New Zealand Law Society
Te Kāhui Ture o Aotearoa

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Public Guidance and Advice
Inland Revenue
Wellington

By email: Public.Consultation@ird.govt.nz.

RE: ED0223: Non-resident employer's obligations to deduct PAYE, FBT and ESCT in cross-border employment situations

1. The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on: *Operational Statement ED0223: Non-resident employer's obligations to deduct PAYE, FBT and ESCT in cross-border employment situations* (**OS**).

2. We welcome the Inland Revenue's decision to issue an OS in connection with non-resident employers' obligations to deduct PAYE, FBT and ESCT ('**employment taxes**') in cross-border employment situations. We have set out some general comments, and then expanded on them in more detail.

General comments

3. In the current climate the OS has become increasingly relevant, due to the increased number of offshore employers that have an employee located in New Zealand.

4. The OS suggests that where an employee moves to New Zealand for personal reasons, their offshore employer has no presence in New Zealand and the employee's activities have no connection to New Zealand, then the employer does not need to register for New Zealand employment taxes. While helpful, this seems to be a change of Inland Revenue practice and suggests that an offshore employer can have a New Zealand tax resident employee for an extended period of time without needing to register for employment taxes.

5. The OS should address a number of related points including: the circumstances in which a non-resident employer's employees may trigger a permanent establishment ('**PE**'); the risks that arise from failing to register for employment taxes early; issues arising from offshore employers employing employees already located in New Zealand; and the implications of third parties that operate employment taxes on behalf of an offshore employer.

6. The OS does not elaborate on the tests for presence (e.g. having a permanent establishment, branch) nor does it acknowledge that these need to be considered on a case-by-case basis. The OS also places too much emphasis on having an 'address for service' as a factor indicating presence.

Current climate

7. In the current climate there is an increasing incidence of employees locating themselves in New Zealand for the short to medium term, not just because of Covid-19 but also due to increases in technology and mobility which means that employees are more able and more free to work from wherever they chose. Employees are increasingly able to work remotely and/or from home. This means that an OS on this topic has become more relevant than ever.

8. The OS suggests that where an employee moves to New Zealand for personal reasons, their offshore employer has no presence in New Zealand and the employee's activities have no connection to New Zealand, then the employer does not need to register for New Zealand employment taxes. We welcome this clarification, particularly in the current climate. However, this seems to be a change in Inland Revenue practice, and it is no longer a requirement that an offshore employer with a New Zealand tax resident employee operating in New Zealand will need to register for employment taxes, even where the employee is in New Zealand for a long period of time.

9. This OS is likely to encourage offshore employers to take the view that they can have employees in New Zealand with no tax obligations, which could ultimately have adverse consequences for the employer and/or employee if they are subsequently required to register.

Points not addressed

10. In addition to the above, we consider it would be helpful to address or mention the following additional points.

Permanent Establishments

11. First, the OS does not address or mention the PE implications of having an employee in New Zealand.

12. It has become increasingly common for offshore employers to take the view that it is possible to have employees in New Zealand without triggering a New Zealand PE, and this is likely to become a lot more common – both because of Covid-19 and because employers are likely to realise, on the basis of their Covid-19 experience, that such arrangements are feasible and beneficial. The first two examples on page 3 illustrate this point.

13. While the best practical advice had previously been that an offshore employer with employees in New Zealand for a significant period of time, say 183 days in aggregate over a 12 month period, is likely to have a New Zealand PE, it is increasingly common for advisors to take the position that an offshore employer will not have a PE where they have someone located in New Zealand for personal reasons, even if it is for a long period of time.

14. It would be helpful if the OS also considered and discussed when and how an employee could give rise to a PE of their offshore employer (for example, as a result of creating an office of the offshore employer in New Zealand), because as noted elsewhere in the OS, if the employer has a PE that will result in an obligation to register for offshore employment taxes.

Risks of not registering

15. Second, the OS does not make clear the risks of failing to register for employment taxes early. In particular, if an offshore employer becomes liable to register for employment taxes, that obligation generally arises from the first day of an employee's arrival in New Zealand. For that reason, the best practical tax advice is that if there is a possibility that an employee will be in New Zealand for a significant period then it will be advisable for that employer to register for employment taxes as early as possible. The failure to do so can result in penalties and interest arising to the employer, which are calculated from the first day of arrival.

Employment taxes operated by third parties and secondments

16. Third, the OS does not address or mention arrangements whereby third-party employers (such as labour-hire companies, temporary agencies) or related companies in a wider corporate group operate employment arrangements on behalf of offshore entities, which arrangements are reasonably common. This issue was recently addressed in the Employment Relations (Triangular Employment) Amendment Act 2019, which extends certain employment rights to employees employed by one employer but working under the control and direction of another business or organisation. It would be useful to confirm (and distinguish) the relative New Zealand tax positions of the employer and the controlling/directing business or organisation to whom the employer provides its employees' services in such arrangements.

17. In addition, it would be helpful for the OS to consider and distinguish those situations where an employee is seconded to a New Zealand employer, rather than representing the offshore employer and how this may result in a different outcome.

Direct employment by overseas employers

18. Fourth, the OS should address the position of an employee that is living in New Zealand and is employed by an offshore employer on the basis that they can continue living in New Zealand (i.e. not where an employee moves to New Zealand). There are increasing examples of employees being employed by overseas employees on this basis, often where an employee was employed on the basis they would more offshore, but due to Covid-19 they have remained in New Zealand for up to 12 months and potentially longer.

Territorial limitation and the tests of presence

19. The OS deals briefly with circumstances where an offshore employer has a presence in New Zealand, being a 'permanent establishment, a branch, contracts that are entered into in New Zealand and performing contracts in New Zealand with employees based here'. However, it would be helpful if each of these circumstances were considered in more detail.

20. In practice, any assessment of whether an employer has an obligation to deduct employment taxes requires the consideration and weighting of a range of factors, including how the contract was obtained, how the contract will be performed, and how the work will be paid for. In practice, there can be situations where an offshore employer enters into a contract in New Zealand or performs part of a contract in New Zealand without having a New Zealand presence.

21. New Zealand's double tax agreements also provide further indications of the factors that should be considered. For example, whether income from employment is borne by or

deductible to a permanent establishment is a common factor that will determine whether employment income will be taxable. This would suggest that factors such as whether the employee's salary is an expense in a permanent establishment's accounts and whether the non-resident has established a New Zealand bank account to pay the salary and wages, may also be important.

22. The OS then goes on to reference, in a separate paragraph, that having an 'address for service' (in New Zealand) will be an indication of New Zealand presence. This places too much emphasis on this one factor. While an offshore company with a New Zealand branch will be required to have an address for service, an address for service can also arise in relatively innocuous circumstances (for example, where a commercial contract mentions a New Zealand lawyer's office as the address for service). In addition, contracts will often provide an address for notices or service of proceedings, which again would not necessarily indicate any permanent presence in New Zealand. Possibly this should instead refer to registration on the Overseas Register at the Companies Office, although this will also not necessarily amount to a taxable presence for income tax purposes (e.g. no PE), and generally the company law and tax law tests are regarded as separate and independent.

References to residence

23. In the analysis at paragraph 21 onwards there are various references to 'non-resident'. This seems to be an implicit reference to non-residence under a treaty but this is not stated (i.e. an employee could be resident in New Zealand under domestic law, but tie-broken to the other country and therefore treated as a non-resident for the DTA provisions referred to). This should be clarified and confirmed.

Conclusion

24. In summary, while the draft OS is helpful and timely, it is not sufficiently comprehensive and does not address the wide range of potential circumstances that arise in this area nor does it address practical considerations that would be helpful to tax advisors generally.

25. We trust Inland Revenue will find these comments helpful. If you wish to discuss them, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

Herman Visagie
NZLS Vice President