

Memo

To: Leanne Yap, Oranga Tamariki
From: Michelle Macdonald & Isaac Moffat-Young, PwC
Date: 28 October 2021
Subject: Tax treatment of payments to Members of the Oranga Tamariki Ministerial Advisory Board

Dear Leanne

We refer to our recent discussions in relation to the Withholding Tax (WHT) and Goods & Services Tax (GST) treatment of payments to members appointed to Oranga Tamariki's Ministerial Advisory Board.

As noted during our meetings on 18 and 20 October 2021, the application of the relevant legislation can become complicated, but the Cabinet Office Circular (19) 1 - Fees Framework for Members provides significant guidance on how Oranga Tamariki should approach its tax compliance obligations. The following provides our detailed advice in relation to the WHT and GST treatment of payments to members appointed to Oranga Tamariki's Ministerial Advisory Board.

Background

We understand that:

- The Minister for Children - has appointed four individuals (the Members or the Board Members) to Oranga Tamariki's Ministerial Advisory Board (the Board) since the Board's inception.
- Each of the Board Members have been appointed to the Board for an initial period of two years from 1 February 2021¹.
- The respective appointment letters set out the rate that the respective Board Members (and the Chair) will be paid in accordance with the Cabinet Fees Framework.
- The Cabinet Office Circular (19) 1 - Fees Framework for Members (the Circular) applies to the Members of the Board.
- Oranga Tamariki has not deducted WHT from any payments to the Board Members in respect of their services to the Board since their appointment.
- **s 9(2)(a) OIA**
- GST is currently being charged by all four Board Members in respect of their services to the Board. In one instance, a Board Member who is not GST-registered is charging GST in respect of their services.
- Although most of the payments to Board Members fall within the current tax year (the year ended 31 March 2022), a portion may have been incurred and paid in the prior tax year (the year ended 31 March 2021).
- Oranga Tamariki is in the process of appointing two additional individuals to the Board.
- Oranga Tamariki is conscious of the importance of meeting all tax compliance obligations, and is mindful that as a government agency, this high-standard of compliance cannot be compromised.

¹ Per the respective appointment letters dated 27 January 2021.



Oranga Tamariki would like clarification on the GST and WHT treatment of payments to the Members of the Board. In the case that any payments to Board Members have not followed the correct tax treatment (both for WHT and GST), Oranga Tamariki would like clarification on how best to resolve this.

We discuss the tax treatment of such payments below, and in addition, provide some more general guidance on the WHT treatment based on our experience across the sector, and our interactions with Inland Revenue when they have considered these appointments as part of their public sector audit activity.

Once you have had a chance to consider the below, we recommend that we set up a call to discuss how Oranga Tamariki addresses the WHT and GST treatment of payments made to the Board Members to date.

Executive Summary

Based on our analysis (attached below), we consider:

- The four Board Members are appointed to perform a schedular activity (being work or services performed by chair or member of a committee, board or council).
- Payments to individuals for performing a schedular activity are known as schedular payments. Under legislation, an employer is required to deduct WHT on schedular payments unless an exemption applies.
- The Board Members have been appointed by the Minister for Children in their personal capacity. Both the relevant legislation and the Circular are compelling support for the requirement that Oranga Tamariki withholds WHT on the payments to the Members.
- WHT should be deducted from payments to the Members at the appropriate rate, unless the Members provide a Certificate of Exemption, or another exemption applies. Based on our review of documentation, we consider it unlikely that another exemption applies.
- Section 6(3) of the GST Act 1985 specifically excludes certain activities from being considered a taxable activity, including any engagement, occupation or employment as a chairman or member of any local authority or any statutory board, council, committee, other body, subject of Section 6(4) of the GST Act. Accordingly, both the GST Act and the Circular provides compelling support that the payments to the Board Members should not be subject to GST.
- Going forward, and subject to the below, the default position should be that WHT applies to payments to all the Board Members (and any additional members to the board), and GST should not apply to the payments to the Board Members.
- As this treatment will differ from the tax treatment that Oranga Tamariki and the Board Members have been applying in the past, the requirement to deduct WHT, and the expectation that GST should not be charged, should be clearly communicated to the Board Members.
- To address the tax treatment of payments in the past, the technically correct position may be for Oranga Tamariki to file a voluntary disclosure in regards to WHT, and request credit notes (or another method) from the Board Members in regards to GST. However, filing a voluntary disclosure could result in adverse consequences, including a situation where; Oranga Tamariki 'grosses up' payments made to the Board Members to calculate WHT and 'bears' the cost of WHT. The result of this could result in the Board Members receiving additional income and a credit for excess tax deducted, therefore the over remuneration of Board Members. In addition, Oranga Tamariki is currently in talks with the Inland Revenue in relation to the GST treatment, the conclusion of which may result in a more 'practical' option. We therefore consider a better option for WHT may be to apply the correct treatment going forward, and discuss the approach of not addressing the WHT in the past with Inland Revenue, along with the historical GST treatment.

- Regardless of whether Oranga Tamariki chooses to address the tax treatment of payments in the past, the final approach to addressing the past should be clearly communicated to the current Board Members, as it will likely impact their personal tax circumstances.

Analysis

Withholding Tax (WHT) treatment

Payments to a chair or member of a committee, board or council or an organisation similar to committee, board or council for work or services performed (including attendance at meetings) falls within the meaning of schedular payments under the Income Tax Act 2007 (the ITA).

Part B (1B) of Schedule 4 of the ITA states:

"A payment has a standard rate of tax of 0.33 for each dollar of the payment, if it is for work or services performed by—

- (a) a local government elected representative;*
- (b) an official of a community organisation, society, or club;*
- (c) a chair or member of a committee, board, or council;*
- (d) an official, chair, or member of a body or organisation similar to one described in paragraph (b) or (c).*

Based on the above, payments for work or services to the Board are, prima facie, subject to WHT. Any allowance or reimbursement of expenses are not subject to WHT as they are not "for work or services".

Where WHT must be deducted, it is required to be deducted at the rate elected by the Board Member, as per their completed IR330C form. If no rate is selected, the rate of 33% should be applied to the payment and if an IR330C has not been completed and provided to Oranga Tamariki, the rate of WHT to be deducted should be 45% (the non-declaration rate).

This principle will apply unless the Board Member provides Oranga Tamariki with a valid Certificate of Exemption (we understand that none of the current individuals appointed have).

Exemptions from WHT

There are a number of exemptions from WHT, as follows:

- Where an individual has obtained a Certificate of Exemption from Inland Revenue. A copy of this should be provided to Oranga Tamariki and can only be applied if it is valid at the time payment is made;
- When the payment is being made to a New Zealand resident company² (we expand on how this applies to Oranga Tamariki below);
- When the payment is being made to a public authority, local authority or Maori authority.

It can therefore be concluded that WHT should apply to the Board Members fees other than:

- Where a New Zealand registered company has been appointed to provide an individual to the committee or panel (again, we expand on this below but this is unlikely to apply as Oranga Tamariki engages with the individual as opposed to a company);
- Where a committee or panel member has provided Oranga Tamariki with a Certificate of Exemption.

The obligation is on Oranga Tamariki to ensure it correctly withholds tax.

² Section RD 8 of the ITA 2007.

Goods & Services Tax (GST) Considerations

To impose GST output tax on goods and services provided, a person must be GST registered. To be registered, a person must have a taxable activity, as defined in Section 6 of the GST Act 1985.

Section 6(3) of the GST Act specifically excludes certain activities from being considered a taxable activity, including any engagement, occupation or employment:

- as a chairman or member of any local authority or any statutory board, council, committee, other body, subject of Section 6(4) of the GST Act.

Effective 30 June 2014, Sections 6(4) and 6(5) of the GST Act were introduced that stated that if a person:

- Is paid a fee or another amount in relation to their engagement, occupation, or employment in circumstances in which they are required to account for the payment to their employer, the payment is treated as consideration for a supply of services by the employer to the person who made the payment to the director, member, or other person.
- In carrying on a taxable activity, accepts an office, any services supplied by that person as holder of that office are deemed to be supplied in the course or furtherance of that taxable activity.

So, for the Board Members, for GST purposes the activity that they are performing is excluded from the definition of a taxable activity, so you would not expect GST to be charged by them unless the member is:

- Paid a fee or another amount in relation to their engagement and they are required to account for the payment to their employer (other organisation), as the payment is then treated as consideration for a supply of services by the individual's employer; or
- They are, say a lawyer, and are appointed to the committee or panel as an extension of their taxable activity as a lawyer.

Based on our review of the appointment letters and the Oranga Tamariki Ministerial Advisory Board Terms of Reference document, we do not consider either of the above two points to be relevant for the current appointed Board Members.

Inland Revenue Practice and Cabinet Office Circular 19/01

As discussed, the Board Members are typically engaged in their personal capacity. As such, the default position is that WHT applies to their meeting fees and no GST will be applied thereon.

However, following the change to the GST legislation in 2014 (outlined above), and some other legislative amendments relating to directors, there has been increased confusion, particularly in relation to where an individual has a personal service company and they are seeking to invoice via this. This confusion was compounded by there being no change to the Income Tax Act 2007, so in effect no official change to the withholding tax position, albeit an Inland Revenue Large Enterprises publication advised that if an individual invoiced via a company, then aside from being able to charge GST, they would not be subject to WHT. For example, if a NZ registered company invoiced for the services of an employee to sit on a Board, then the fee could be treated as exempt from WHT as it was being paid to a company.

However, Inland Revenue have been taking a very 'high-bar' approach to determining when a Board Member or other statutory figure is acting as an agent or representative of another entity which has agreed to perform the services; this has been very noticeable in audits undertaken by Inland Revenue across the public sector. We have seen correspondence from Inland Revenue to other public authorities outlining their view that tribunal members and statutory positions should be treated as statutory Board members for tax purposes resulting in a requirement for WHT to be deducted.

Inland Revenue's 'high-bar' approach has now been supported by *Cabinet Office Circular (19) 1 - Fees Framework for members appointed to bodies in which the Crown has an interest*³. Fees paid by Oranga Tamariki to members of the Board are governed by this Circular and hence the commentary in this Circular must be considered. This document includes a specific note surrounding members in which:

- *"A board member cannot simply divert a payment to a company to avoid having WHT deducted. If the member wishes for no WHT to be deducted from payments received for directorship services they provide the board in their individual capacity, they must have applied for, and been granted, an exemption certificate;*
- *The fact that the board member has a fiduciary or contractual duty to account for the fees to a third party (e.g. their employer) does not affect how the payer should apply the schedular payment rules. The fact that a member has a fiduciary duty to account to a third party is irrelevant to the payer's withholding and payment obligations⁴;*
- *Whether or not there is a withholding obligation will depend on who has been contracted to provide the service to the board, and in what capacity they have been contracted. It will not depend on who the member wishes the payments be made to. Even if a payment is directed to a third party at the request of the person providing director services, the payer should still treat the payment as being to the person who provided the services."*

In addition, paragraph 167 states that:

- *"If and only if, the member is performing the service (to which the payment of fees relates) as an agent or representative of another entity which has agreed to perform the services, then the payment of fees is derived by that entity and not by the member. A payment of fees to a company is not subject to withholding tax. A payment of fees to a Trust or a Partnership is subject to withholding tax, unless they hold an exemption certificate."*

Application to Oranga Tamariki

It is clear that all of the Board Members have been appointed by the Minister for Children in their personal capacity⁵. As the Board Members are subject to the Circular, both the relevant legislation and the Circular are compelling support for the requirement that Oranga Tamariki withholds WHT on the payments to the Members. Accordingly, WHT should be deducted from payments to the Members at the appropriate rate, unless the Members provide a Certificate of Exemption (see page two), or another exemption applies. In addition, the GST Act provides compelling support that the payments to the Board Members should not be subject to GST.

The Circular implies that in certain circumstances, it may be appropriate for Oranga Tamariki to pay a company for the services of the individual (in which case WHT would not need to be deducted) and for the company to charge GST. We consider this would only be appropriate if:

1. Oranga Tamariki engages with a company for the services of an individual; or
2. Oranga Tamariki engages with an individual;
 - receives an invoice from a company; and
 - the company is the individual's employer; and
 - the company requires the individual to return any fees earned outside the company, or operating as an employee under the company, to the company.

³ Particularly reference paragraphs 164 - 174

⁴ Although we note this is not what Inland Revenue stated in their Large Enterprise newsletter in August 2014!

⁵ Per the respective appointment letters dated 27 January 2021.



Based on our experience within the sector, we consider the second option is commonly misinterpreted. Accordingly, if the second situation arises, Oranga Tamariki should request the individual confirm in writing, that it applies. We note that we would typically only expect this situation to apply if the company is an independent employer, not in situations where the company is the individual's personal services company where the individual is the sole director.

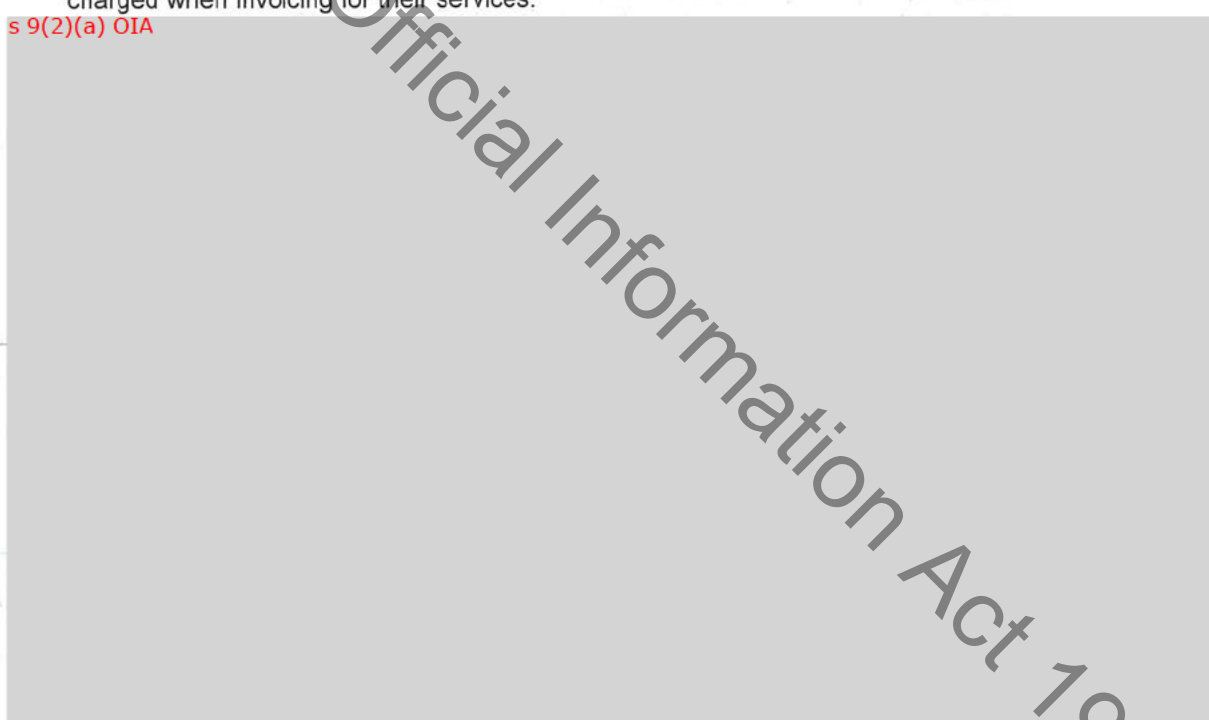
If the above is confirmed, only then can Oranga Tamariki pay the Board Members fees to the company without WHT being deducted. In addition, if the company issues a valid tax invoice, GST could also be charged.

Going forward – Tax treatment of payments to current Board Members

For the current Board Members, we recommend that Oranga Tamariki:

- Request the individuals complete an IR330C;
- Deduct WHT from the Board Members fees in the future at the appropriate rate;
- Provide the Board Members with a copy of the Circular, highlighting that GST should not be charged when invoicing for their services.

s 9(2)(a) OIA



Going forward – Tax treatment of payments to future Board Members

Oranga Tamariki has indicated that they are planning on engaging additional Board Members in the future. To avoid angst over the applicable GST and WHT treatment of future Board Members, we recommend the appointment process should be explicit in that:

- Board Members are appointed by the Minister for Children in their personal capacity;
- WHT will be applied to the members fees;
- GST should not be charged when invoicing for payment.

As part of the appointment process, Oranga Tamariki should:

- Request that the member complete an IR330C, whereby they can request the appropriate withholding tax rate; and
- Note that a Board Member can apply to Inland Revenue for a Certificate of Exemption if they do not want withholding tax to be deducted.

If an individual seeks to invoice through a company, charge GST and not have WHT deducted, Oranga Tamariki should ask the individual to confirm, in writing;

- The company invoicing is the individual's employer;
- The company requires the individual to return any fees earned outside the company, or operating as an employee under the company, to the company;
- The company is GST registered.

If this is undertaken at the time of appointment, then any ambiguity in relation to WHT and GST treatment will be mitigated. In the case that WHT applies to all Board Members, this will also help facilitate simplifying the payment of the individuals via the payroll/payday filing – this can be more complex when GST and WHT is applicable for some members but not others.

Addressing historical payments

There are a number of options available to Oranga Tamariki in regards to addressing the WHT and GST treatment of the payments made to the Board Members to date. We have outlined these at a high-level below.

Withholding Tax (WHT) treatment

In regards to WHT, the technically correct option may be to file a voluntary disclosure with the Inland Revenue. This would result in reporting the income and tax that was required to be withheld in respect of the payments to each Board Member to Inland Revenue. As none of the Board Members have provided or completed an IR330C, Oranga Tamariki would be required to report and deduct tax at the non-declaration rate of 45%.

However, there are a number of complexities that arise with this approach. The first is that the individuals have already been paid, thereby unless Oranga Tamariki wishes to make additional deductions from future payments to the Board Members, or seek a refund of the WHT from the Board Members, Oranga Tamariki would be required to treat the amount paid as the net amount, gross this up for WHT, and pay the resulting WHT on behalf of the individuals. This could result in an increase to the Board Members record of income with the Inland Revenue (thereby the over remuneration of the Board Members). In addition, as tax would be paid at 45%, as opposed to the maximum possible marginal tax rate of 39%, the Board Members may further benefit from a refund of tax paid by Oranga Tamariki.

A more 'practical' approach could be for Oranga Tamariki to not address the past, and to communicate this with Inland Revenue, citing the complexities of attempting to adjust the past in the technically correct manner. Under this approach, the Board Members will be solely responsible for declaring and paying any tax that arises in respect of their payments to date through the filing of their income tax returns (we note that they are legally obliged to declare and pay the tax that arises on all their sources of income anyway).



Goods and Services Tax (GST) treatment

We understand that Oranga Tamariki is currently in communication with Inland Revenue in regards to the historical treatment of GST. Presuming that the GST-registered Board Members have been paying the GST charged to Oranga Tamariki to the Inland Revenue, and Oranga Tamariki has been claiming the equivalent amount of GST in their GST returns, Inland Revenue would not be better or worse off if Oranga Tamariki sought to reverse the GST treatment (either by way of credit note or another method). On this basis, s 9(2)(a) OIA [redacted] the Inland Revenue may conclude that Oranga Tamariki does not need to correct the past.

s 9(2)(a) OIA [redacted]

Pending the result of the discussions with the Inland Revenue, Oranga Tamariki may request a refund of the GST from the Board Member and processing this through the next GST return, or file an adjustment in their GST return to reverse the GST claimed. If the latter is chosen, any GST not refunded would be income to the Board Member.

Due to the impact on each Board Members personal tax circumstances, the final option should be clearly communicated to the Board Members.

Due to the complexity and consequences of each option, and the fact that Oranga Tamariki is currently involved in discussions with Inland Revenue in relation to the GST treatment, we recommend that we have a call to discuss how best to address the historical payments made once you have had a chance to consider the above.

General

We trust the foregoing helps clarify the appropriate treatment for Oranga Tamariki. Once you have considered, if you have any further questions please contact us.

Yours sincerely

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