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Tax Alert

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Changes to the property tax landscape

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Changes to the property tax landscape

By Robyn Walker

In late March 2021 the New Zealand Labour Government shocked property owners around the country with some major changes to the taxation of land – a bold move not often seen under MMP, potentially leaving some with a new found appreciation of the rumoured "handbrake" New Zealand First applied to the last Government, and some happy to finally see some action.

Much of the focus has been on the reaction to the announcement: the aggrieved landlords, the businesses worried that they may be next, the policy wonks upset about the lack of advice and consultation. However, subject to some finessing of the finer details, the proposals are said to be set in stone; and so rather than focusing on whether this is good or bad policy, in this article we focus on the actual proposals and some frequently asked questions.

The changes – put simply

- The bright-line test has been changed from 5 years to 10 years for property subject to a binding agreement dated on or after 27 March 2021. An exclusion applies for "new builds", which will remain subject to a 5 year bright-line test.
- The application of the "main home exemption" from the bright-line test is modified.
- Laws have been changed to put short-stay accommodation in what are essentially "normal houses" on an equal tax footing to long-stay accommodation. Properties used for Airbnb, bookabach etc are brought within the definition of "dwelling" and therefore should be subject to the bright-line test and certain other rules applying to long-term accommodation.
- Interest deductions on residential property acquired on or after 27 March 2021 will not be allowed from 1 October 2021. Interest on loans for properties acquired before 27 March 2021 can still be claimed as an expense, but the interest deductions will be phased out from 1 October 2021. An exclusion from the new interest denial will apply for "new builds".
- If money is borrowed on or after 27 March 2021 to maintain or improve property acquired before 27 March 2021, it will be immediately non-deductible rather than subject to the phase out rule.
- Property developers should not be affected by these changes and will still be able to claim interest as an expense.

What can be influenced?

The changes to the bright-line test have been put in legislation already, but the changes to interest deductibility has not. The government has indicated that it will undertake consultation on aspects of the rules. This is expected in late May, with legislation following shortly thereafter.

What is being consulted on	What is not being consulted on
• The definition of a "new build" • How to ensure "business" loans are still deductible • What interest deductions can be claimed if you end up taxed under the bright-line test	• The change to the bright-line test • The main home exemption • Disallowing interest deductions • Exempting new builds

Frequently asked questions

I have just bought a property – how do I know what rules apply?
The key will be to establish whether a binding contract was entered into on or after 27 March 2021. This can include a contract which is subject to conditions (e.g. builders report, finance etc). If an offer was submitted before 23 March 2021 (the date of the announcements) which was unable to be withdrawn, that property will be treated as being acquired before 27 March 2021. If a purchaser has made an offer but has an "or nominee" clause (i.e. it is not yet known who the intended legal owner will be), the date of the nomination will be the relevant date, even if the contract is entered into before 27 March 2021.

What is the change to the "main home exemption"?
Any residential property that has been used as the owner's main home for the entire time they owned it will continue to be completely exempt from any bright-line test.

For residential properties acquired on or after 27 March 2021, including new builds, there is now a 'change-of-use' rule. This will affect the way tax is calculated if the property was not used as the owner's main home for more than 12 months at a time within the applicable bright-line period. This rule taxes any gain on the property in proportion to the time it is not a main home. For example, if a property has been owned for 9 years which within that time has been rented out for 2 years, 2/9th of the gain on the property will be taxable.

What is a "new build"?
This is still to be consulted on. Intuitively it should be newly constructed buildings, but this may be defined in some way which connects to the date of completion of the building; i.e. when it received a code of compliance certificate. Consultation should also cover trickier issues, such as whether an extensive renovation can be a new build, and what happens when a house is demolished and replaced with a new one (meaning in total New Zealand's housing stock hasn't been increased in the process).

If I end up paying tax on a property, can I claim deductions then?
New Zealand taxes net income, so under our current tax framework if an amount is taxable income, you should normally be entitled to claim deductions for the cost of earning that income. If you acquired property with the intention of selling it, you'll be taxable on the sale regardless of how long you owned it. You'll be entitled to claim a deduction for the costs of acquiring and improving that property at the time it is sold. Anyone caught under the bright-line test will be able to claim a deduction for the cost of the property. Intuitively that should also include any interest costs, but this is still to be consulted on.

How are interest costs being treated?
For property acquired before 27 March 2021, the ability to deduct interest will be phased out over a four-year period, starting from 1 October 2021. Any "new borrowing" after 27 March 2021 will be immediately non-deductible.

Income year (for standard balance date)	Percent of interest you can claim
1 April 2021 – 31 March 2022 (transitional year)	1 April 2021 to 30 September 2021 – 100% 1 October 2021 – 31 March 2022 – 75%
1 April 2022 – 31 March 2023	75%
1 April 2023 – 31 March 2024	50%
1 April 2024 – 31 March 2025	25%
1 April 2025 onwards	0%

What is new borrowing?
This may be wider than you think, and still needs to be clarified. What we know is that:

- If a property was acquired before 27 March 2021, you can deduct the interest on the loan under the phased-out approach. This will include loans drawn down for such property if the property settles after 27 March 2021.
- If you incur additional debt (from drawing on the same loan or taking a new loan) on or after 27 March 2021, interest on that portion of the loan will not be able to be claimed as an expense from 1 October 2021 onwards. Anyone with a floating mortgage may need to keep a close eye on account balances.

For more information, contact your usual Deloitte advisor.

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Latest tax legislation solves some problems you didn't know you had

By Robyn Walker

It's fair to say that tax can be quite complex sometimes. The length of the Income Tax Act 2007 ("the ITA07") is testament to this fact (the current PDF version on the Parliamentary Counsel Office website runs to 3,670 pages); and it's inevitable that sometimes there are going to be some quirks and unexpected outcomes hidden within all those pages.

Fortunately, amongst other things, within its 114 pages, the recently enacted Taxation (Annual Rates for 2020/21, Feasibility Expenditure and Remedial Matters) Act 2021 ("the amendment act") makes some amendments to fix some quirks within the legislation; but potentially with every problem that is fixed, another one takes its place. In this article we explain a few of the changes in the new amendment act which may fix problems you didn't know you had. We also recap some of the other major reforms included in the amendment act.

The amendment act has not passed through Parliament without some controversy. There are a number of taxpayer unfavourable changes which came under criticism from submitters and even members of the Finance and Expenditure Committee and its independent advisor, but the changes still made their way into legislation (changes to GST and mobile roaming costs and purchase price allocation rules fall into this camp).

Likewise the announcement that the bright-line test was being extended from 5 to 10 years was put straight into the legislation via a supplementary order paper and turned into enacted legislation in less than a week.

Another criticism which can be levied against the amendment act is its extensive use of retrospective legislation – 207 clauses or subclauses come into force before the date of royal assent. As the Clerk of the Finance and Expenditure Committee pointed out during the legislative process, retrospective provisions were used extensively, without justification. New Zealand's Legislation Guidelines prescribe that legislation should be prospective not retrospective, with provision that retrospective legislation may be appropriate in some limited circumstances, such as if it is intended to be entirely to the benefit of those affected, or it validates matters generally understood or intended to be lawful but are not due to a technical error. It's understood that most retrospective changes in the amendment act are merely technical tidy-ups which are intended to be taxpayer favourable.

Donated Trading Stock

Section GC 1 of the ITA07 is a section that many taxpayers may currently be oblivious to. What this section says is that trading stock is always deemed to be disposed of for market value. The background to this section was that in the 1940's (when the total length of New Zealand's tax legislation ran to around 50 pages) there were some examples of retiring farmers gifting livestock to relatives, but as a quirk of the legislation, the relative was still able to claim a tax deduction for the market value of the livestock. To put a stop to this, an equivalent of today's section GC 1 was created to ensure that the retiring farmer had to pay tax.

Fast-forward to the 21st century and life is different now. There are numerous different regimes that exist to protect the tax base from businesses trying to give trading stock away in a mischievous fashion; however section GC 1 still exists and potentially captures a number of one-sided "social good" transactions within its ambit. Potentially caught transactions include supermarkets donating (not quite) expired food to foodbanks rather than

putting it in the bin, retailers giving away bottles of water to people following a natural disaster, hand sanitiser businesses donating their stock to front-line essential workers etc. There are some arguments to support section GC 1 not applying in these circumstances, but it's far from clear.

The issue of section GC 1 having an overreach was previous corrected on a temporary basis following the 2010 Canterbury earthquakes, and, in response to COVID-19, once again we have another temporary measure which will effectively switch-off the overreach of section GC 1 for qualifying transactions between 17 March 2020 and 16 March 2022. While this solves the problem for now, section GC 1 will still pose a problem after 16 March 2022, so we're hopeful that between now and then a permanent solution can be found.

Unexpectedly caught under the bright-line?

You'd naturally think that if you're taxed on the income from the sale of an item that you should receive a tax deduction for the cost of that item, right? Unfortunately, until now, the ITA07 has been less than clear when an asset has been acquired for private use (e.g. a family holiday home which is then sold within the bright-line period) as there is a prohibition on claiming deductions for private expenditure. Fortunately, the amendment act inserted a retrospective change that applies from the first date that the ITA07 applied (1 April 2008) to allow deductions for the cost of private property which is taxed on disposal.

What is a dwelling?

Still on the topic of the bright-line, a question was raised as to how the bright-line test (and other rules relating to property) applied to property which wasn't actually used as anyone's residence; e.g. a property held vacant or for short-term rental. The bright-line test applies to "residential land", residential land includes property with a "dwelling" on it, and a dwelling was defined as "...any place used predominantly as a place of residence or abode...". You may see where the uncertainty arises if a property is actually empty more often than it is used.

As the amendment act was working its way through the Finance and Expenditure Committee, a decision was made to change the definition of dwelling with effect from the date that the bright-line test was originally introduced in 2015. A dwelling is now retrospectively defined as "...any place configured as a residence or abode, whether or not it is used as a place of residence or abode...". There is no analysis provided as to how many property sales may now be subject to tax because of this retrospective change.

Can you remind me what else is in the amendment act?

The title of the amendment act could lead you to incorrectly conclude that the extent of the tax reform in the bill is limited to feasibility expenditure changes and a few other "remedial" matters. However, there is much more to this act than just remedial matters. Some of the changes have been the subject of previous Tax Alert articles, and some will be covered in future Tax Alert articles (there is too much to cover in one edition). Key reforms include:

- Allowing certain feasibility expenditure to be deductible over five years when a project is abandoned;
- Introducing a new business continuity test to allow taxpayers to carry forward losses in more circumstances;
- New rules to require businesses to agree purchase price allocations when buying/selling a mixture of different asset types (note, the application date of these reforms as been deferred from 1 April 2021 to 1 July 2021);
- Some taxpayer favourable and unfavourable changes to the Research and Development Tax Credit Regime;
- Providing some additional exemptions from the new trust disclosure rules;
- Concessions to allow IFRS taxpayers to following the IFRS-16 treatment for certain leases;
- Changes are made to the land sale rules to ensure that taxpayers who are habitually buying and selling land cannot interpose different legal entities to avoid creating a "pattern" of land sales;
- Telecommunications businesses will need to charge New Zealand GST to customers when they are roaming on their mobile devices outside of New Zealand. This change will take effect from 1 April 2022;
- The processes around unclaimed monies are modernised;
- It's confirmed that dividends are derived on a cash basis;
- Improvements are made to assist taxpayers who are dealing with mycoplasma bovis.

Note, this is not a comprehensive list as the amendment act made over 50 substantive sets of changes. The links included above also explain the proposals as originally introduced in June 2020 and as some refinements to proposals were made during the legislative process, there may be some changes to the positions as explained in those articles.

Conclusion

The amendment act makes a number of positive changes for taxpayers, but also includes a range of changes which might unexpectedly catch people out – particularly those laws which were added into the legislation after public consultation had ended. Large amounts of the legislation in the amendment act applies with retrospective effect; and so the real message out of this process is to ensure that tax advice is sought before entering into transactions as there may be new unknown and unpleasant tax outcomes; unfortunately tax advice received on a transaction in the past does not mean that the same answer applies the next time to carry out a similar transaction.

For more information on the amendment act please contact your usual Deloitte advisor.

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Feasibility issues no more?

By Robyn Walker

The saga that has been the tax deductibility of "feasibility expenditure" has been going on for more than the four-year time bar, and more than the seven-year record keeping requirement. Now we can say that the issue is mostly put to bed with the passing of the most recent tax legislation; however, there are still some unresolved issues meaning this may not be the last word on this topic.

Most people familiar with tax will know what is meant by "feasibility expenditure", but those needing a history lesson can refer to one of our earlier articles.

The Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021 contains new laws which will allow much of the feasibility expenditure, previously classed as "black hole expenditure", to be tax deductible spread over five years. There is a de minimus rule will allow an immediate deduction if total qualifying expenditure is less than $10,000 even if a project is not abandoned. The new rules apply to expenditure incurred after the 2019-20 income year.

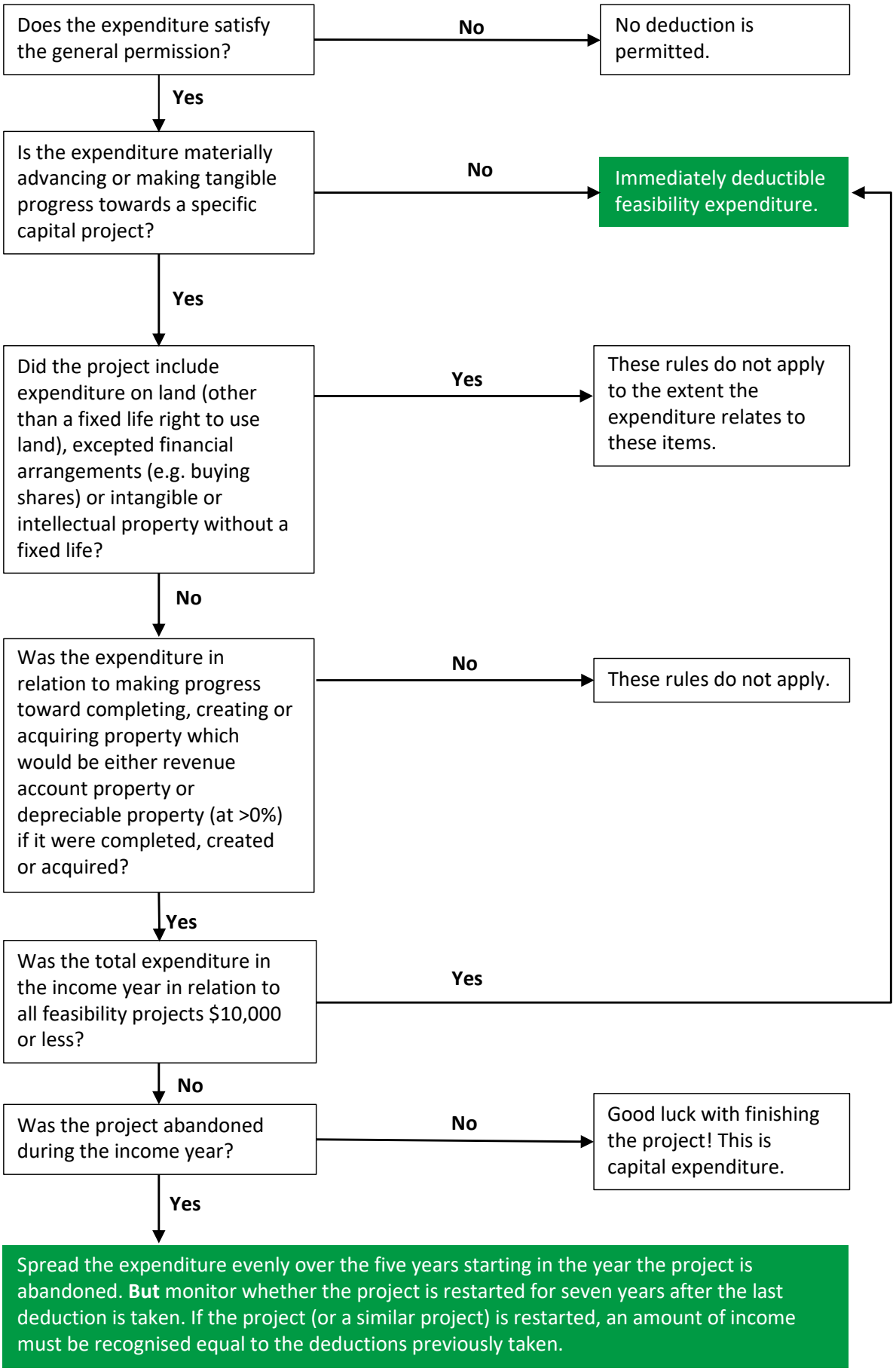
Like all tax rules, there are some in's and out's to be aware of. For example, if the feasibility expenditure relates to buying a business, the rules will not apply if the project is related to acquiring shares in the target company rather than its assets. Similarly, there is no ability to "game" the tax system by abandoning a project, claiming the deductions over five years, and then completing the project. In the event that a taxpayer abandons a project and then "subsequently completes or creates the property, or acquires the property or similar property", then the full amount of total deductions previously claimed under the five-year spreading rule becomes income. Taxpayers will need to monitor whether a project has been reinstated for seven years – this may be more relevant when a project was abandoned for a reason which may change; for example, a project was technically possible, but it was not financially feasible at the time.

The rules also require that the "general permission" is first satisfied in relation to the project. What this means, is that the expenditure needs to have a nexus to either deriving income or it must be incurred in carrying on a business. In practical terms, if the feasibility expenditure relates to something with an insufficient connection to your existing business/income sources, the rules won't apply. Inland Revenue illustrates this in its Interpretation Statement on Feasibility Expenditure with an example of a saw-milling business which wants to start producing garden tools – the conclusion being that the expenditure investigating a garden tool business does not satisfy the general permission. While there is no solution to this problem in this legislation, the issue is being considered for inclusion in the next Tax Policy Work Programme. Perhaps, this is something to bear in mind if you have or are contemplating "pivoting" your business in order to survive the current business environment.

The flowchart illustrates some of the key points to be aware of when applying the new rules.

For more information please contact your usual Deloitte advisor.

Feasibility Expenditure Flowchart



OMG my tax return is wrong

Having just been through the taxing lead up to 31 March, the flurry of tax returns completed and filed by the tax agents deadline inevitably means that some mistakes will have been made; whether that is a transposition error, a more substantial error or omission, or a position which was taken prior to retrospective legislation being enacted which is now incorrect.

Given the New Zealand tax system is based on a concept of voluntary compliance and self-assessment, if it is subsequently discovered that a tax return contains an error there are options available to get it fixed.

Contact Inland Revenue

Simple errors, such as the wrong number in the wrong box can usually be fixed by calling Inland Revenue or sending a SecureMail message through myIR.

Small errors

Errors at the smaller end of the scale don't need to be fixed immediately. Taxpayers have the option under section 113A of the Tax Administration Act 1994 to self-correct total errors of up to $10,000 in the next return.

Notice of Proposed Adjustment

If a taxpayer becomes aware of a problem with a tax return it is possible to lodge a "notice of proposed adjustment" with the Inland Revenue. Adopting this approach puts a formal procedure in motion; most notably there are time periods within which Inland Revenue need to respond, meaning that it can be a quicker way to resolve problems. A taxpayer generally has four months from the date of lodging a tax return to file a notice of proposed adjustment.

Voluntary Disclosure or Section 113 Request

Once outside the notice of proposed adjustment period, mistakes can still be corrected. The process to be adopted generally depends on whether the mistake means that the taxpayer has underpaid tax (a voluntary disclosure is made) or the taxpayer has overpaid tax (a section 113 request is made).

The benefit of adopting any of these processes is that it demonstrates to the Inland Revenue that you're taking your tax obligations seriously and undertaking some degree of self-review of tax positions. Front-footing mistakes with Inland Revenue provides some protection from penalties.

Contact your usual Deloitte advisor for more information.

Wage Subsidy and Transfer Pricing Specific Adjustments

These amendment processes could also be useful for amending an incorrect transfer pricing position on government support subsidies. There is a developing international consensus in respect of outcomes arising from such subsidies for COVID-19 relief, and intercompany transactions that may shift the economic benefit. This was covered in our February 2021 article on transfer pricing. In light of the cross-border nature of the issue the Inland Revenue have initiated a short form process that allows taxpayers to adjust both the New Zealand and Australian entities' tax position without undue compliance cost or audit risk.

Is tax pooling still relevant for managing your tax payments?

By Liz Nelson

Now that the 2020 income tax returns have been filed, it is time to look back and ensure that the right tax payments have been made to Inland Revenue.

At the same time, given the 2021 income year is coming to a close for many balance dates, final instalments of provisional tax will fall due over the next few months.

In this article we look at how tax pooling can not only help with getting provisional tax right, particularly in the context of the unpredictable times we are living in, but also provide flexibility in managing your cashflow around provisional tax.

Increased profits or missed payments

There will always be cases where mistakes are made or your precise tax liability cannot be calculated by the final instalment.

Taxpayers have the ability, provided the time restrictions are met (within 75 days of terminal tax date), to purchase tax from a tax pool in order to pay for missed instalments or to top up the final instalment of provisional tax. The process can be done online. For example if you have a terminal tax date of 7 April 2021, you have until 21 June 2021 to get your 2020 tax payments in order through tax pooling.

Based on our experience, it is generally possible to find sufficient surplus overpaid tax from taxpayers to match with taxpayers who have underpaid their tax for a given income year.

Ability to earn interest

One of the benefits of paying provisional tax to a tax pool is the potential to earn interest on overpaid tax.

Since 8 May 2020, Inland Revenue have been charging interest on underpaid tax at 7%, but only "paying" interest on overpaid tax at a rate of 0% (yes, that is not a typo), a spread that would make most people's eyes water.

So, if you pay provisional tax directly to Inland Revenue and you overpay, you will receive no interest from Inland Revenue.

On the other hand, if you make tax payments into a tax pool, there is usually the potential to sell overpaid tax to other taxpayers and receive a return on the overpaid tax. We spoke to Tax Traders, who said they typically have sufficient demand to sell historic overpaid tax to taxpayers who have underpaid their tax, and the rate at which interest is earned can at times be significantly greater than an on-call interest bearing account. Tax Traders have indicated that large 2020 tax surpluses currently being sold are fetching quite attractive interest rates as there is significant demand for backdated tax for the 2020 income year.

Variable profits

Given the uncertain times, many taxpayers may be expecting a decline in profits, or loss carry-backs. What does that mean for provisional tax payments?

If you make provisional tax payments to Inland Revenue, you have two choices: pay based on the standard uplift method (which risks overpaying at the first two instalments if profits are declining); or take

a risk and pay based on an estimate. The second option will expose you to that 7% interest rate if your estimate ends up being wrong.

Tax pooling provides a third option, allowing you to make payments directly into a tax pool based on your forecast without filing an estimate with Inland Revenue. Provided an estimate is not filed, interest will only be charged based on the lesser of your actual tax liability, paid in equal instalments, or your tax liability as calculated under the standard uplift method.

Depositing with a tax pool gives the protection of standard uplift in the event there is an upswing in profits later in the year, provided you are able to top up any underpaid tax from the tax pool.

Accessing refunds earlier

Getting a refund of provisional tax paid to Inland Revenue is no simple task – the typical request is subject to long processing times, may only be processed after the tax return for the relevant year is filed, and you may be asked to prove you have sufficient imputation credits.

Refunds of tax payments made to a tax pool are not subject to these restrictions, and can be paid out to the taxpayer at any time during the year. While there are Anti-Money Laundering (AML) requirements for accessing refunds, these can be dealt with online from a smartphone or tablet that has a front-facing camera, and can even be done when setting up a tax pooling account in order to ease the refund process.

Flexibility to finance

Outside of trading tax payments, tax pooling also offers taxpayers the option to finance future or past tax obligations. Tax pools can provide regular, structured payment options for taxpayers that can be built into forecasting and cash flow models, reducing the risk of late or missed provisional tax payments.

Most tax pools offer tax financing, allowing taxpayers to postpone tax payments at a competitive interest rate.

Taxpayers with irregular or unpredictable cash flows can choose to pay in flexible instalments or lump sums/pay as you go arrangements rather than fixed instalment amounts at set dates.

Further, the deposited funds can be drawn from as a line of credit, as an additional source of cash if required (with an option to be able to reinstate the deposit at a later date for a small fee in some instances). This option has been crucial for many taxpayers to bolster cashflow over COVID-19 lockdowns when access to other funding sources has been restrained.

These options can provide taxpayers with flexibility to manage tax payments in a way that better aligns with their cash flow requirements.

Audit / Voluntary Disclosures

Tax pooling assists in cases of increased assessments, either as a result of an Inland Revenue audit or through the voluntary disclosure process.

Provided specific requirements are met, taxpayers can purchase funds from tax pooling intermediaries in order to settle tax liabilities arising from increased assessments. The advantage of this is lower interest rates and potentially the elimination of late payment penalties. Tax Traders, for example, have backdated tax as far back as the 2009 calendar year if required.

Tax pooling continues to be relevant under the recent changes to the provisional tax rules. We see the most benefit for taxpayers that pay all their provisional tax instalments directly into a tax pool.

For specific advice on the provisional tax rules or tax pooling, including how you can use tax pooling to settle your terminal tax, please contact your Deloitte tax advisor.

Example:

Dog Walkers Ltd is a provisional taxpayer with a March balance date that pays provisional tax in three instalments. Dog Walkers' RIT for the year ended 31 March 2019 was $150,000.

Dog Walkers has paid provisional tax for the 2021 year into a tax pool based on its 2019 RIT, being 110% of $150,000 ($55,000 at each instalment).

Dog Walkers has prepared its income tax return for the year ended 31 March 2020 and has RIT of $100,000.

Once Dog Walkers files its 31 March 2020 income tax return, its provisional tax obligations for the 2021 tax year under the standard uplift method will change to 105% of $100,000, dating back to the first instalment that was due on 28 August 2020 ($35,000 due at each instalment).

As Dog Walkers has paid $55,000 at the first two instalments, but is now only required to have paid $35,000 at these instalments under the standard uplift method, there is an excess of $20,000 at each instalment date that may be sold or swapped within the tax pool, giving it the opportunity to earn interest at a rate higher than the 0% paid by Inland Revenue.

Depending how the rest of the 31 March 2021 year goes, Dog Walkers may still be required to top up to the final tax liability on the final provisional tax instalment date for the 2021 year (due 7 May 2021). As Dog Walkers has a terminal tax date of 7 April 2022, Dog Walkers has until 21 June 2022 to arrange the relevant swaps to get their 2021 tax payments in order through tax pooling.

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Recapping Deloitte's FBT and employment taxes webinar – key things you need to know under the 39% rate

By Stephen Walker

We recently held our annual Fringe Benefit Tax (FBT) and employment taxes webinar and were fortunate enough to be joined during the event by two of Inland Revenue's technical specialists on FBT. We had over 700 attendees join us for the webinar, which goes to show just how important employment tax issues are to businesses in New Zealand, and also perhaps highlights how hard it is for taxpayers to get to grips with the tricky compliance beast that is FBT.

Unfortunately, we ran out of time during the session to properly tackle the numerous questions that were raised, and so we thought it might be helpful to address some of the more common queries received.

This also means those of you that were unable to attend are able to get a feel for the issues that are out there, and provides an opportunity for you to reach out directly to us with your FBT and employment tax related queries.

Key themes

FBT rate changes, attribution and software solutions

Without doubt, the key theme and issue on everyone's mind was the new FBT rate changes, which came into effect from 1 April 2021.

For those of you that don't know, the single rate has moved from 49.25% to 63.93% and the alternate rate has increased from 43% to 49.25%. In addition, the pooling rate moved from 42.86% to 49.25%. We know from Inland Revenue data that around 90% of taxpayers currently use the single rate to calculate their FBT (and our poll conducted during the webinar indicated that 51% of our audience uses the single rate).

We saw during the session that if those same taxpayers adopt the same approach next year, they will see an eye-watering 30% increase in their FBT costs. We covered during the session how important it will be for taxpayers to use attribution from the 2021-22 FBT year in order to keep FBT cost increases to a minimum. This is especially the case where there are a large number of employees earning under the $180,000 p.a. top tax rate threshold.

With the increased need to attribute benefits to employees, where possible FBT calculation software should be used to make FBT compliance easier. Here at Deloitte we are able to demonstrate TaxLab's FBT software product to clients, so please do not hesitate to reach out to us if you are interested in seeing how this software works, and how it can help you and your business with FBT returns going forward.

The FBT consequences of the new top personal tax rate were also explained in our March 2021 Tax Alert.

FBT reviews

With these new rate changes, it's never been a better time to make sure you are getting your FBT returns correct. This was emphasized by Inland Revenue in the webinar, in identifying some of the common errors they see when reviewing and auditing taxpayers. Indeed, from our own experience, we've not conducted an FBT review yet where we haven't found an error or a missed opportunity to save on FBT costs. With FBT rates going up, it's going to be more important than ever to ensure both that opportunities to save

FBT costs are maximised, and that you are compliant with the rules, as the cost of getting it wrong is also going to go up. Undertaking regular reviews of taxes like FBT also demonstrates to the Inland Revenue that you have good governance processes in place.

Common questions and errors identified

FBT vs PAYE vs Entertainment

For those of you who attended the webinar, you may recall we discussed this common error, together with some examples to bring the issues to life. Interestingly, the poll results also indicated that a number of audience members struggle to get this area right, and this was again highlighted in comments made by Inland Revenue.

The general rule when determining if something is subject to PAYE or FBT is to follow the contract. If the **employee** is contractually obliged to pay for something but the cost is met by the employer, excepting genuine business expense reimbursements, it will be subject to the PAYE regime. Generally, where the **employer** is contractually obliged to pay for the item provided to the employee, it will be subject to the FBT regime. The exception to the general rule is accommodation, which when taxable will always be subject to PAYE. Once you've determined whether you're in the PAYE or FBT regime, then you need to look at the separate exclusions / exemptions that apply to each regime,

Sitting alongside the PAYE and FBT regimes is the entertainment regime, which adds another layer of complexity around the provision of food and drink to employees. The entertainment regime limits income tax deductions to 50% where the expense is classified as entertainment expenditure. The policy rationale behind this is that expenditure on private benefits received from business entertainment should not be fully deductible. Common examples include entertainment off premises (e.g. Christmas party), entertainment on premises where food and drink (other than a light refreshment) are provided, and corporate boxes. These entertainment rules generally override the FBT rules (so you're only caught under one regime). However, FBT will apply instead of the entertainment regime if:

- The employee did not receive benefit in course of performing their employment duties; and
- They did not receive it or use it as a necessary consequence of their employment; and,
- The employee can choose when to use the benefit.

Motor vehicles

A number of questions were submitted on determining the benefit value of motor vehicles.

It's worth remembering that, unlike other fringe benefits, motor vehicles are subject to FBT when they are made **available** by the employer to the employee for their private use (noting that the commute to work will generally be considered private use). It doesn't matter whether the employee then chooses or not to use the vehicle privately, and so in this sense actual private use is irrelevant. What is key is the motor vehicle's availability to be used privately.

In terms of the calculation itself, there are two options to choose from: the cost method or the tax written down value ("TWDV") method.

If the vehicle is leased, you should ask your leasing company to provide you with the GST inclusive cost value and/or TWDV to be used for FBT purposes. Most lease contracts will state these values already.

When using cost, ignoring any exempt days, the taxable value is computed at 20% annually (5% quarterly) of the GST inclusive cost price. When using TWDV, again ignoring any exempt days, the taxable value is computed at 36% annually (9% quarterly) of the GST-inclusive TWDV.

That said, when using the TWDV method, the minimum GST inclusive value that can be used is $8,333, so the minimum annual taxable value for a vehicle that is fully available for private use using the TWDV method is just under $3,000. The choice as to which method to use is made in the first FBT return for which the vehicle is provided to an employee. Once a method has been chosen for a particular vehicle, the same method must be used for that vehicle until the earlier of the date it is disposed of, the date it ceases to be leased, or five years have passed since the start of the period of the vehicles first FBT return.

Application of de-minimis exemption

Finally, a number of questions were also submitted on the practical application of the de-minimis FBT exemption.

The so called "de-minimis exemption" only applies to unclassified benefits provided to an employee where:

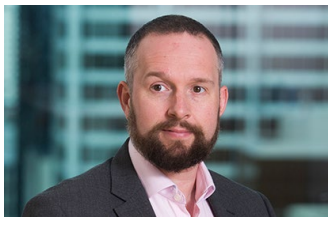
1. The total taxable value of all unclassified benefits provided to the employee in the quarter did not exceed $300 ($1,200 for the year if filing annually); **and**
2. The total taxable value of **all** unclassified benefits provided to **all** employees in the last four quarters (including the current one) has not exceeded $22,500.

It is worth noting that for the second test, the threshold is assessed across all associated members of the employer's group.

If the first threshold is exceeded for a particular employee, but the second is not, then FBT will only apply to the benefits provided to that particular employee. However, if the second threshold is exceeded by the group at any point during the assessment period, then FBT will be due on all unclassified benefits (including the first $22,500 of benefits), irrespective of whether the first threshold was met.

If you have any questions at all about how the FBT rules should apply to your business, or you would like to know more about how the new FBT rate changes could impact your FBT costs going forward and the practical steps you can take to minimise this, please reach out me, or your usual Deloitte advisor.

Contact



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Snapshot of recent developments

Tax legislation and policy announcements

Applications close soon for Resurgence Support Payments

Applications for the second round of the Resurgence Support Payments for the alert level increase on 28 February opened on 8 March in myIR and will close on 12 April 2021.

Special report on Resurgence Support Payments

On 23 February 2021, the special report on the Taxation (COVID-19 Resurgence Support Payments and Other Matters) Act 2021 was released. The report summarises the legislative changes, the rationale and consequences of the changes. The Act does not include the details of what will be published about applications; however this report notes the current policy on what information will be published.
The information will be published on a searchable database on Inland Revenue's website and will include the name of the recipient of the grant, the amount paid, and the period of alert level escalation for which this payment relates. However, these will not be published if the recipient has fewer than three employees, or the amount paid is capped at four times the declared revenue decline.

Budget 2021 Date

On 24 March 2021, Finance Minister Grant Robertson announced that Budget 2021 will be delivered on Thursday 20 May 2021. The Budget will focus on the Government's overarching objectives for this Parliamentary term which are: continuing to keep New Zealand safe from COVID-19, accelerating the recovery and rebuild and addressing key issues like climate change, housing affordability and child poverty.

Direct credit refund date for totalisator duty, lottery duty, casino duty and unclaimed money

Tax Administration (Direct Credit of Totalisator Duty, Lottery Duty, Casino Duty, and Unclaimed Money) Order 2021 was published on 22 March 2021. This Order in Council specifies 27 April 2021 as the date on and from which totalisator duty, lottery duty, casino duty, and unclaimed money may be refunded by direct credit under section 184A of the Tax Administration Act 1994 to a bank account nominated by the taxpayer.

MLI entered into force in respect of Chile

On 1 March 2021, the Multilateral Convention (2016) (MLI) entered into force in respect of Chile and will have effect on the Chile – New Zealand Income Tax Treaty. For Chile, the MLI takes effect on 1 January 2022 in respect of taxes withheld and other taxes. For New Zealand, the MLI takes effect on 1 January 2022 in respect to taxes withheld and 1 September 2021 for other taxes.

Inland Revenue statements and guidance

COVID-19 company tax residency

Inland Revenue has extended their current guidance on the impact of COVID-19 on company tax residency to apply until 1 October 2021 (it was to be reviewed at 1 April 2021), when the position will next be reviewed.

Revenue Alert on diverting personal services income

On 29 March 2021, Inland Revenue released Revenue Alert RA 21/01 – "Diverting personal services income by structuring revenue earning activities through a related entity such as a trading trust or a company: the circumstances when Inland Revenue will consider this arrangement is tax avoidance". This Revenue Alert was re-issued ahead of the increase in the top marginal tax rate on 1 April 2021 and reiterates the Commissioner's view on this matter which follows the Supreme Court's decision in the *Penny and Hooper case*. This statement replaces RA 11/02.

Attribution - income from personal services

On 19 March 2021, Inland Revenue issued Interpretation Statement IS 21/02 – "Income tax – Calculating income from personal services to be attributed to the working person". It provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in s GB 27 to s GB 29 of the Income Tax Act 2007.

2021 tax disclosure exemption

On 31 March 2021, Inland Revenue published Determination ITR32 – "2021 International tax disclosure exemption". The statement allows certain groups of residents who have a control or income interest in a foreign company or an attributing interest in a foreign investment fund (FIF) to be exempt from the disclosure requirement for the income year corresponding to the tax year ended 31 March 2021. The 2021 disclosure exemption also removes the requirement for a non-resident or transitional resident to disclose interests held in foreign companies and FIFs.

Clarification of the Government Service Rule

On 1 April 2021, Inland Revenue issued Commissioner's Statement CS 21/02 – "Clarification of the Government Service Rule". This Statement clarifies the interpretation of the Government Service Rule as set out in the Interpretation Statement on Tax Residence – IS 16/03, and sets out the Commissioner's position in relation to whether a person is "absent" for the purposes of section YD 1(7) of the Income Tax Act 2007.

Common Reporting Standard jurisdiction determination

On 26 March 2021, Inland Revenue released determination AE 21/01 – "Participating jurisdictions for the Common Reporting Standard (CRS) applied standard". The determination adds Albania, New Caledonia, Nigeria, Peru and Turkey to New Zealand's list of participating jurisdictions for the purposes of the CRS applied standard. This determination also contains a full list of Participating Jurisdictions with effect from 1 April 2021.

Employee share schemes – employer expenditure or loss income

On 15 March 2021, Inland Revenue published draft Questions We've Been Asked PUB00385 – "When an employer is party to an employee share scheme, when does an employer's expenditure or loss under s DV 27(6) or income under s DV 27(9) arise?"

This draft statement is relevant to any employer who is party to an employee share scheme and considers the timing of any deduction or income arising for the employer under s DV 27(6) and DV 27(9) of the Income Tax Act 2007. This draft item does not consider arrangements that may be subject to the application of s BG 1 (tax avoidance) or s GB 49B (employee share schemes).

The draft statement states that the relevant expenditure, loss and income will arise when the related "employee amount" that is inserted into the calculation formula in s DV 27(7) is recognised for the employee share scheme employee. Submissions close on 27 April 2021.

Real estate sector the focus of new Inland Revenue campaign

Inland Revenue is turning its hidden economy focus on to the real estate sector, including both the under reporting of income and overstating of expenses. Inland Revenue analysis of this sector suggests that real estate agents / salepeople are claiming a high level of expenses relative to their income. If Inland Revenue is concerned that a taxpayer is overclaiming expenses they will receive a letter from Inland Revenue asking for proof of expenses. Deloitte is available to help resolve any tax issues.

Note: The items covered here include only those items not covered in other articles in this issue of Tax Alert.

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