Similarly, it is not always possible to gather and process compensation data from global sources in time to meet New Zealand's reporting and payment dates.
 - PAYE, FBT and ESCT obligations have been differently interpreted by employers, tax advisors and Inland Revenue. A recent operational statement [*Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations*](#) (OS 21/04) (the Operational Statement) has clarified that the obligations arise for an employer with a sufficient presence in New Zealand. Under the current rules, if there is no presence in New Zealand, an employee should pay PAYE directly to Inland Revenue. However, no equivalent rule exists for FBT and ESCT.
 - NRCT withholding obligations are inflexible and require modernisation. In addition to the issues which arise for employers, specific issues exist for payers of non-resident contractors. These relate to exemption from the NRCT withholding obligation. Breaches of the thresholds and/or delays in the exemption process may result in a cost borne by New Zealand businesses.
13. Strictly, breaches of the rules require a voluntary disclosure to report the underpaid tax to Inland Revenue and correct the tax position for each affected employer, payer and/or individual. Voluntary disclosures are time-consuming and costly to prepare and from an administrative perspective are time-consuming to process and resolve.

Affected population

14. The key groups affected by the proposal are the employers of cross-border employees and payers of non-resident contractors. These are most likely to be medium and large enterprises. There may also be impacts for individual cross-border workers.
15. While the population affected by the cross-border worker rules is not currently quantifiable, we assume it is small as a proportion of total employees working in New Zealand. Based on stakeholder conversations, businesses and entities which make use of highly-skilled cross-border workers are typically medium or large enterprises. The data available indicates that the numbers of workers potentially affected by the proposal are in the low tens of thousands.
16. Employers and employees in the Recognised Seasonal Employer scheme are out of scope of these reforms.
17. No specific population groups will be disproportionately affected by the changes proposed.

Consultation

18. An officials' issues paper [*Cross-border workers: issues and options for reform*](#) was published in October 2021. Following written submissions, stakeholders were offered

the opportunity for follow up discussion and meetings were held to better understand the submissions. Submissions resulted in adjustments to some, but not all, proposals

19. Feedback from the Public consultation indicates that the structural settings are sound. As such, the proposals do not change the rate of tax payable or the circumstances in which tax is payable. However, there is an opportunity ensure that the rules better fit the specific circumstances which apply to the employers of cross-border employees and the payers of non-resident contractors. Feedback from consultation was used to produce a package of improvements is proposed which:
 - Improve the flexibility of, and/or clarify, the PAYE, FBT and ESCT and NRCT rules, and
 - Support the integrity of the PAYE, FBT and ESCT rules.
 - Make a number of remedial amendments.
20. These changes are broadly intended to modernise the rules to better reflect the issues that arise in connection with cross-border work and to reduce compliance costs.
21. By addressing these issues, we can increase the flexibility and clarity of the system for taxpayers. As the changes proposed are largely administrative or timing changes, the fiscal impact is expected to be minimal.

What objectives are sought in relation to the policy problem?

22. The objectives of the review are to reduce compliance costs and modernise the rules.
23. Measures to simplify tax rules often face a trade-off between the accuracy of the rules in question and reduced compliance costs. This main review has focused on ensuring that tax compliance is supported by reducing the focus on the strict requirements of current tax administration. It is expected that this will reduce compliance costs with limited impacts on the amount of tax collected.
24. An additional focus of the review has been to seek to improve and modernise tax data. This will enable Inland Revenue to better police the tax rules for cross-border workers. This is particularly relevant in the context of non-resident contractors, where the burden of assessing the schedular payment thresholds is on the payer; although the payer may not have, or be easily able to obtain, the relevant information. The provision of improved data to Inland Revenue enables a simplification of the threshold test.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

1. Given our objectives, our criteria include:
 - *Flexibility*: flexibility should be provided where possible.
 - *Compliance*: compliance costs should be minimised as far as possible.
 - *Administration*: proposals should fit within existing administrative and operational systems. Administration costs should be minimised.
 - *Clarity & Certainty*: the proposal should increase the clarity of the law to improve certainty for taxpayers.
 - *Fiscal impact*: fiscal costs to the government should be minimised.
 - *Stakeholder support*: changes should be broadly supported by stakeholders.
2. There may be trade-offs between increasing flexibility and improving the integrity of the tax base and decreasing compliance and administration costs. To provide flexibility will require operational changes, for example to systems and guidance. For stakeholders there may be changes to their systems and processes. In particular, new reporting requirements may increase compliance costs.

What scope will options be considered within?

3. Prior to the release of the officials' issues paper, a range of issues had been raised with Inland Revenue across a broad range of cross-border working scenarios. Some of these issues were policy-based, others operational. Informal discussions with the stakeholders who raised concerns were held to assist in scoping the officials' issues paper. Through this process it became clear that most issues, and the most important issues to stakeholders, related to inbound cross-border workers (i.e. those working in New Zealand).
4. We considered whether further guidance would resolve the issues raised, but based on discussions with stakeholders, it became apparent that while guidance would be welcome, it would not be sufficient to resolve the concern around the inflexibility of the current rules and the relatively high compliance costs incurred. In addition, the Operational Statement highlighted an integrity issue which could only be addressed by legislation.
5. Work undertaken in developing the issues paper indicated that the fundamental policy settings are sound. No clear case for more radical reform was established. Adjustments to the existing rules to recognise the particular compliance circumstances of employers, payers and individual cross-border workers within the existing framework will meet the objectives above.
6. A number of operational matters were raised in the informal discussions, mostly around Inland Revenue's processes. Operational matters were excluded from the officials' issues paper which focused on policy and legislative matters. Following the legislative changes, operational support will be required to embed the new rules.

What options are being considered?

Option One – Status quo

7. Option one is the status quo. The population affected by these rules is assumed to be small when viewed as part of the total number of persons working in New Zealand.
8. However, the status quo means that identified problems would remain unresolved and pressure for change would continue. Employers and payers are eager to see reform in this area. Moreover, the current rules do not recognise the compliance circumstances which arise for cross-border workers.
9. *Flexibility*: stakeholders find the lack of flexibility in the system challenging, and as the nature of work becomes increasingly mobile and demands for cross-border workers increase, this could become increasingly problematic.
10. *Compliance*: compliance costs will remain high for employers and payers. If numbers of cross-border workers increase the associated costs will also rise.
11. *Administration*: there is an administrative burden for Inland Revenue in processing and resolving voluntary disclosures. A lack of reform in this area will continue to be a draw on organisational resource. There is also a lack of information which hinders Inland Revenue's ability to monitor the system.
12. *Clarity & Certainty*: leaving known problems unclarified will allow uncertainty to persist in the system, adding to compliance difficulties for taxpayers. This would be contrary to Inland Revenue's objectives for an easy to get right, hard to get wrong tax system.
13. *Fiscal impacts*: under this option there would be no fiscal impact, besides the potential for unintentional non-compliance due to the lack of reform.

Option Two – Reform package

14. Option two is to make a number of tax technical legislative changes to support the objectives of reducing compliance costs and modernising the rules to better fit employers and payers of cross-border workers, as well as those workers themselves.
15. The officials' issues paper proposed a package of reforms:
 - PAYE, FBT and ESCT flexibility. Flexibility will permit a period for catch-up payments of underpaid tax to be made via existing systems. It is intended that where a catch-up payment is made, a voluntary disclosure will not be required. In addition, the package confirms that a variety of options for compliance is appropriate, for example a related New Zealand company may discharge the non-resident employer's employment-related tax obligations.

Submissions indicated stakeholders favoured flexibility. A longer catch-up period was preferred – this has been accommodated in the new rules by extending the period from 28 to 60 days. Further, the category of employees has been extended from those on a shadow payroll to other cases where appropriate, such as those who pay via the IR 56 mechanism.

- PAYE integrity: Integrity measures will support and clarify the existing PAYE, FBT and ESCT obligations. In particular, while existing rules transfer a PAYE obligation to an employee where the employer does not withhold, this is not the case for FBT and ESCT. A corresponding mechanism will therefore be introduced for FBT and ESCT to support the integrity of the rules.

Stakeholders appreciated the intention to bring further clarity to the application of the PAYE, FBT and ESCT rules in cross-border employment arrangements. However, the threshold approach proposed drew limited support. Other mechanisms were favoured, and a safe harbour approach is now proposed.

Concerns were raised about the transfer of FBT and ESCT obligations to employees causing a possible cashflow disadvantage to the affected employee. This could arise where the employer does not fund the payment of the tax or take advantage of other flexibility measures. The affected population is unquantifiable but is likely to be small. As this measure is required to support tax integrity, it is included in the final package.

- **NRCT flexibility:** The NRCT package will simplify the threshold tests for NRCT by requiring the payer to consider their only contract with the non-resident contractor. Related to this measure, reporting of non-resident contractor details to Inland Revenue is required. The package contains a catch-up payment option for breaches of the NRCT rules, a nominated taxpayer approach to establishing a compliance history and discharging tax obligations and provides for broader and retroactive certificates of exemption in specified circumstances.

Stakeholders supported the flexibility particularly with regards to certificates of exemption, although many submitters favoured further reforms in that direction. Given that the policy intent of NRCT is to support the integrity of the New Zealand tax base via managing the basis for exemption from withholding tax, we have not enhanced the proposals following consultation.

In addition, some NRCT proposals which drew a degree of support from submitters, such as the establishment of a register of exempt non-resident contractors, we do not intend to proceed with at present. It was unclear whether the benefits of establishing such a register were likely to outweigh the costs.

Finally, submitters appreciated the proposed simplified approach to the NRCT thresholds, but felt that the reporting requirement proposed was likely to impose compliance costs. One submitter felt the costs would be potentially significant, due to the number of payments made, the different systems in which the payment details are recorded and the proposal to make reporting monthly. It is likely that the costs involved will differ between payers. Other submitters felt that reporting would be reasonable, provided the information required was kept to a minimum and reporting was not required monthly.

Reporting allows Inland Revenue to introduce greater simplicity and flexibility in the rules, in exchange for data which enables Inland Revenue to police the rules more effectively. The intention is to base the report on information commonly obtained by the payer as part of contractual due diligence. As such, reporting has been retained in the package of proposed reforms. Compliance costs will be minimised as far as possible in the design of the requirement. The reporting requirement and associated changes will be introduced from 1 April 2024 to enable time to prepare systems and processes.

16. In addition, four remedial changes are included in the package. These changes aim to improve the clarity and coherence of the rules.

How do the options compare to the status quo/counterfactual?

	Option One [<i>Status Quo</i>]	–	Option Two Reforms package	–	Option Two - comment
Flexibility	0		++		Flexibility is greatly enhanced by the proposals. This is largely achieved through timing changes for tax payments and simpler administrative processes. These reforms better reflect the realities faced by cross-border workers than the status quo.
Compliance costs	0		+		More flexible processes and greater clarity in the system is expected to mean that overall compliance costs are reduced compared to the status quo. Removing the need for voluntary disclosures in specified cases will reduce costs for employers and payers of cross-border workers and enable easier compliance. The introduction of a reporting requirement for NRCT will increase compliance costs for payers. It is clear that the reporting requirement will impose higher costs on those taxpayers who use a greater number of non-resident contractors and may entail systems changes.
Administration	0		+		For the most part, Inland Revenue will use existing systems to support the proposals. Inland Revenue's administration costs may increase due to the new reporting requirements, although costs incurred in administering voluntary disclosures are expected to reduce.
Clarity & Certainty	0		++		The proposals improve the clarity and certainty of employment-related taxes for cross-border workers. Unclear rules creating uncertainty as to when employment-related tax obligations arise are a key issue with the status quo. Resolving this helps stakeholders to understand their responsibilities and contributes to Inland Revenue managing a tax system that makes tax easy to get right.
Fiscal impacts	0		0		In line with our objectives, the fiscal impacts are minimal. Most reforms change administrative requirements or propose timing changes for the payment of tax. The

			PAYE, FBT and ESCT integrity measures may result in a small fiscal increase.
Stakeholder support	0	+	Generally, stakeholders support the direction of the proposals. Some stakeholders would have liked us to go further or to make reforms in areas which were scoped out of the officials' issues paper. Following written submissions, stakeholders were offered the opportunity for follow up discussion and meetings were held to better understand the submissions. Submissions resulted in adjustments to some, but not all, proposals.
Overall assessment	0	+	Compared to the status quo, the package of reforms supports the objectives of reducing compliance cost and modernising the rules.

Option Two Reform package							
	Flexibility	Compliance	Administration	Clarity & Certainty	Fiscal impacts	Stakeholder support	Overall rating
PAYE Flexibility	++	++	++	0	0	++	++
PAYE integrity	+	+	+	+	0	++	+
NRCT flexibility	+	+	+	+	0	+	+

Example key for qualitative judgements:	
++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
--	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

- Option two is better than the status quo. The proposals are broadly in line with the objectives of reducing compliance costs and modernising the rules to achieve a better fit for employers, payers and cross-border workers. When viewed as a package there are clear benefits for both stakeholders and Inland Revenue. Although some proposals

may impose a cost on an employer, payer or cross-border worker, the concerns raised will be taken into account to the extent possible when finalising the design.

What are the marginal costs and benefits of the option?

Affected groups	Comment <i>nature of cost or benefit (e.g., ongoing, one-off), evidence and assumption (e.g., compliance rates), risks.</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.</i>	Evidence Certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
Additional costs of the preferred option compared to taking no action			
Regulated groups (It is expected that this is a small group of taxpayers consisting of larger businesses and entities, and workers whose non-resident employer permits remote working.)	Ongoing. The NRCT reporting requirement would be regular and may require changes to processes or systems for some payers.	Low	Low
Regulators (Inland Revenue)	One-off costs will include systems changes to support the new rules and the production of guidance. Ongoing costs will include monitoring the reports and other compliance activity.	Low	Low
Others (e.g., wider govt, consumers, etc.)	N/A	N/A	N/A
Total monetised costs	Ongoing	N/A	N/A
Non-monetised costs	Ongoing	Low	Low
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Ongoing. Employers and payers are expected to benefit from increased certainty and flexibility which supports reduced compliance costs.	Low	Low
Regulators	Ongoing. The costs of system changes and processing reports may be offset by the expected reduction in the number of voluntary disclosures.	Low	Low

Others (e.g., wider govt, consumers, etc.)	N/A	N/A	N/A
Total monetised benefits	Ongoing	N/A	N/A
Non-monetised benefits	Ongoing	Low	Low

Example key for qualitative judgements:

- ++** much better than doing nothing/the status quo/counterfactual
- +** better than doing nothing/the status quo/counterfactual
- 0** about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

18. Both costs and benefits to this proposal are likely to be ongoing. The changes seek to make the rules clearer and easier to apply and to make it easier to comply. This enables ongoing compliance and administrative benefits.
19. The fiscal impact is expected to be small, as the proposals seek to change how and when tax is paid, rather than the amounts paid. To the extent tax integrity is improved there may be a small fiscal gain and it is possible that the simplification of NRCT thresholds may result in a small fiscal loss. Losses and gains are expected to balance.
20. Current Inland Revenue sources of direct information on cross-border workers are limited. This makes it difficult to quantify the costs and benefits. Instead a qualitative assessment has been made. Most insights into the nature of the problem and the potential solutions were gained from Inland Revenue operational staff and private sector stakeholders.

Section 3: Delivering an option

How will the new arrangements be implemented?

1. The proposals are included in the 2022 omnibus taxation bill. The PAYE integrity measures will apply from 1 April 2023. The PAYE and NRCT flexibility measures are intended to apply from 1 April 2024. The latter date allows time for taxpayers to prepare for systems changes, particularly to support the reporting requirement.
2. Inland Revenue will be responsible for producing guidance to support the changes and for the administration of the rules as part of its normal operational activity.

How will the new arrangements be monitored, evaluated, and reviewed?

3. Inland Revenue would monitor the effectiveness of the proposed reforms on an ongoing basis, through normal use of data analytics and compliance activity. The new data obtained by reporting requirements will assist with analysing whether the new rules are functioning well or if further reforms are necessary.