

# NZPPA 17th Annual Payroll Conference

## PwC Employment Tax Update



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# Your presenters



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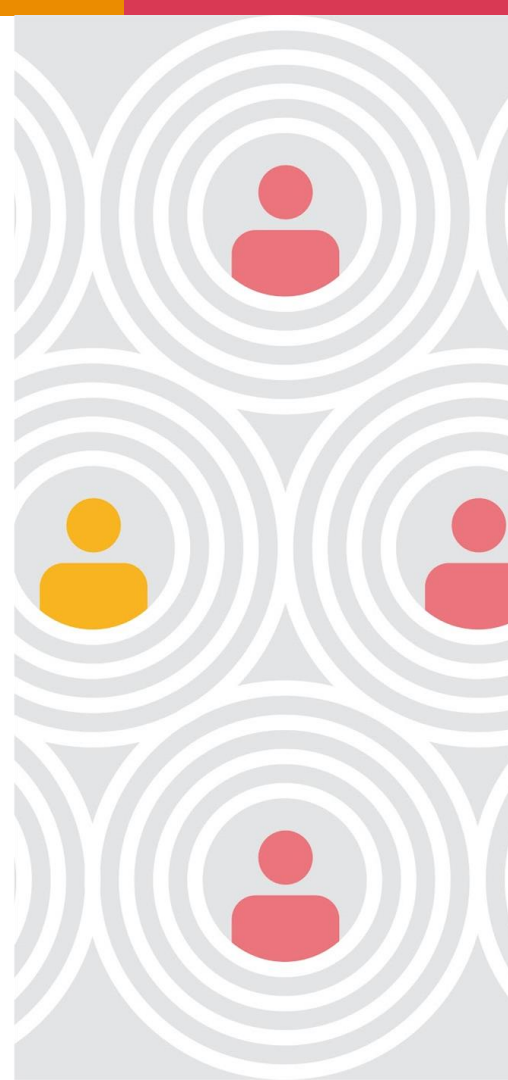


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# Agenda

During today's session we will cover:



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- Introduction
  - Inland Revenue activity
  - Be prepared for risk review
  - Examples from the front line
    - Payroll system reliance
    - Section 123 and termination payments
    - Employee share schemes
    - Pay codes
    - Employee share schemes
    - Payroll processes
  - Questions
-



## Inland Revenue Activity



# Headlines

NEW ZEALAND / BUSINESS

## 'Time running out' for tax dodgers as Inland Revenue announces details of crackdown

11:58 am on 12 July 2024

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BUSINESS > PRESSRELEASE



## Inland Revenue Funding Used To Support Compliance

July 12, 2024

Home / Business

## Inland Revenue to spend \$29m on chasing tax cheats

Business Reporter · 12 Jul, 2024 12:32 PM

MONEY / CONSTRUCTION

## The tax man is coming for you

From **The Detail**, 5:00 am on 18 July 2024

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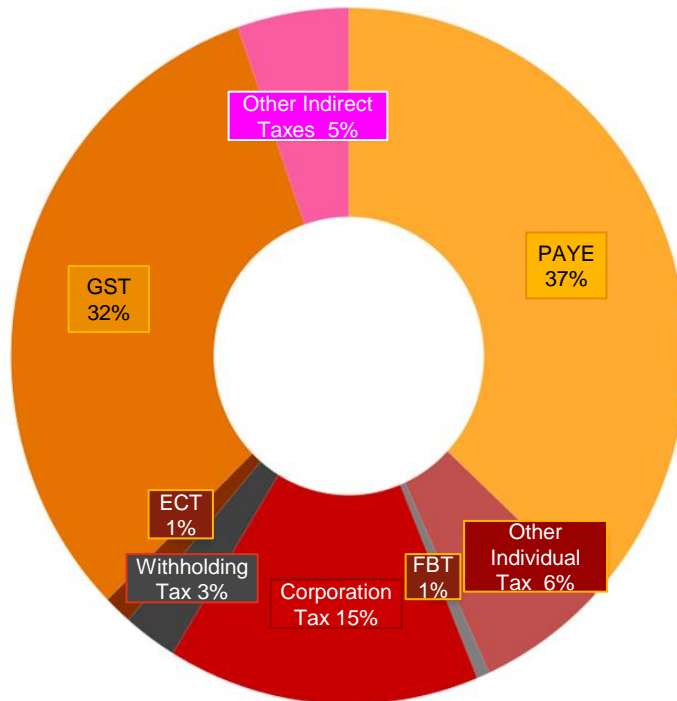


# Tax revenue 2023/24

**32%**

of the New Zealand 'tax-take' is from **GST**.

~\$40 billion of GST revenue over the year



**37%**

of the New Zealand 'tax-take' is from **PAYE**.

~\$46 billion of revenue over the year.

**FBT** accounts for only **1%** of total 'tax-take'.

~\$769 million of FBT revenue over the year.

Source: The Treasury Te Tai Ōhanga - Tax Outturn Data May 2024

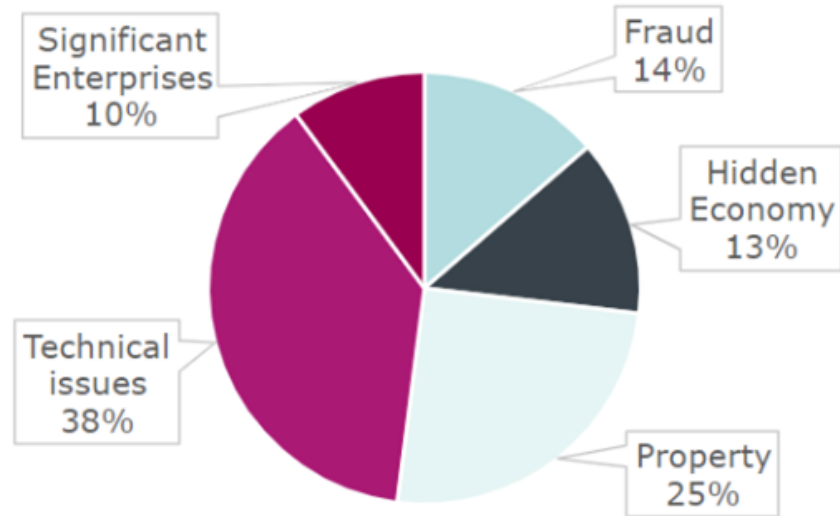


# Inland Revenue Audit Activity July to September 2024

1,908 audits opened

1,623 audits closed

## Audits opened







# Inland Revenue approach to tax compliance

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- Make it easy to get right
- Make it hard to get wrong
- Focus on increasing enforcement activity after a period of lower than usual activity
- Make new use of data and insights

## Story from a specialist

*Analytics showed errors with lump sum (extra pays), PAYE under-deductions, and ESCT calculations. Issued a comprehensive payroll questionnaire to understand PAYE compliance procedures and resulting risks and exposures.*

*Found issues including ESCT not being calculated correctly, PAYE deductions on extra pays not always accurate, NRCT obligations not well understood and certain employees not eligible to be enrolled for KS.*

*Reassessments were required, system changes recommended and training of staff on tax obligations to be undertaken.*

*Inland Revenue 2024*



# Risk indicators

## Examples of indicators / reasons why businesses / employers are being selected for Inland Revenue review

- Large employers
- Complex workforce
- Unionised workforce
- A large number of allowances
- Restructures
- Changes with payroll software
- A history of non compliance with their tax obligations

## Inland Revenue's approach

- Data analytics
- Risk review questionnaire
- Additional questions and requests for information
- In-person site visit
- Confirmation of outcomes from the review / commence formal audit



**Managing IR communications is crucial**

# Our Experience: Inland Revenue's general approach to audit

IR's tax governance compliance strategy is centred around undertaking onsite reviews.

These onsite reviews involve:

- Talking to staff who are responsible for implementing and supporting payroll systems
- Carrying out end-to-end walk throughs of documented processes and systems.
- Evaluating the quality and completeness of documented processes and systems.
- Requesting and analysing electronic accounting data and other records / documentation.

Typical IR request:

- Chart of accounts
- Ledger accounts
- Process documentation for recording income, expenditure, GST, PAYE, FBT
- Bank statements
- Your latest annual attestation confirming compliance with your tax governance policy and controls
- Reconciliations (e.g accounting to statement of taxable income, GST to financial statements)
- Wage records
- Working papers

# What is Tax Governance?

Optimising people, processes and technology to effectively manage risk for all tax types.

## **Strategic Direction: “tone from the top”**

The business strategy and risk management sets the tone of the Tax Strategy including the Tax Risk Appetite of the business.

**Strategy**

**Governance and Risk Management**

## **Tax Governance and risk management**

Tax Risk Management **Policy** for managing existing tax risks and process for identifying new risk.

## **Operational implementation**

To embed the strategy within the organisation and add value to deliver the strategic objectives.

**People**

Are the right people doing the right thing in the right place

**Process**

Are the processes operating effectively to maximise efficiency and effectively manage tax risks

**Technology**

Is the right technology adopted to mitigate risk, maximise efficiency and manage tax risk

**Policies and Procedures**

**Risk and Control Matrices**

**Objective assurance**

# Appendix A: Inland Revenue Questionnaire

## Inland Revenue Tax Governance in Practice Questionnaire

- 1 Does the company have a well-documented overarching tax strategy?
- 2 Does the CFO or Tax Manager formally confirm, as latest once annually, that this strategy has been regularly reviewed, updated where necessary and followed in practice?
- 3 Does the company have a tax control framework to manage day-to-day tax risks?
- 4 Has the operation of the tax control framework been tested independently in the last three years?
- 5 In the last three years, have any tax control deficiencies been identified? If yes, have any follow up actions been taken to remediate those deficiencies?
- 6 Are key internal policies, procedures and controls covering the data collection, analysis, calculation, recording and reporting for tax filing and other tax compliance requirements, documented and available for examination if required?
- 7 Does a review take place at least annually for changes to accounting policies upon which group financial statements are prepared and all items examined where tax treatment may differ materially from financial accounting treatment?
- 8 Is there a robust process in place for the finance and/or tax teams to stay on top of all relevant changes in tax law and related Inland Revenue guidance
- 9 Is a process in place to identify significant transactions (including those which need to be reported to the board or relevant board sub-committees) in respect of which external advice and/or binding rulings may be required
- 10 Does senior management report regularly to the board or relevant board subcommittees on potentially material tax issues or risks?



Corporate boards should proactively develop appropriate tax policy principles, as well as establish internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk. The board should be informed about all potentially material tax risks and responsibility should be assigned for performing internal tax control functions and reporting to the board.\*

\* Sourced from: Inland Revenue, Multinational Enterprises – Compliance Focus 2019 page 10

### Tax Administration Act

New amendments introduced March 2019 giving IRD the power to collect, use, and compel disclosure of tax information- effectively giving IR powers to regularly collect large datasets (and transactional-level data).



# Being prepared for scrutiny - Payroll tax governance

## TAX GOVERNANCE MATURITY MODEL

### Emerging

Certain processes have been used to develop some capabilities, but they continue to be ad hoc and hence need further significant improvements

### Progressing

Certain process improvements have been initiated but these are not yet systematically implemented and institutionalised

### Established

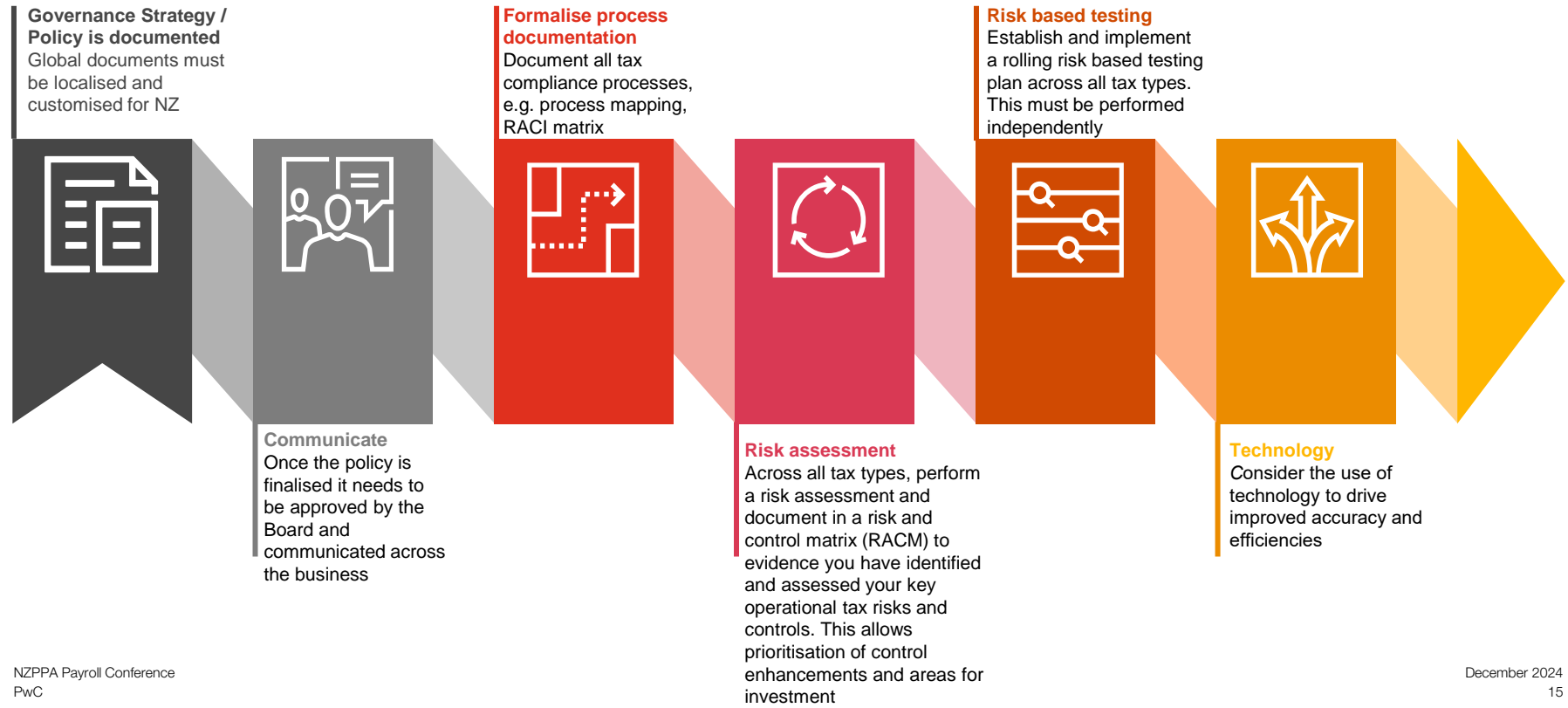
Robust processes have been put in place, resulting in a high degree of capability and they are institutionalised – on average, we expect MNEs to cluster around this level

### Aspirational

Processes have been optimised resulting in a paradigm shift, with use of new/innovative tools/technology and transparent reporting

# Tax Governance: Strategy & Tax Risk Management Policy

Overview of steps to implement and maintain an effective tax control framework





## Common issues with payroll



# Common issues with payroll

## Reliance on payroll systems

A common misconception that payroll systems are compliant



## Section 123 and termination payments

Complex area of payroll that can have adverse implications for both the employer and employee(s) if it isn't managed correctly

## Employee share schemes

Employee share schemes are notoriously problematic and misunderstood

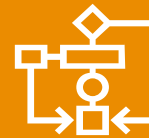


## Pay code configuration

Correctly configured pay codes are one of the key foundations to payroll systems and overall compliance

## Superannuation schemes

Important to understand the interaction between KiwiSaver and bespoke superannuation schemes



## Payroll processes

Robust processes are fundamental to any organisation



# Reliance of payroll software

- Employers are heavily reliant on payroll software to correctly manage their payroll obligations.
- Misconception that the payroll software will always get things correct from a calculation and reporting perspective.
- Where there is an over reliance and things go wrong, there can be significant implications for both employers and employees.
- Duty of care for employers to ensure that their payroll system is compliant and up to date.
- Recently we have identified a number of issues in relation to employer superannuation contribution tax (ESCT) rates.
- Some payroll software requires a degree of manual intervention to ensure that ESCT rates are correct for new employees.

## Case study

- Larger employer with thousands of employees.
- Error with the way they were applying ESCT rates for new employees.
- ESCT rates being applied were too high in the first year of employment.
- Employer KiwiSaver contributions were negatively impacted for employees.
- Organisation had been relying on the payroll system to correctly determine the ESCT rates.



# Section 123 and termination payments

- Section 123 payments require careful consideration and the relevant legislation must be applied with caution.
- These payments are a particular focus area of Inland Revenue and is a key component of their risk reviews and audits.
- Employers should be familiar with the rules relating to section 123 payments and where there is any uncertainty, professional advice should be sought.
- Key to understand how redundancy and retirement payments should be treated for payroll purposes and that pay codes are configured correctly.

## Case study

- Several section 123 payments that had been made over the past couple of years.
- No process in place for making payments and those who were authorising the payments lacked the knowledge and a general understanding of the rules relating to section 123 payments.
- Payments were being treated as section 123 payments despite no personal grievance being raised.
- Remediation was required as there were PAYE, KiwiSaver and ACC earners' levy shortfalls.



# Employee share schemes

- Despite the ESS reporting rules coming into effect in 2017, many employers still aren't applying the rules correctly.
- ESS reporting has been identified as a high-risk area by Inland Revenue.
- Errors can include non-reporting, incorrectly reporting the value of benefits and incorrectly claiming income tax deductions.
- Documentation and communication with employees is fundamental to effectively managing ESS obligations.
- There are several recent Inland Revenue publications that help to clarify the ESS rules.
- Employers should ensure they have familiarised themselves with these publications and whether they have been meeting their obligations.

## Case study

- Employer had an employee share scheme in place and shares had been exercised by a number of participants.
- The employer had not complied with their reporting obligations in respect of the ESS benefits.
- The failure to report the ESS benefits had a direct impact on both the employer and the participants of the scheme.
- A voluntary disclosure was required with the employer agreeing to fund the tax shortfall.



# Pay code configuration

- Pay code configuration for PAYE, KiwiSaver and ACC earners' levy is a fundamental element of any payroll system.
- Incorrectly configured pay codes can have widespread implications across a large number of employees are pay periods.
- To effectively manage associated risks, Regular reviews should be undertaken to check pay code settings.
- Application of legislation needs careful consideration with regards to non-taxable allowances and is often misunderstood.
- Collective Employment Agreements are often a catalyst for payments which aren't being treated correctly tax and payroll reporting purposes.

## Case study

- Collective Employment Agreement entitled employees to a meal allowance of \$10 where an employee is required to work more than 1 hour of overtime.
- Consideration was not given to the tax treatment of this particular payment and a non-taxable pay code was created to process these payments.
- The employer took the necessary steps to remediate the error as soon as it was identified.
- Due to the inability to identify those employees who actually did qualify for a non-taxable meal allowance and those that didn't, all historic payments were required to be grossed up for PAYE, KiwiSaver and ACC earners' levy.



# Superannuation schemes

- The rules relating to alternative superannuation schemes are relatively complicated and are often misunderstood.
- It's important for employers to understand the how the rules apply to different types of funds, including complying funds, non-complying funds and KiwiSaver.
- Employers need to ensure that they are complying with their obligations, specifically in relation to their employer superannuation contributions.
- Due to the complexities and implications that may arise as a result of getting things wrong, this is an area where professional advice should be sought where there is any uncertainty.

## Case study

- Alternative superannuation scheme offered by employer which comprised of a complying and a non-complying fund as well as KiwiSaver.
- Where an employee was making contributions to both KiwiSaver and the non-complying fund, the employer was only making employer contributions to the non-complying fund.
- Based on the employer contributions, was identified that the employer wasn't complying with the KiwiSaver Act resulting in the employer being required to make significant remediation payments.



# Payroll processes

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- Robust processes are fundamental to any payroll function.
- Inland Revenue's review scope has widened with an increased focus on the underlying processes and controls.
- Organisations need to ensure there is documentation in place to support these processes.
- Key roles and responsibilities should be clearly defined as part of the overarching payroll process.
- Processes should be clearly documented and reviewed and updated regularly.

## Case study

- Large employer that had no formal documented processes in place or defined roles and responsibilities.
- This result in a number of material issues which dated back a number of years.
- New employees had been added to the payroll using 000-000-000 IRD number.
- Prior payments were not amended to reflect the correct IRD number which resulted in earnings being under reported to Inland Revenue.



**Questions**







# Thank you

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