

Regulatory Impact Statement

Reform of tax treatment of non-resident fishing crews

Agency disclosure statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

The problem addressed is the unsuitability of the current income tax treatment for non-resident members of fishing crews. This treatment results in over-taxation, is unnecessarily complex and imposes additional compliance costs on the affected taxpayers.

The proposed solution will mean that the non-resident members of fishing crews are taxed at the correct rate and are not required to file a tax return.

The class of taxpayers likely to be affected is limited to the non-resident members of fishing crews and their employers.

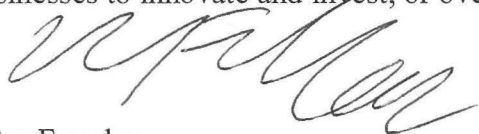
Targeted consultation with the industry and other interested bodies has been undertaken on the policy proposal, which is intended to ensure compliance while making payment of tax easier and fairer for non-resident crews. Feedback from the consultation has been positive overall. The received feedback helped to shape the preferred policy solution – that is, the introduction of the new tax mechanism for non-resident fishing crews.

All submitters supported the introduction of the flat tax rate on the New Zealand-sourced income of non-resident members of fishing crews, and the removal of the requirement on them to file returns. The majority of submitters proposed that all members of non-resident fishing crews be subject to the same tax mechanism, including the flat tax rate.

Several submitters requested clarification on how to determine what portion of income is subject to New Zealand tax. It is proposed that the same mechanism should apply to all members of the crew, to minimise their compliance costs and Inland Revenue's administrative costs.

It is important that, to give effect to the proposed solution, these amendments are passed at the earliest available opportunity, to provide for certainty of tax treatment of the members of non-resident fishing crews.

There are no significant constraints, caveats and uncertainties concerning the regulatory analysis undertaken. The preferred solution does not impose additional costs on businesses, impair private property rights, restrict market competition, reduce the incentives on businesses to innovate and invest, or override fundamental common law principles.



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STATUS QUO AND PROBLEM DEFINITION

1. A number of New Zealand fishing companies bring in non-resident crews to work either on the companies' own vessels or on vessels that are chartered from foreign operators. The members of these crews are non-resident for tax purposes. Approximately 1,000 to 2,000 non-resident crew members are employed by these companies each year.
2. The non-resident crew members are typically flown into New Zealand and start their employment shortly after arrival. Their term of employment can last from several weeks to several months. Their work includes fishing, landing fish at ports, and doing other employment-related tasks as may be required by their employers (for example, performing maintenance of the vessels or loading them with supplies while on shore). They work mostly in the exclusive economic zone (EEZ)¹ of New Zealand, beyond the Territorial Sea²; and spend a limited amount of time within New Zealand's territorial limits³ at any time of their engagement with the fishing company. It has been estimated that many of the non-resident crew members spend approximately 20% of the time they are employed within New Zealand's territorial limits.
3. The Government has decided to change the management regime for foreign charter vessels (FCVs) and introduced the Fisheries (Foreign Charter Vessels and Other Matters) Amendment Bill, which is promoted by the Minister for Primary Industries and has had its second reading. It is expected that the bill will be passed by the end of May 2014.
4. The Fisheries (Foreign Charter Vessels and Other Matters) Amendment Bill includes a requirement that all FCVs have to be flagged as New Zealand vessels ("reflagging") by May 2016. The companies utilising reflagged FCVs will need to comply with New Zealand employment laws and regulations, including meeting their tax obligations.
5. Prior to reflagging, most of the members of non-resident fishing crews were employed by overseas employers. Following reflagging, New Zealand companies will become the employers of the crews. The crew members remain non-resident for tax purposes, and as such they will be taxable on their New Zealand-sourced income only. New Zealand-sourced income forms a part of their total income, and represents the amount of income that can be apportioned to time spent within New Zealand's territorial limits.
6. For the majority of New Zealand-based salary and wage earners, the current PAYE mechanism provides accurate tax deductions during the year, thereby reducing the need for these taxpayers to file end-of-year tax returns. In addition, there are domestic service providers who reduce the compliance costs involved in filing an end-of-year return, such as tax refund intermediaries.
7. However, applying the existing PAYE taxation mechanism to non-resident members of the crews would result in over-taxation of their income, as the crew members work for part of the year only. They would also need to file tax returns to be able to access refunds of overpaid tax. However, most of the non-resident crews leave New Zealand within

¹ Exclusive Economic Zone (EEZ) comprises an area which extends from the coast to 200 nautical miles (370 km), and includes the Territorial Sea.

² Territorial Sea is the belt of coastal waters extending 12 nautical miles (22.2 km) from the New Zealand coast.

³ Territorial limits of New Zealand, for the purposes of this RIS, include both the land and the Territorial Sea.

days of the end of their engagement with the fishing companies. They would face significant difficulties in filing tax returns and receiving their refunds while based overseas. Additionally, many may not have knowledge of the relevant processes or the ability to access specialist services to assist them with filing tax returns.

8. Therefore, the problem addressed by this RIS is that the current income taxation mechanism (that is, the use of the tax code “M” and annual filing of a tax return) is not suitable for non-resident members of fishing crews, as it results in over-taxation, is unnecessarily complex and imposes additional compliance costs on these taxpayers.

OBJECTIVES

9. The objectives are to:

- increase the accuracy of tax deductions during the year for members of non-resident fishing crews
- minimise compliance costs to the members of non-resident fishing crews
- minimise administrative costs to Inland Revenue (by ensuring that the solution is feasible and can be implemented in a timely and a cost-effective manner).

10. It is acknowledged that there were trade-offs to be considered between the objectives. The preferred solution proposes a flat rate of 10.5% for all members of non-resident fishing crews. The application of this rate indicates the trade-off between accuracy of tax deductions, compliance and administrative costs.

REGULATORY IMPACT ANALYSIS

11. There are two options considered in this RIS:

- Retaining status quo: this would include using the annualised tax rates, which are accurate for full-year earnings only, and the need to file an income tax return at year’s end to obtain any refund.
- Introducing new tax rules: these would involve a flat tax deduction rate and simplifying the tax obligations for members of non-resident fishing crews. A tax code taxing the earnings at the correct rate will be used, thereby removing the need or the requirement to file a tax return. Suggestions of methods to calculate the New Zealand-sourced portion of incomes of members of non-resident fishing crews were given careful consideration. However, they were dismissed because of their overall complexity. These suggestions are discussed in more detail below.

Status quo

12. This option would involve members of non-resident fishing crews using the standard “M” tax code or applying for a special tax code (“STC”). If the M tax code is used, the members of fishing crews will be overtaxed, because this tax code assumes that an employee works for a full year. They would need to file a tax return at the year’s end to

obtain a refund of the overpaid tax. If an STC tax code is used, the members of fishing crews will need to apply for the code before their first wage payment and to file a tax return at the year's end.

Introducing the new taxation mechanism for non-resident fishing crews (preferred option)

13. This option would involve applying a flat 10.5% tax rate to the earnings of non-resident crew members, which would be final (unless a member chooses to file a return). The flat 10.5% rate would apply to the New Zealand-sourced portion of income of non-resident crews, and this portion would need to be calculated by employers based on the actual percentage of time spent by their employees within New Zealand's territorial limits.
14. The flat 10.5% reflects the fact that the annual New Zealand-sourced income of the overwhelming majority of non-resident fishing crews is less than \$14,000. This 10.5% flat rate corresponds to the rate charged on the same income earned by New Zealand residents.
15. There are a very small number of people in these non-resident fishing crews who earn annual New Zealand-sourced income above \$14,000. The new taxation mechanism and the flat 10.5% tax rate will also apply to these members, for reasons of reduced compliance and administrative costs. A similar scheme already exists in relation to non-resident seasonal workers under the recognised seasonal employment scheme, under which all workers subject to the scheme are taxed at the same 10.5% flat rate even though a small percentage of them earn incomes higher than those of the majority.
16. ACC earner premium deducted would be based on the New Zealand-sourced income of the non-resident crew members, with the applicable rate being the rate in force at the time of the deduction.
17. The requirement to file a tax return would be removed. Although non-resident members of fishing crews will be able to file end-of-year tax returns if they wish to do so, it is not expected that they will do so to a significant degree. This is because the withholding rate of 10.5% will be the correct final rate in nearly all cases.

18. The following table provides an impact analysis of both options:

Option	Meets objectives	Fiscal impacts	Compliance	Administrative impacts	Net Impacts
Status quo	Only meets one of the three objectives (minimising administrative costs).	The net fiscal gain is calculated at \$0.6m, the same as for the option below. Although there would be over-deduction of tax during the year, there would be an entitlement to apply for refunds. It is difficult to accurately estimate the extent of these refunds.	<p>Additional compliance costs imposed due to inaccurate tax deductions during the year, requiring fishing crew to file annual tax returns to get a refund.</p> <p>Foreign fishing crews do not have access to the same mechanisms to reduce compliance costs associated with filing that New Zealand taxpayers have (for example, access to tax refund intermediaries).</p> <p>Language differences and being overseas when required to comply with tax return obligations also increase compliance costs.</p> <p>Refunds can either be put into New Zealand bank accounts or sent by way of cheque. However, accessing the funds of a New Zealand bank account, or banking a New Zealand cheque overseas, may be difficult.</p> <p>The current process assumes a person is in New Zealand when required to comply with their tax obligations. Although their obligations can be complied with from overseas, it is more difficult to do so.</p>	This option is administratively feasible. There would be minor costs, such as processing of tax returns.	This option does not address the problem definition, only partially meets the stated objectives. This option has high compliance costs for taxpayers relating to return filing.
New taxation mechanism for non-resident fishers	Meets all three objectives (accuracy, minimising administrative and compliance costs).	This option correctly deducts tax during the year resulting in a fiscal gain of \$0.6m for a full year.	<p>No additional compliance costs are incurred in obtaining a flat tax rate.</p> <p>Removing the requirement to file an end-of-year return will reduce compliance costs for foreign fishing crews.</p>	This option is administratively feasible. An existing tax regime, applying to workers who fall under the recognised seasonal employment scheme, can be extended to non-resident members of fishing crews. The costs associated with implementing of this option would be minor.	This option addresses the problem definition, meets all of the objectives. This option minimises both administration and compliance costs by ensuring correct tax deductions and removing the need to file a return.

Social, environmental or cultural impacts of both options

19. There are no social, environmental or cultural impacts of the options. The groups primarily affected by the amendments proposed are the members of non-resident fishing crews.

Consultation

20. Targeted consultation was undertaken with approximately 800 representatives of the New Zealand fishing industry, on the proposed tax regime to be put in place to ensure compliance while making payment of tax easier and fairer for non-resident crew under the new reflagging regime. Feedback from the consultation has been positive overall. The received feedback helped to shape the preferred policy solution – that is, the introduction of the new tax mechanism for non-resident fishing crews.
21. Submissions were received from six submitters: Independent Fisheries Limited, Sanford Limited, Sealord Group Limited, Solander Maritime Limited, Talleys Fisheries Limited, and the New Zealand Council of Trade Unions. The Treasury and the Ministry for Primary Industries have also been consulted.
22. All submitters supported the introduction of the 10.5% flat tax rate on New Zealand-sourced income of non-resident members of fishing crews, and that the requirement to file tax returns for the members of non-resident fishing crews be removed.
23. In relation to the ACC earner premium, some submitters stated that the applicable rate should be that in force at time of the deduction from wages, and that it should not be set at a 1.7% flat rate. This submission has been accepted.
24. Further in relation to the ACC earner premium and the ACC employer contribution, some submitters stated that it should not be payable, as they use private insurers instead. This submission has been declined because, in accordance with the Accident Compensation Act 2001, employers have to deduct the ACC earner premium from wages paid to employees, and Inland Revenue has to forward this premium to the Accident Compensation Corporation. As to the ACC employer contribution, this is the sole responsibility of the Accident Compensation Corporation.
25. The majority of submitters proposed that all non-resident crew members, including captains, be subject to the same mechanism, including the 10.5% flat tax rate. Although captains earn incomes higher than those of the rest of the non-resident crews, the majority of submitters advocated for equal tax treatment of captains to reduce compliance costs on the captains and minimise administrative costs to their employers and to Inland Revenue.
26. Several submitters asked for clarification on how to determine what portion of income is subject to New Zealand tax. New Zealand fishing companies that use non-resident fishing crews engage them on different bases, and the duration of employment contracts can differ from several weeks to several months.
27. One submitter proposed a “rolling average” method, under which the portion of the New Zealand-sourced income in any current year is calculated on the basis of the data from the previous five income years. This submission was declined because of its overall complexity: if the submission was accepted, recently established fishing companies would

not be able to use it, because of the lack of data. Additionally, using the “rolling average” method would require recalculation of the portion of time spent by non-resident fishing crews within New Zealand’s territorial limits. Therefore, it is doubtful that this method would result in reduced compliance costs.

28. To accommodate all circumstances, the portion of income that is sourced in New Zealand and is therefore subject to New Zealand tax should be based on the actual percentage of time spent by employees within New Zealand’s territorial limits.

Conclusions and recommendations

29. Introducing the new mechanism for members of non-resident fishing crews is the preferred option because it is an effective and simple solution. It achieves the objective of ensuring that the members of non-resident fishing crews are taxed at the correct tax rate and are not required to file tax returns. It also ensures that the implementation of the new tax mechanism is administratively feasible and can be done in a timely and cost-effective manner by Inland Revenue.
30. The status quo is not favoured because it is likely to involve unnecessary complexity for the members of non-resident fishing crews, as well as overtaxing their earnings.

Implementation

31. The amendments will be included in the Fisheries (Foreign Charter Vessels and Other Matters) Amendment Bill, or will form part of the Taxation (Annual Rates, Employee Allowances and Remedial Matters) Bill, by way of a Supplementary Order Paper at the Committee of the Whole House stage of the relevant bill. It is essential that these amendments are passed at the earliest available opportunity, to provide for certainty of tax treatment of the members of non-resident fishing crews.
32. The necessary legislative changes will be made to the Income Tax Act 2007 and Tax Administration Act 1994 to put this taxation mechanism into effect, with application from 1 October 2014.
33. There should be no significant implementation issues with the amendments. Inland Revenue will communicate the change in the rules through existing channels, including updating its guides.
34. The new rules will be administered by Inland Revenue as part of its business as usual activities.

Monitoring, evaluation and review

35. There are no specific plans to monitor, evaluate and review the changes under the Income Tax Act 2007. If any concerns are raised, officials will determine whether there are substantive grounds for review under the Generic Tax Policy Process (GTPP). Inland Revenue will administer the new regime as part of its “Business as Usual”.
36. In general, Inland Revenue’s monitoring, evaluation and review of new legislation takes place under the GTPP. The GTPP is a multi-stage tax policy process that has been used to

design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and the review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external issues to be addressed are also built into this stage. In practice, any changes identified as necessary for the new legislation to apply as intended would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.