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Tax Alert

December 2018

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Merry Tax-mas

By Robyn Walker

There is nothing like the release of a new Taxation Bill in the lead up to Christmas. This time around, it's likely to be everyday New Zealanders who will feel the effects of the Bill in their back pockets when they're doing Christmas shopping about this time next year.

The Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill ("the Bill") contains two fundamental tax changes, and some other remedial matters. The two substantive changes are:

- Introducing an offshore supplier GST registration system for non-residents selling goods to end-consumers in New Zealand. This change will see GST being charged on low value online shopping purchases which may currently escape the GST net. This change was covered in detail in our November 2018 Tax Alert.
- Introducing ring-fencing rules for residential rental properties (discussed below).

Amongst the remedial changes in the Bill are an amendment to the employee share scheme rules to deal with a financial reporting issue; amendments to the trust rules to ensure beneficiaries do not become settlors of a trust when allocated beneficiary income is retained in the trust; a clarification of how the distribution rules work for co-operative companies; clarification on the application of the common reporting standard; a change to how loss of earnings insurance proceeds should be taxed when there is an assignment of rights; a correction

to the GST remote services rules; and a clarification to how GST input tax can be claimed for capital raising costs.

Residential rental ring-fencing of losses

Following on from consultation early this year and announcements in Budget 2018, the Bill contains the legislative details of new rules which will apply to residential rental property from the 2019/20 income year (from 1 April 2019 for most taxpayers).

The Bill may seem innocuous based on its title, but included within its 'remedial' matters are significant amendments to how taxable income will be calculated for rental properties. This change is expected to generate a further $190 million of tax for the Government each year from the 40 percent of property owners regularly claiming residential rental losses.

What is proposed?

The intended outcome of the Bill is that residential property investors will no longer be able to offset losses generated from rental properties against other income (for example salary and wages) to reduce their overall tax liability. To achieve this, property investors will no longer be able to claim deductions in excess of income arising from property. Instead those deductions will be carried forward until there is sufficient income from property (that is, the losses are "ring-fenced" and can only be accessed by earning property-related income in most circumstances).

For investors with more than one property, there will be an option to apply the rules on a portfolio basis (the default approach) or to elect to apply the rules on a property-by-property basis.

What is residential land for the purposes of these rules?

The existing definition of residential land used for the bright-line rules will apply. This definition encompasses land with a dwelling on it, land where there is an arrangement to build a dwelling on it, or bare land that may have a dwelling built on it under the operative district plan rules. Residential land is not limited to land in New Zealand and includes all land (as is the case with the existing 5 year 'bright-line' test). Excluded from this definition is farmland and land used predominantly as business premises.

Exclusions

Property held by widely-held companies is excluded from the rules. So too is property which is a taxpayer's main home, property subject to the mixed-use asset rules, property which will be taxed on sale and certain employee accommodation.

Most notably from the above list, if a taxpayer notifies the Inland Revenue that a property will be taxable on sale (i.e. it is land held in dealing, development, subdivision, and building businesses or was bought with the intention of resale) the ring-fencing rules may not apply. This exclusion exists because there is less concern about allowing rental losses when it is known that any capital gains will be taxed on disposal. The application of this exclusion depends on whether the taxpayer is applying the rules on a property-by-property basis or if all properties in the portfolio will be taxable (the same treatment must apply to the whole portfolio).

What next

The Bill has been introduced into Parliament and still needs to go through full Parliamentary processes. This includes submissions being made by the public (a due date for submissions had not been set at the time of writing this, but this is likely to be late January or early February 2019).

We would expect a number of submissions to be made on the Bill, given the direct impact to the bottom line of many landlords and the imminent application of the rules, with no gentle transition into the rules. We will also watch with bated breath to see what recommendations come out of the Tax Working Group, who are considering the extension of taxation of capital income; the results of which may render these ring-fencing rules largely redundant.

For more information please contact your usual Deloitte advisor.

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Only pay your family what they're worth

By Robyn Walker and James Rigter

As we approach Christmas you're probably thinking about family; well if you're thinking of paying a Christmas bonus to your spouse or hiring your children to work as "interns" over the Christmas holidays, you should be aware that Inland Revenue ("IR") have recently released a draft Question We've Been Asked ("draft QWBA") entitled "What are the requirements for claiming tax deductions for payments to family members for services?"

We've given the answer away with the title of this article, as any excessive remuneration will be treated as non-deductible. The IR also have strict documentation requirements, and depending on whether your business is run through a company it is necessary to seek explicit IR approval in order to claim any deductions.

There are strict requirements to be met if you want to pay 'family members' to work in your business

Who is a 'family member'? The draft QWBA states that a family member is your spouse or partner, parent, sibling, child or other relative such as a sister-in-law or father-in-law.

The draft QWBA highlights three requirements that must be met before a business can claim a deduction for payments to family members for services:

- the family member must provide services to the business;
- the amount paid must not be excessive; and
- if the family member is the spouse or partner of the business owner, the prior approval of the Commissioner of Inland Revenue must have been received before claiming the deduction; unless the business is run through a company.

The consequence of not meeting the above requirements is that a deduction is denied for the amounts paid to the family member. While not explicitly stated by the draft QWBA, the family member will still be expected to return all amounts received as taxable income. When the payer of the remuneration is a company, any excessive amounts paid to a spouse or partner are treated as a dividend.

The draft QWBA makes reference to specific legislation that applies to these scenarios. If you're not aware of the rules, sections DC 5, GB 23 and GB 25 of the Income Tax Act 2007 are the relevant rules.

Section DC 5 states that a person is denied a deduction for a payment to their spouse, civil union partner, or de facto partner for services if the Commissioner has not given approval. The Commissioner may approve deductions only if:

- the Commissioner considers that the payment is for services rendered; and
- the services are not domestic services or otherwise services connected with the home; and
- the payment is incurred by the person exclusively in deriving their assessable income; and
- the approval is granted before the deduction is claimed.

This last limb is important, as the Commissioner will not retrospectively grant approval, so application must be made and approval received before filing a tax return.

In addition to requiring prior approval, the Commissioner also requires detailed record keeping to provide evidence of the services provided by the family members. The draft QWBA recommends wage books, diaries recording the dates, hours worked, and nature of the services provided, along with other evidence. However, even if approval is received and detailed records are kept, if the Commissioner considers the rate of pay is excessive, deductions will be denied (QWBA 14/09 "Income tax – meaning of 'excessive remunerations' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors" is a useful reference point or determining whether an amount paid is excessive).

A good idea, to prevent the Commissioner turning up as the Christmas Grinch, is to ensure payments to any family members are made at a similar rate to what you would pay a third party to carry out the same service.

For more information, contact your usual Deloitte advisor.

Approval is required before filing a tax return in which deductions are claimed in relation to payments for services provided by a spouse or de facto partner

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Snapshot of recent developments

Legislation and policy update:

R&D tax bill

Since our last Tax Alert, the Taxation (Research and Development Tax Credits) Bill had its first reading in Parliament and has been referred to the Finance and Expenditure Committee (FEC). The Government is keen to pass these measures into law in mid-2019. To enable this passage, the submission date on these measures is 14 December 2018 with the report back from FEC to Parliament due on 1 April 2019.

ARMTARM bill

We expect the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill to be reported back from the FEC to Parliament imminently. To remind readers, this bill contains the major changes which are intended to simplify the tax obligations for individuals and allow automated tax refunds (and assessments). As these rules are proposed to apply from 1 April 2019, the bill must be enacted prior to this date. We will report on any developments in our next Tax Alert in February 2019.

GST offshore supplier registration bill

The Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill was read a first time on 11 December 2018 and has been referred to the FEC who will then set a submission date (we think this is likely to be late January or early February 2019).

Increased minimum family tax credit

The Income Tax (Minimum Family Tax Credit) Order 2018 comes into force on 1 April 2019. This order increases the prescribed amount in section ME 1(3)(a) of the Income Tax Act 2007 from $26,156 to $26,572. The prescribed amount is used when calculating the amount that a person may be allowed as a tax credit (referred to in section ME 1 as a minimum family tax credit).

Finalised Inland Revenue items:

Income tax – treatment of the costs of resource consents IS 18/06

On 5 November 2018, Inland Revenue released IS 18/06 Income tax – treatment of the costs of resource consents. This finalised interpretation statement considers the tax treatment of the costs of obtaining a resource consent.

The ability to deduct or depreciate expenditure on a resource consent depends on the type of expenditure and the type of consent. It is necessary to understand the different types of resource consents for tax purposes and to be able to identify what expenditure is included in the cost base of the resource consent (or another asset) for depreciation purposes. These key concepts and a discussion of *Trustpower Limited v CIR* [2016] NZSC are covered in Part One of this statement. The tax treatment varies depending on the circumstances. Part Two of this statement considers the specific situations in which expenditure on resource consents may be deductible or depreciable.

GST – When will goods and services supplied in connection with the repatriation of human remains from New Zealand be zero-rated?

This finalised question we've been asked, QB 18/15 was released on 5 December 2018 and considers the GST treatment of goods and services supplied in relation to the repatriation of human remains from New Zealand overseas. In particular, it considers when the goods and services can be zero-rated. This updates and replaces PIB 168 "GST on Human Remains for Repatriation" (January 1988: 5).

Draft Inland Revenue items for consultation:

Standard Practice Statement – voluntary disclosures ED0201

On 6 December 2018, Inland Revenue released an exposure draft of a standard practice statement ("SPS") on voluntary disclosures for consultation. Section 141G(1) of the Tax Administration Act 1994 allows a shortfall penalty to be reduced if, in the Commissioner's opinion, the taxpayer makes a full and voluntary disclosure to the Commissioner of all the details of the tax shortfall. This statement sets out the factors the Commissioner will consider when forming an opinion as to whether a taxpayer has made sufficient disclosure of all details of the tax shortfall. In particular this draft SPS provides detailed discussion on the four essential elements of a voluntary disclosure. That is, that a voluntary disclosure:

- must disclose a tax shortfall, and
- must disclose all of the details of the tax shortfall, and
- must disclose something to the Commission, and
- must be made voluntarily.

Feedback on this draft SPS can be made until 31 January 2019.

Tax Cases:

Appeal for deductions in relation to expenditure in deriving foreign dividends allowed

NRS Media Holdings Ltd v Commissioner of Inland Revenue [2018] NZCA 472

The Court of Appeal has allowed an appeal from the taxpayer with regard to deductions taken for expenditure incurred in deriving exempt foreign dividends under section DB 55 of the Income Tax Act 2007. The Commissioner had disallowed the expenditure as not having sufficient relationship to dividends paid to it by its subsidiaries as a result of comparing the "nexus" wording in section DB 55 to section DA 1. The Court found that by taking into account the plain words of the section, the statutory context and recorded legislative intent, the ambit of deductibility provided by section DB 55 is to be decided in accordance with general principles of deductibility. The Court also held that the taxpayer had met the required nexus test. It should be noted that section DB 55 has since been repealed as a result of the Controlled Foreign Company (CFC) reforms and the removal of the Foreign Dividend Withholding Payment (FDWP) regime.

Taxpayer's residency appeal denied

Van Uden v Commissioner of Inland Revenue [2018] NZCA 487

Having unsuccessfully challenged decisions in the Taxation Review Authority (TRA) and High Court, Mr van Uden, a ship's captain, who is at sea for approximately eight months every year, appealed to the Court of Appeal in the matter of whether he had a permanent place of abode in New Zealand for the 2005-2009 income years.

The Court dismissed this appeal (following guidance in the *Diamond* case) as the "objective integrated fact assessment" did not support Mr van Uden's characterisation that he felt more connected to Europe and did not have the intention of using the New Zealand property in question as a home.

A consequence of having a permanent place of abode meant that Mr Van Uden was tax resident for these years and therefore liable to pay tax on his interest in his foreign employer's superannuation fund (which was a Foreign Investment Fund or FIF).

Further, because Mr van Uden had not disclosed his FIF income and overseas salary in his tax returns, the Court agreed with the Commissioner's decision to lift the four year time bar allowing the earlier years to be reassessed. Finally, an unacceptable tax position penalty imposed by the Commissioner was also upheld.

Anti-avoidance cased dismissed

Frucor Suntory New Zealand Ltd v Commissioner of Inland Revenue, [2018] NZHC 2860

A win for the taxpayer in this High Court tax avoidance case in which Justice Muir ruled that section BG 1 of the Income Tax Act 2007 had not been appropriately invoked by the Commissioner. The arrangement entered into by Frucor Holdings Ltd involved, among other steps, an issue of a Convertible Note (the Note) to the New Zealand branch of Deutsche Bank, and a forward purchase of shares that the bank could call for under the Note by Frucor's Singapore based parent Danone Asia Pte Ltd.

Justice Muir stated that this was a transaction that had "real and (from a New Zealand perspective) legitimate economic drivers", and was self-evidently more "commercial" than the zero-coupon arrangements in Alesco. Interest was incurred and paid by Frucor both legally and, at a single-entity level, economically. At the time of writing this, it was not known whether the Commissioner would appeal this decision.

Season's Greetings

This is the last Tax Alert issue for 2018, a year that has once again been extremely busy on the tax policy front. We hope you have enjoyed our articles this year.

We would like to send best wishes all our readers for the holiday season and hope you have a relaxing holiday break over the new year.

Tax Alert will return in February 2019.

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