

Tax Alert

A focus on topical tax issues – November/December 2009



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As is usual for this time of year, the government has been very busy of late from a tax point of view. Since our last issue in October, a new tax bill has been introduced, while another one has been reported back on, added to by way of a supplementary order paper and passed. Inland Revenue too has also been busy issuing discussion documents, rulings and exposure drafts.

In this issue, we outline the very important changes to the rules for paying supplementary dividends to non-residents and NRWT changes. We cover the proposed changes to the GST treatment on sales of land and other high-value assets. The Inland Revenue has won a test case in the TRA against a LAQC which was set up by the shareholder to hold her residential

property to enable deductions for interest and property expenses to be claimed. We comment on the reported back changes to the RWT and PIE tax rate alignment measures and briefly outline the contents of the new tax bill introduced which permit retirement savings to be transferred between Australia and New Zealand and tinker with the KiwiSaver rules. There is an article on the finalised list of eligible expenses that can be claimed when relocating employees which may give rise to opportunities when structuring packages. Hopefully there is something for everyone in this bumper issue, which is our last for 2009.

The partners and staff of Deloitte wish all our readers a very merry Christmas, a safe, relaxing holiday and happy New Year. Tax Alert will return in February 2010.

Important changes to supplementary dividend rules and NRWT introduced

Important changes have been made to the rules regarding tax credits for supplementary dividends paid to non-residents in respect of non-portfolio interests (i.e. voting interests of 10 percent or more) in New Zealand companies.

The changes have become necessary as a result of the recently signed, but not yet in force, tax treaties with Australia and the United States which can reduce the domestic rate of non-resident withholding tax (NRWT) on non-portfolio dividends to 15 percent, 5 percent or zero, depending on the shareholder's stake in the company and whether certain other criteria are met. The issue is also relevant for the new Singapore treaty although there is no zero NRWT rate under that particular treaty. It is likely that similar reductions in other treaties will be adopted over time – Canada and the United Kingdom are the next treaties on the list to be updated.

The reduced treaty rates for dividend withholding tax impact on New Zealand's unique supplementary dividend rules which allow a company paying a dividend to a non-resident to pay a supplementary or additional dividend to effectively eliminate the cost of NRWT required to be deducted from the dividends. This supplementary dividend is funded by a tax credit which is able to be claimed by the company paying the dividend. The net effect of the regime is that the total New Zealand tax paid in respect of profits distributed to the non-resident does not exceed the 30 percent company tax rate. These rules are more commonly known the "foreign investor tax credit" rules or the FITC regime.

To complement these changes, a domestic withholding tax exemption from NRWT for imputed non-portfolio dividends paid to non-residents will be introduced from 1 February 2010.

From 1 February 2010, the supplementary dividend rules will no longer apply to dividends paid to non-portfolio investors. The rules will only be able to be used for dividends paid to a non-resident that holds less than 10 percent in direct voting interests in the company where the post-treaty rate is 15 percent or more. The provisions dealing with supplementary dividend holding companies are also to be repealed from the 2014 income year.

To complement these changes, a domestic withholding tax exemption from NRWT for imputed non-portfolio dividends paid to non-residents will be introduced from 1 February 2010. This means dividends paid by a company to a non-resident with a 10 percent or more direct voting interest will have a zero rate of NRWT. The zero rate only applies to the extent to which a dividend is fully imputed. It also applies to interests of less than 10 percent but where the post-treaty rate is less than 15% - this latter case would be relevant where the beneficial owner is the contracting state, a political subdivision or local authority (including a government investment fund.)

For unimputed dividends, the domestic rate of NRWT is 30 percent but a tax treaty could reduce this to 15 percent, 5 percent or zero depending on what criteria are met.

The following table summarises how the new domestic tax rules and new tax treaties will broadly operate when a dividend is paid by a New Zealand company to a non-resident investor:

10 percent or more direct voting interests or less than 10 percent direct voting interest and post-treaty NRWT rate is less than 15%	Supplementary dividend rules are not available(i.e. no FITC) Fully imputed dividend – domestic NRWT rate is nil
Less than 10 percent direct voting interests and post-treaty NRWT rate is 15% or more	Can pay a supplementary dividend to non-resident (i.e. FITC applies) Fully imputed dividend – domestic NRWT rate is 15 percent

The changes have been introduced by way of a supplementary order paper amending the Taxation (Consequential Rate Alignment and Remedial Matters) Bill which was passed through Parliament at the end of November. For specific advice relevant to your situation, please contact your usual Deloitte tax advisor.

GST– Major changes on the horizon

By Jeanne du Buisson and Allan Bullôt

A discussion document on 'GST: Accounting for land and other high-value assets' has been released. It explores changes to the GST regime to reduce GST risks to the Government for transactions between businesses. The Government considers it is losing at least \$50 million per annum, predominantly from land transactions with insolvent property developers.

This discussion document follows the June 2008 issues paper and the submissions that followed. The proposed changes will see the most significant changes to GST since the financial services changes in 2005.

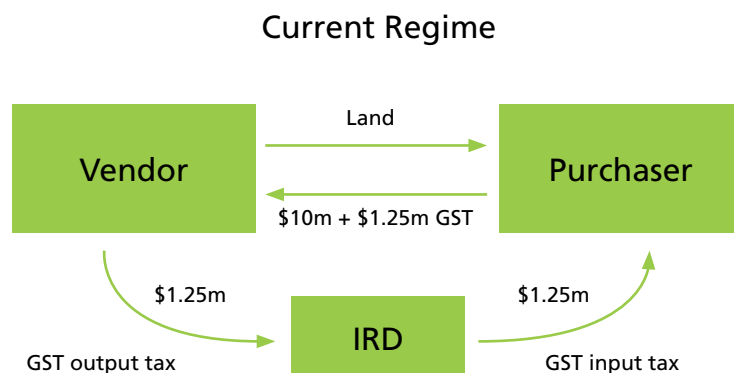
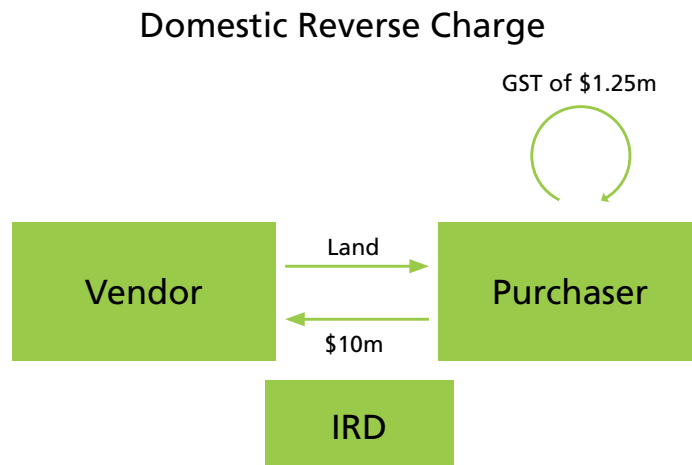
The most significant proposal in this document is the introduction of a Domestic Reverse Charge (DRC) mechanism that is proposed to apply to transactions involving land, transfers of a 'going concern', and other high-value transfers (over \$50 million). The Government is concerned with the risks of not collecting GST, particularly on transactions involving land.

Of concern to the Government are large GST claims but with no corresponding output tax payments, principally due to Inland Revenue having a lower priority for the GST debt from an insolvent GST registered vendor, than the priority held by a secured creditor. A DRC tries to eliminate this problem.

How does it Work?

The DRC is proposed to be compulsory and would shift the obligation to charge and return GST from the vendor to the purchaser in certain circumstances. The purchaser would account for the output tax and claims the input tax simultaneously and the vendor would not be liable for output tax. This would eliminate cash flow issues for both the vendor and purchaser typically associated with paying/claiming back GST, but will also ensure that GST refunds are not paid without the corresponding output tax payment.

The diagram below illustrates the difference between the existing GST regime and the treatment under a DRC:



As shown, the purchaser is no longer required to pay the GST component to the vendor under the proposed regime. The purchaser claims input tax at the same time as accounting for the output tax liability. It is proposed that the DRC be mandatory for the following transactions between GST registered persons:

- Land
- The sale of a business as a going concern
- High-value transactions (over \$50 million excluding GST)

Our Thoughts on the DRC

The driving reason behind the introduction of a DRC is Inland Revenue's perception of a significant loss of GST on transactions undertaken by insolvent property developers, and this is the reason for the proposals being compulsory. From a practical perspective the DRC will have the same impact for secured creditors of insolvent GST registered vendors as would occur if the priority for GST due to Inland Revenue was increased over the priority of the secured creditor.

We support the introduction of a DRC on a voluntary basis as a simplified and cheaper alternative to the current practice of using GST offsets for high value asset transfers between GST registered entities.

However the compulsory nature of a DRC may introduce additional uncertainty for some transactions, particularly where there are questions on whether a supply is indeed a "going concern" or not. Given going concern questions have generated more GST court cases than any other issue in New Zealand GST, the proposed DRC approach for going concerns seems to be a step backwards from a practical perspective. By removing the requirement for the parties to agree in writing that there is a transfer of a going concern we are arguably back in the bad old days of having uncertainty as to the GST treatment of significant transactions, something that should be avoided.

We disagree with the use of the \$50 million criteria for compulsory DRC and instead would propose that there be a voluntary option to use a DRC for transactions not involving land or going concerns above a certain value.

There are a number of other more detailed aspects of the proposed DRC, including the time of supply rules, which will also likely need to be altered.

The proposed changes will have wide reaching impact if implemented and will require substantial changes to the GST accounting systems of many businesses. The DRC proposal is a significant change with broad application. While aspects of a DRC are positive, the compulsory nature of the change will cause issues.

There are a number of other proposals in the document which for space reasons we haven't commented on in this print edition of Tax Alert, but you can find out about these in our online version via our website.

Deloitte is involved in on-going discussions with Inland Revenue on these proposed GST changes. Submissions close on 18 December 2009. If it goes ahead, we expect the DRC to be included in the early 2010 Tax Bill.

If you have any queries on the proposed changes, please contact your Deloitte tax advisor or one of our specialists in the Indirect Tax Team.



IFRS for Income Tax Update

By Iain Bradley

As we discussed in our article "Taxing times ahead for taxpayers with uncertain tax positions" in the June 2009 edition, the International Accounting Standards Board (IASB) issued an Exposure Draft ED/2009/2 Income taxes on 31 March 2009 with a view to replace the current IAS 12.

During the consultation process, the IASB received 168 comment letters. While most respondents were supportive of the two key objectives of this ED, being (1) improvement of IAS 12 and (2) convergence with US GAAP, there was a general concern that the ED failed to achieve them.

The IASB noted that the proposals contained in the ED did not receive much support, the biggest concern being the treatment of uncertain tax positions and the associated compliance costs.

The IASB is now reconsidering the direction of the income tax project to undertake a short-term convergence project with a major focus on priority issues. These priority issues are likely to include uncertain tax positions and the tax effect of property revaluations.

It is possible that the new fast-tracked project may include the US "FIN 48" requirements for uncertain tax position accounting. Entities should remain vigilant, particularly in the contentious and commercially sensitive area of uncertain tax positions as the experience with FIN 48 in the US indicates that this area can be a real commercial concern warranting careful planning. For further information on this issue, please contact Iain Bradley.

Rental of home via LAQC arrangement deemed tax avoidance

The Taxation Review Authority (TRA) has held that an arrangement whereby "Mrs B" rented her residential home from a loss attributing qualifying company (LAQC) in which she was the sole shareholder in a manner which generated tax losses, to be a tax avoidance arrangement. Justice Barber has held that on "the balance of probability, the arrangement must have been designed to circumvent the prohibition on the deductibility of private or domestic expenditure." In his view, the economic substance of the transaction was that the property was the private residence of Mrs B and the LAQC's tax losses were generated by tax deductions arising from expenditure of Mrs B, which would normally be private to her.

Following the two step approach laid down in the *Ben Nevis* judgement, Justice Barber found that while each component step fell within the black letter law of the relevant provisions, namely the deduction and LAQC provisions, the arrangement, when viewed as a whole was not the kind contemplated by Parliament when enacting these provisions. In addition, the authority held that this arrangement was not commercially realistic and involved pretence. For example, there was no tenancy agreement between Mrs B and the LAQC, no bond was ever paid by Mrs B, the LAQC didn't operate a bank account and it was Mrs B that incurred the expenses with the amounts charged to the LAQC via journal entries and recorded as shareholder loans. Justice Barber also discarded the defence that the effect of tax avoidance was merely incidental and that the LAQC had property investment, asset protection and estate planning as its main purposes for entering the arrangement. He stated that having only a sole shareholder rent the property is to some degree inconsistent with a property investment purpose as no external funds were ultimately received into the so-called business. There was no evidence that Mrs B, being an employee, has any trade creditors or was carrying out any business which required protection from creditors. Thirdly, estate planning would explain the use of a trust but not the use of a LAQC.

This decision may not be a surprise to most given the Commissioner has publicly raised concern about such arrangements with the issue of an Inland Revenue Alert in 2007. It should also be noted that it is a TRA decision only and it was not clear at the time of writing this article whether an appeal would be lodged.

RWT tax rate alignment bill passed

In early November, the Finance and Expenditure Committee (FEC) reported back on the taxation bill which seeks to align the RWT tax rates on interest and the PIE tax rates with the income tax rates. Our August 2009 Tax Alert covered the original bill proposals in detail. Apart from the change to default rates for RWT on interest noted below, the bill passed through Parliament at the end of November with no other major changes.

Essentially the rate of RWT on interest that must be withheld by the payer will depend on whether a tax file number (aka an IRD number) is provided by the recipient to the payer and also whether the recipient has provided a rate election to the payer. Broadly from 1 April 2010, an interest recipient will be able to select the rate relevant to their marginal tax rate whether this be 12.5%, 21%, 33% or 38% for individuals or 30% or 38% for a company. In electing the lowest rate of 12.5%, an individual must have a reasonable expectation at the time of election that their income will be \$14,000 or less.

Where a tax file number is provided but no rate election made by the recipient, the bill had proposed to increase the default rate of RWT for those with bank accounts existing prior to 1 April 2010 to 21% from 1 April 2010 and then to 38% from 1 April 2011 unless they confirmed their correct rate before this date. The FEC has recommended that for existing accounts this default rate should stay at 21% and not increase on 1 April 2011. One reason given is that this would impose significant administration costs on the payer to notify their existing clients that the default rate is increasing. However the Inland Revenue will be able to instruct interest payers to shift individuals to a more appropriate rate should it determine that the RWT rate is inconsistent with their marginal rate. If a person is moved to a higher rate by the Inland Revenue, the payer would then be able to elect another rate subsequently. This would be necessary in cases where Inland Revenue was not aware of all facts to be taken into account such as available losses to offset or where taxable income varied from one year to another for various reasons.

However for those taxpayers that open a new bank account from 1 April 2010 and do not elect a rate, the default rate will be set at 38% regardless of whether a tax file number is provided. This is to provide an incentive to select the appropriate RWT rate for their marginal rate when they open a new account at the same time they provide the payer with their tax file number.

For a taxpayer that has previously made an election at 39%, this rate is no longer an option from 1 April 2010 and so the intention is that the rate will automatically drop to 38% without the taxpayer having to again make an election.

For more information on these proposals, please contact your usual Deloitte tax advisor.

The Inland Revenue will be able to instruct interest payers to shift individuals to a more appropriate rate should it determine that the RWT rate is inconsistent with their marginal rate.

Relocating, tax free

By Justine Tuhakaraina-Reed and Mike Williams

The long awaited reforms to relocation expenses received royal assent on 6 October 2009 and have now been enacted to apply retrospectively from the 2003 income year. The Inland Revenue has published a list of eligible relocation expenses and these can now be paid tax free. For employers who have paid tax on relocation items provided to employees, they can now claim a refund of that tax as far back as the 2003 income year.

The Inland Revenue's list of eligible relocation expenses includes all reasonable expenses associated with relocation that you would expect to see. Indeed, tax agents were consulted to determine what expenses are usually incurred in moving employees nationally and internationally and therefore the list is relatively comprehensive. Costs such as transportation of the assignee and their family to the host location, the shipping of household goods, searches for housing and initial accommodation costs on arrival in the host location etc are all noted. The list also includes some other costs that we might not have been expecting to see:

- A familiarisation trip to the new location immediately prior to relocation, for a maximum of 7 days in the new location (this excludes travelling time between the old and new locations). This has been increased from the 5 days initially proposed and will give New Zealand employers an opportunity to offer a reasonable look-see visit to potential employees from overseas;
- Costs associated with breaking rental leases, selling an existing home and disposing of personal effects are also included as eligible relocation expenditure. However, capital losses incurred in the selling of the existing home cannot be paid tax free;
- The costs associated with a temporary replacement vehicle while awaiting transportation of the employee's own vehicle (or one month's hire where the employee does not own their own vehicle). This was not originally included in the Inland Revenue's original proposed list but as the use of a vehicle is fairly standard when relocating an employee, it makes sense that it is now included;

- Accommodation or value of employer provided accommodation once the employee has arrived in the new location, for up to three months after arrival can also be provided tax free. We consider the three month time limit to be generous and allows sufficient time for the employee to find suitable accommodation;
- A catch-all \$500 for miscellaneous relocation costs to cover any other expenses not expressly covered in the list of eligible expenses.

Most employers have been applying a pragmatic approach to relocation expenditure for some time. For employers who have paid tax on relocation related costs, an opportunity now exists to make a claim for a refund of the tax paid.

Going forward, this clarification provides significant opportunities for New Zealand employers when structuring employment agreements and remuneration packages for relocating employees and international assignees.

If you have any queries in relation to the above matters or would like to discuss further, please contact your normal Deloitte tax advisor or one of our GES specialists.



New Tax Bill introduced

On 19 November 2009, the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill was introduced into Parliament. This bill contains measures to enable portability of retirement savings between a New Zealand KiwiSaver scheme and an Australian complying superannuation fund.

Trans-Tasman Super portability

The key point of these measures is to protect the value of savings on transfer so that entry or exit taxes will not arise in the respective countries. When a member of a KiwiSaver scheme permanently emigrates to Australia, they will be able to transfer all of their crown contributions including member tax credits. The retirement savings will not be able to be drawn in cash but must be transferred in full to an Australian complying superannuation fund.

As regards when Australian-sourced retirement savings are transferred to a New Zealand KiwiSaver scheme, a person who is retired may withdraw their Australian sourced retirement savings at age 60 (rather than the normal age of 65). The Australian-sourced contributions will not qualify for the annual member tax credit. The Australian-sourced funds may not be withdrawn to use for the purchase of a first home, diverted to a member's mortgage repayments, nor counted towards eligibility for the deposit subsidy.

KiwiSaver changes

Changes have been made to the KiwiSaver rules to accommodate the trans-Tasman portability issues above. In addition new rules have been introduced to apply from 1 July 2010 which prescribe how under-18 year olds may enrol in KiwiSaver. Children under 16 years may only be enrolled by their legal guardian and may not enrol themselves. Children between 16 and 17 must co-sign with their legal guardians in order to enrol.

Other matters

Following consultation earlier this year, some amendments are proposed to the binding rulings regime, particularly concerning what the Commissioner can and cannot rule on. There are also measures to cancel branch equivalent tax account (i.e. BETA) debits that arose on conduit relieved dividends. Since the repeal of the conduit regime as part of the recently enacted international reforms, it has emerged that some companies may still be able to use their BETA debit balances to effectively continue conduit tax relief and so the bill includes measures to prevent this.

Queries or comments regarding Alert can be directed to the editor, Veronica Harley, ph +64 (9) 303 0968, email address: vharley@deloitte.co.nz.

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The Editor, PO Box 33, Auckland.
Ph +64 (0) 9 309 4944.
Fax +64 (0) 9 309 4947.

New Zealand Directory

Auckland PO Box 33, Ph +64 (0) 9 309 4944, Fax +64 (0) 9 309 4947

Hamilton PO Box 17, Ph +64 (0) 7 838 4800, Fax +64 (0) 7 838 4810

Wellington PO Box 1990, Ph +64 (0) 4 472 1677, Fax +64 (0) 4 472 8023

Christchurch PO Box 248, Ph +64 (0) 3 379 7010, Fax +64 (0) 3 366 6539

Dunedin PO Box 1245, Ph +64 (0) 3 474 8630, Fax +64 (0) 3 474 8650

Internet address <http://www.deloitte.co.nz>

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