Tax Alert

A focus on topical tax issues – June 2015

In this issue

Existing property tax rules to be bolstered

By Iain Bradley and Veronica Harley

On 17 May 2015 the Government announced as part of the budget 2015, proposals to bolster the existing tax rules and improve compliance in respect of property transactions.

Amongst the compliance measures announced is a "bright-line" test which will tax residential property sold within two years of purchase. This bright-line test will not apply to a seller's main home, inherited property from a deceased estate or that which is transferred as part of a relationship property settlement.

Despite some media reports, this is not a capital gains tax as such. Essentially it strengthens a long-standing rule which already taxes gains made where land is acquired for the purpose of, or with the intention of selling it. The problem with the existing rule is that savvy taxpayers can work around it to a degree and it can be difficult for Inland Revenue to set about proving that an intention to sell existed at the outset. A bright-line test takes away any argument over having to prove or disprove this intention. Inland Revenue is clearly aware of the so-called "investors" who turn over rental properties in short succession and this rule will impact this group.

Whether two years is the right length of time for a bright-line test remains to be seen. It would appear to be a somewhat arbitrary line in the sand. On the one hand, it may create just enough doubt in a speculator's

Continued on page 2...

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mind at the time of purchase about what the state of the market will be in two years' time – albeit that a taxed profit is better than no profit at all. For those that argue it is not long enough, there is always the existing rule for Inland Revenue to fall back on in any event. If a pattern of buying and selling properties "around the two year mark" emerges, Inland Revenue may view this as supporting an argument that there was always an intention to sell at the outset. On the other hand, any bright-line test at all could have a detrimental effect for those seeking to purchase homes and result in housing stock being tied up longer as investors hold onto residential property for at least two years.

We still need the finer details of these measures. An issues paper will be released in July 2015 for consultation with the final measures being introduced in a tax bill scheduled for late August 2015. The bright-line test will apply to properties bought on or after 1 October 2015 with any profits being taxed at the marginal income tax rate of the seller.

A number of other property compliance measures were also announced at the same time which target non-resident buyers and sellers of property.

- All non-residents and New Zealanders buying and selling any property other than their main home, will need to provide a New Zealand IRD number as part of the usual land transfer process with Land Information New Zealand.
- All non-resident buyers and sellers must provide their tax identification number from their home country, along with current identification, such as a passport.

- To ensure that there is compliance with anti-money laundering rules, all non-residents purchasing New Zealand property must have a New Zealand bank account before they can get a New Zealand IRD number.
- The Government will also investigate a withholding tax for non-residents selling residential property. Indications are that such a withholding tax will be automatically withheld on such transactions which will then require the non-resident to apply for a refund from Inland Revenue to the extent applicable. This in turn raises interesting issues about which intermediary will be required to withhold such a tax from the sales proceeds and the compliance costs of doing so (i.e. would this be the bank or lawyer responsible for withholding the tax and passing it to Inland Revenue?) Officials will consult further about this with the withholding tax to be introduced mid 2016.

These compliance measures look like a sensible step in seeking to ensure property investors, whether they are non-residents or New Zealand residents, pay their fair share of tax in relation to property sales. It will also help to identify the true overseas buyers and sellers of property and ensure tax can be collected at source more easily from those non-residents, particularly those subject to the two year bright-line test that might otherwise escape the New Zealand tax net.

The measures may also act as a deterrent for some property investors speculating in the New Zealand property market. Those that buy and sell quickly in the hopes of making a tax free gain may now be more cautious about doing this or at least how much they are prepared to pay for a property, which in turn may just free up some housing stock for other buyers looking for a place to set down roots and call home.

For more information, please contact your usual Deloitte advisor.

Government issues paper on NRWT: related party and branch lending

By Bruce Wallace and Patrick McCalman

On 7 May 2015, the Government issued an Officials' issues paper "NRWT: related party and branch lending". Interest, dividends and royalties sourced in New Zealand and paid to non-residents (known as non-resident passive income or NRPI) is subject to non-resident withholding tax (NRWT).

This issues paper is focussed on strengthening the NRWT rules in relation to interest arising on related party debt and it also proposes material changes to the application of the Approved Issuer Levy (AIL) regime.

NRWT is levied on interest at the rate of 15% but is generally reduced to 10% when a double tax agreement is applied. Officials consider that the NRWT rules sometimes have limited application due to the wide variety of transactions available to prevent or delay the payment of interest with a New Zealand source. In certain cases, where interest is paid to a non-associated non-resident lender, NRWT is payable at a rate of 0% and instead the approved issuer pays a levy which is calculated at a rate of 2% on the interest paid.

While this issue is a New Zealand domestic law issue, it has been included as an item under the base erosion and profit shifting (BEPS) project in the Government's Work Programme as the primary focus is on the appropriate taxation of income derived by non-residents from New Zealand. The Minister of Revenue Todd McClay states "Acting to remedy this deficiency in our tax laws is part of New Zealand's response to the issue of multinational tax avoidance".

As a starting point, the proposals are extremely wide-reaching. It will be important for all arrangements to be tested under these proposals in order to identify any cases where the scope should be narrowed and unintended consequences addressed.

The proposals can be grouped in the following three categories:

Preventing arbitrage of NRWT rules with financial arrangement rules

Essentially under current law, NRWT is not payable to Inland Revenue until the income on which it is payable is distributed, credited or dealt with on the non-resident lender's behalf. However, from the New Zealand borrower's perspective, the financial arrangement rules apply to determine the income or expenditure and timing of any interest deductions (typically on an accrual basis). This potential mismatch of the tax rules can mean a deduction can be claimed by the New Zealand borrower under the financial arrangement rules, while the NRWT liability may be deferred. It may also result in amounts that are essentially interest not being subject to NRWT.

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The Government has decided that this is not the correct policy outcome. The paper has three suggestions for addressing this mis-match and shoring up the tax base. These changes will only apply to certain arrangements between associated persons. These are to:

- Broaden the kind of arrangements that give rise to NRPI by amending the definition of "money lent" for the purposes of the NRWT rules so that there is better alignment between NRPI and financial arrangement expenditure
- Widen the definition of "interest" to bring the rules for determining the amount of NRPI more into line with the financial arrangement rules
- In certain cases, impose NRWT annually on an amount equal to the financial arrangement income that would have arisen if it were subject to the financial arrangement rules. That is, imposing NRWT on accruing income calculated according to a YTM or expected value method, rather than on payments made where there is a more than immaterial element of deferral. The detail behind this is quite complicated.

Preventing associated persons accessing the AIL rules

The effect of NRWT on the cost of capital for New Zealand borrowers was recognised back in 1991 when the AIL regime was introduced. Under this regime, a person to whom money is lent, may elect to pay AIL in relation to a security for the purposes of the NRWT rules. AIL can only be used where the borrower is not associated with the lender. The reason for this restriction is that related-party lending can be a substitute for equity from a parent and be used to increase interest deductions thereby reducing the taxable profit that would arise if the parent invested with equity. AIL at 2% on related party interest would be inappropriately low when that interest deduction reduced the New Zealand borrower's taxable income, which is generally subject to a 28% or higher income tax rate. Officials consider that the current restrictions which prevent related parties from accessing the AIL regime are not robust enough and can be easily structured around. Therefore the following changes are proposed:

- That NRWT be paid (rather than AIL) on back-to-back loans and other forms of indirect funding
- That NRWT be paid (rather than AIL) in situations where interest is paid to a non-resident who is not associated with the borrower but is part of a group of persons (including non-residents and New Zealand residents) who are acting together and would be associated with the borrower if they were a single entity. This would significantly expand the associated person acting together concept for AIL purposes.
- That AIL be limited to loans where it is expected that more than 75% of the total borrowings will be from a financial institution in the business of lending money to the public or raised from a group of 10 or more associated persons. This test will not apply to a borrower who is a financial institution in the business of lending money to the public.

Restricting the branch exemption

Currently there are exemptions from NRPI for interest payments that are made by foreign branches of New Zealand companies or that are made to foreign companies with New Zealand branches. These exemptions mean that certain interest payments are not currently taxed. Officials now suggest this is not consistent with the policy intent. The proposals therefore include:

- Limiting the existing offshore branch exemption so that interest paid by the offshore branch of a New Zealand resident is subject to NRWT or AIL to the extent that the interest is paid on money which is lent to a New Zealand resident
- Limiting the existing onshore branch exemption from NRWT so that it applies only to interest that is received by a non-resident in connection with a business carried on through a fixed establishment in New Zealand. Where a non-resident operates a New Zealand branch, New Zealand-sourced interest income not connected with their New Zealand branch would be non-resident passive income (NRPI), subject to NRWT or AIL
- Extending the AIL regime to allow members of New Zealand banking groups to access the AIL rules on interest payments to their non-resident associates. The reasoning in the paper notes "this recognises that the owners of New Zealand banks are themselves margin lenders, whose funding in the main is sourced from unrelated lenders. The tax system would be improved by providing them with a transparent way to borrow from offshore with an appropriate level of tax, rather than leaving them to rely on the offshore and onshore branch exemptions, neither of which has a policy which supports its use in this context".

Comment

The reforms proposed will increase the amount of tax that is imposed on borrowing by New Zealand residents from non-residents. They will also have an impact on non-resident direct investment in New Zealand. It will be very important for parties impacted by these changes to engage in the consultation process. This includes both non-resident lenders and New Zealand borrowers.

The issue with taxing cross border lending is whether the non-resident is able to claim a credit in their home jurisdiction for the tax imposed. If not, then that tax cost is likely to be priced into the interest rate they charge and effectively borne by the New Zealand borrower. Given the potential negative effect this could have on New Zealand's economic growth and international competitiveness we would expect that Officials have undertaken appropriate analysis to ensure that these proposals will not have a negative impact on the cost of funding to New Zealand businesses or the level of foreign investment in New Zealand.

These changes represent a radical shift in New Zealand's long standing international tax policy settings which have been in place since at least the 1990s. Inland Revenue is intimately familiar with the outcomes which to date have been blessed from a policy and operational viewpoint. The current rules allow access to international finance markets without an additional tax cost for New Zealand borrowers. It is quite possible that an additional AIL cost will at least in part be passed on to New Zealand borrowers.

The proposals seemingly run contrary to the changes in 2011 which provided limited exemptions from AIL for listed New Zealand dollar bonds. The 2011 changes had their origin in the Capital Markets Task Force which recognised the barrier that AIL imposed on accessing international financial markets. These proposals run contrary to that recognition and essentially seek to go further and limit the access to the AIL regime other than in the context of the banking sector.

In imposing a tax (albeit in some cases a 2% levy), New Zealand is out of step with a number of its trading partners (e.g. Australia, UK and the US) who provide various exemptions from withholding tax in similar circumstances to ensure that tax does not act as a barrier/cost to capital flows.

The proposals are to be introduced in a tax bill scheduled for late 2015. The reforms will generally apply to financial arrangements entered into on or after enactment of the legislation (in the second half of 2016). For financial arrangements entered into before enactment, taxpayers will be required to apply the new rules for the income years following enactment.

Submissions close on 16 June 2015. For more information about these measures, please contact your usual Deloitte tax advisor.

Inland Revenue releases BEPS Questionnaire

Inland Revenue has commenced sending out an **International Questionnaire** to foreign-owned compliance-managed taxpayers and to foreign-owned taxpayers in the Basic Compliance Package process (apart from banks and insurers). The questionnaire is designed to collect key information about financing/ debt and transfer pricing issues for non-resident owned groups of companies operating in New Zealand. This information is sought to assist Inland Revenue with measuring the impact of Base Erosion and Profit Shifting (BEPS) on New Zealand.

The questionnaire will further enhance Inland Revenue's risk assessment processes and will be in addition to the current Basic Compliance Package and Compliance Management process. It will feed into key policy decisions in order to keep New Zealand informed as countries move towards implementing measures arising from the BEPS Action Plan.

In the longer term, Officials have advised that targeted electronic disclosures will be considered as part of the larger Business Transformation programme currently being undertaken by Inland Revenue.

For more information about the questionnaire, please contact your usual Deloitte advisor.

Many NZ Businesses to be affected by Australian Budget GST Changes

By Hana Straight and Sam Hornbrook

If a business makes supplies of services to Australian consumers, the new rules announced in the Australian budget are likely to have an effect.

Australia has recently announced the introduction of the 'Netflix' tax which applies Australian GST to supplies of all services, not just digital services, provided to Australian residents who are not registered (or required to be registered) for GST.

The new rules will apply from 1 July 2017 and will require a business to track who supplies are being made to. If supplies are being made to Australian consumers, an Australian GST registration requirement may arise (the level of the registration threshold is still to be confirmed). Australian GST at 10% would then need to be returned on the supplies.

Given that the GST component will be unrecoverable to the recipient, affected New Zealand businesses will need to consider whether to increase their prices by 10% or shoulder the burden of the GST component themselves, as well as the increased compliance costs.

Consultation is now open on the changes and closes on 7 July 2015.

Given the wide reaching nature of the changes, we encourage all New Zealand businesses to consider the effect and potential obligations that may be created.

If you would like to discuss the changes, please contact your Deloitte advisor.

Further information can be found **here**.

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Tax@hand is our global app which is accessible on all devices. Users have the ability to personalise their news feed and select only topics and geographies of interest by creating an account using a LinkedIn profile. Further, tax@hand has a resources tab which hosts key tax rates and facts for each country which is handy to have in your pocket! There is also a **website** which hosts all the content if you want to take a look at the content. Visit the tax@hand website: **www.taxathand.com**

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What's happening in the world of BEPS?

The Base Erosion and Profit Sharing (BEPS) project is the most significant event on the international tax stage for 50 years. Since its official launch by the OECD and G20 in July 2013, what have been the key developments, both globally and in Asia Pacific? And what has happened in the last six months?

Deloitte has set up the **BEPS Central site** which is your one-stop shop for everything BEPS-related. Here you can find all the official documents on the BEPS project, as well as related Deloitte opinion and analysis.

Another way to keep up with what's happening in the BEPS world is to tune into the Deloitte Dbriefs.

Dbriefs are live online webcasts, aimed at an executive level audience, providing a discussion on relevant business topics which you can access from the comfort of your own office. Attending the live session will count towards CPD credits. Further, sessions are archived for up to 6 months. To access archived sessions see the library **here**.

Special edition webcasts coming up in the next month include:

- BEPS Action 7: Revised Discussion Draft on PE Status (and Related Unilateral Measures in the UK and Australia on "Diverted Profits")
- Cross-border Digital Services: A Brave New World for Indirect Tax?
- Base Erosion and Profit Shifting (BEPS): What's Happened So Far? And What's Next?

To find out more, click **here**

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