Issue 01
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DavidCo Limited

Views on News
Happenings in NZ Tax

est. 2011

Welcome!
It is nearly the end of June at the time of writing this, and I can't help wondering what happened to the first half of 2011. Quite a lot has happened though: the Eastern Hemisphere was rocked by two major earthquakes, with our own dear Christchurch bearing the brunt of one of them (not to mention the major aftershocks since then), and Japan the other. The Arab Spring has sprung and Osama Bin Laden got shot. Prince William got married and Catherine, the Duchess of Cambridge, is the new darling of the world press. Planking has swept the world as the new kids' craze (if in doubt, ask the Prime Minister)! The economic climate is improving, both in New Zealand and overseas. My first university degree was in economics, and a basic principle of macroeconomics is that people's expectations govern outcomes. After the natural disaster(s) which befell us earlier this year, we could perhaps be excused for feeling a little sorry for ourselves but, if we all had a little faith and acted in the full expectation of positive outcomes for ourselves and for our nation, the economic climate will improve a lot faster.

The budget was good insofar as it has provided for the unexpected expenditure that arose as a result of the Christchurch earthquake, and focused on providing the funds to meet this expenditure in ways other than reversing the positive tax and other fiscal decisions made in 2010.

Speaking of tax changes, plenty has happened in the tax world in New Zealand. From 1 April, tax rates are lower almost across the board, the GST Act has been given a major overhaul, buildings are no longer depreciable, the thin capitalisation threshold has been lowered, and the LAQC regime has been replaced with the LTC regime. Gift duty is due to be abolished on 1 October, and major changes to the PIE and International tax regimes are in the process of being enacted. The income-sharing tax Bill is also due to be enacted shortly and tax changes to soften the impact of the Christchurch earthquake have just been enacted.

I have been keeping up with the tax changes and the objective of this website is to share the fruits of my reading and research with you. I plan to issue this newsletter at least monthly, and of course, the material on this website will be regularly reviewed to keep it as up-to-date as possible.

Happy reading.

SURVIVING IN THE NO LAQCs TAX ENVIRONMENT

The LAQC tax regime has been repealed with effect from 1 April 2011. Shareholders in LAQCs have been given the option of transitioning tax-ree into a look-through company (LTC), or a partnership or limited partnership, or a sole tradership. Otherwise, an LAQC would simply continue as a QC, which is the easiest thing to do, but then there can be no attribution of losses to shareholders.

Becoming a sole trader, if an LAQC has only a single shareholder, will mean the company has to be wound up (unless there is some other use for it), and limited liability will be lost. Transitioning into an LTC or a limited partnership will carry a significantly higher tax compliance burden: income and deductions are attributed to individual owners, or partners, under both of these tax regimes.

Transitioning into a limited partnership, which is an entirely different legal entity, will require the resolution of some significant non-tax legal issues. Electing to become an LTC would be the lower cost option. (If an ordinary QC is to become an LTC, the rights carried by the shares may need to be changed so that all the shares carry exactly the same rights.)

The PDF attachment in the Close Companies and Partnerships section contains a detailed comparison of the QC, LTC and partnership/limited partnership tax regimes. One thing that's immediately obvious is that changing the capital structure of an LTC after it is established, could have some quite significant tax consequences for the owners: both from income arising through a deemed disposal of the underlying LTC interest, and from the potential impact on deductions due to the change in the owner's basis.

Therefore, a review of the existing capital structure of a QC or an LAQC would be in order before transitioning to an LTC. There are 2 years in which to effect a transition.

If a partnership or a limited partnership is more likely to fit the bill, the thing to do would be to notionally establish the preferred partnership structure, go through a checklist of all the non-ax legal issues involved, and then make the changes, if any, to the existing QC structure, to allow the most convenient and tax compliant transition.

See the Close Companies and Partnerships section for the details. http://davidco.co.nz/index.php?page=smallbiz#5

ACCOUNTING FOR GST ADJUSTMENTS

Just when the dust has settled from the software changes required to accommodate the GST rate change from 12.5 to 15%, a new set of apportionment rules came into effect on 1 April 2011. Adjustments now need to be made annually.

Adjustments that increase input tax will result in income. "Deductible output tax" is allowed as a deduction. Alternatively, adjustments could have an effect on the costof depreciable property. (See the GST section http://arundavid.biz/index.php?page=gst#58) Care needs to be taken to ensure that the accounting system correctly accounts for these annual adjustments.

Providers of financial services have some additional challenges. The new apportionment rules provide them with some latitude in deciding how best to make adjustments for taxable and non-taxable supplies. The existing business to business, and financial services to financial services, concessions have been retained. The apportionment method decided on, will need to factor in the impact of these concessions.

Check out the GST section for a detailed comparison of the old rules and the new rules. http://davidco.co.nz/index.php?page=gst#4

0% RATE OF AIL FOR SOME INTEREST PAYMENTS

The International Investment tax Bill that was reported from the Finance and Expenditure Committee on 9 May, contains a proposal for a zero rate of approved issuer levy on a very limited range of registered securities. The Labour members expressed concern, but given the very specific nature of the concession, it is unlikely to make a big splash. See the Larger Companies section for more details. http://davidco.co.nz/index.php?page=largebiz#109

NO LTC IN SIGHT FOR FLAT-OWNING COMPANIES IN THE GST SOUP!

From April 2011 shareholders in a flat-owning company are potentially affected by two adverse tax changes: they cannot elect for the company to be treated as a look-through company (LTC) for tax purposes, and the sale of shares in the company could be subject to GST.

From 1 April 2011, the GST definition of land includes shares in a flat-owning or office-owning company. Therefore the supply of the shares in such companies by a registered person in the course or furtherance of a taxable activity will no longer be an exempt supply, unless it could be argued that it constitutes the supply of a dwelling under section 14(1)(d). An amendment proposed in the Tax Administration Bill confirms that a supply of land that is exempt under section 14(1)(d) should be treated as a separate (exempt) supply. See the GST section for the details. http://arundavid.biz/index.php?page=gst#20

For flat-owning companies that are qualifying companies (QC), the options are: to either remain as a QC for the time being, or possibly transition into a limited partnership to allow loss attribution. However, flat□owning companies are a well-recognized vehicle, and are catered for in regulations and legislation, including Part 7A of the Land Transfer Act. There are likely to be a number of non□tax legal and regulatory complications in changing to a limited partnership. For registered person shareholders, there may well be GST consequences in changing to a limited partnership. See the Close Companies and Partnerships section for the details. http://davidco.co.nz/index.php?page=smallbiz#13

CANTERBURY EARTHQUAKE MEASURES DON'T GO FAR ENOUGH

The Canterbury Earthquake Measures Act provides an exemption from tax for employment income (that does not replace a PAYE payment) and known value fringe benefits to a combined maximum value of $3200, if paid within the first 8 weeks following either 4 September 2010 or 22 February 2011. The provision of accommodation and fringe benefits whose value is unknown is exempt. Donations of trading stock for less than market value to a non-associated person will be allowed from 4 September 2010 to 31 March 2012. Such donations of trading stock will not be a dutiable gift.

Unfortunately the depreciation rollover relief that was promised in the "Fact Sheet - Earthquake depreciation issues" released by the IRD in April has not eventuated. The rollover relief was due to apply to the end of the 2015–16 income year.

Three more generic amendments to the depreciation rules were also promised in the Fact Sheet, only one of which has been legislated: the deductibility of disposal and demolition costs of buildings irreparably damaged by the earthquake. The other two: the timing of the "deemed sale" when insured assets are written-off (which at present occurs on the date of the event that resulted in the write-off, whereas the proposal was to defer the deemed sale until insurance proceeds could be reliably estimated), and the write-off for any loss on buildings destroyed by an event beyond the owners control.

It is to be hoped that the promised depreciation relief measures have just been delayed, and will eventuate soon.

WARNING: QCs WITH NON-ATTRIBUTING FIF INTERESTS OF 10% OR MORE

QCs with non-attributing FIF interests of 10% or more – be warned! A change proposed in the International Investments tax Bill will remove the ability of QCs to continue to hold such interests. The change is proposed to be retrospective in effect, applying from 1 July 2009. Continuing to hold such investments could result in an inadvertent loss of QC status. See item (1) in the attached PDF in the Close Companies section. http://www.davidco.co.nz/dl/QCPartnershipLTCComparison.pdf

DEPRECIATION ON BUILDINGS NOW 0%

The 2011/2012 income year is upon us and buildings are not depreciable anymore. Some buildings that were treated as non-buildings before July 2009 can continue to be depreciated ("grand-parented structures"), and so can buildings listed in Schedule 39 acquired before 1 April 1993. If the Commissioner issues a provisional rate stating that a class of building has an estimated useful life of less than 50 years, buildings in that class can also be depreciated.

The slightly good news is that if the building contains commercial fit out that was not previously separately depreciated, depreciation at 2% can continue to be claimed based on 15% of the building's adjusted tax value. See the Larger Companies section and the attached PDF on 2011 Depreciation Changes for all the details. http://davidco.co.nz/index.php?page=largebiz#7

GOING CONCERN ….. OR NOT

As most people know, there has been a significant change to the GST treatment of land transactions. A supply by a registered person that consists wholly or partly of land must be zero-rated under section 11(1)(mb) if the recipient (purchaser) represents that the land is to be used in a taxable activity and that it will not be used as a principal place of residence of the recipient. If the supply has been incorrectly zero-rated the GST payable is the responsibility of the recipient.

If a supply as a going concern includes land, and the supply has been incorrectly zero-rated, the GST payable is the responsibility of the supplier. The supplier can raise the price by the GST payable under section 78E. However, if the appropriate representations have been made, the supply could have been zero-rated under section 11(1)(mb), in which case, any GST subsequently payable will be the responsibility of the recipient. It may well be that the preferred solution when land is supplied will be to zero-rate the transaction as a supply of land, rather than as a going concern. See the GST section for the details. http://davidco.co.nz/index.php?page=gst#23

NO MORE GIFT DUTY FROM 1 OCTOBER

The Tax Administration and Remedial Matters Bill reported from the Finance and Expenditure Committee on 20 June contains a clause (Clause 110) providing that no gift duty is payable in relation to a gift made on or after 1 October 2011. Contrary to popular belief, this is not yet law, and the exemption will not apply to gifts made before 1 October.

SWEEPING CHANGES PROPOSED TO THIN CAP RULES FOR OUTBOUND COMPANIES AND TRUSTS

Under changes proposed in the International Investment tax Bill currently before Parliament, the thin capitalisation rules to that apply to NZ outbound companies and trusts are going to be given a complete overhaul. The rules currently apply only to companies and trusts with CFC interests. Under the proposals, the rules will also apply to companies and trusts that own FIF interests of more than 10% in an Australian resident FIF, or any FIF interests for which the proposed new attributed FIF income method (AFI method) is used for calculating FIF income. The AFI method is to replace the branch equivalent (BE) method.

Changes are also proposed to limit the current exclusions. The current exclusion for a company or trust with finance costs not exceeding $1 million is to be replaced by an exclusion only if the NZ group finance cost does not exceed $1 million. The exclusion for interest deductions that do not exceed $250,000 is being replaced by a new threshold test.

The new threshold test is supposed to cater for a higher level of interest expenditure that may be warranted due to goodwill that is not recognized in the accounts. To use this test, the companies must have a higher than normal level of debt, and interest deductions must exceed interest income. The test involves calculating the interest-income ratio by comparing interest expenditure to the net cash profit available to fund such expenditure.

The advantage with this test is that dividends do not form part of the calculations. However, the worldwide group's interest-income ratio must always be calculated. Interest deductions will be denied if the NZ group's interestincome ratio is higher than the lesser of: 50% or 110% of the worldwide group's interest income ratio. Check out the Larger Companies (http://davidco.co.nz/index.php?page=largebiz#82)and Trusts sections (http://davidco.co.nz/index.php?page=trusts#35) and the attached PDFs in those sections for all of the details.

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BREACHING THE THIN CAP THRESHOLD – PENALTY MAY BE HIGHER THAN YOU THINK

The thin capitalisation threshold is lower from the 2011/2012 income year onwards. The New Zealand group debt percentage threshold is 60% (down from 75%). The worldwide group debt percentage threshold is unchanged at 110%.

The penalty for breaching the threshold will be higher than just the excess interest deductions. The interest apportionment formula for calculating income when the threshold is breached includes, as interest, dividends paid on fixed-rate foreign equity and fixed-rate shares (and potentially dividends on stapled debt securities) that have been issued by the company and are held by NZ residents. Such dividends are not deductible, but are treated as interest deductions disallowed.

The calculation of NZ group debt also includes fixed-rate foreign equity, fixedrate shares and stapled debt securities, that are held by NZ residents. These shares do not have to be issued by the company - they could have been issued by any NZ group member. The debt can be measured daily, quarterly or at year-end, so there is time to review and adjust the position if warranted. See the Larger Companies section for more details. http://davidco.co.nz/index.php?page=largebiz#74

DEDUCTIBILITY OF USE OF MONEY INTEREST CONFIRMED

An amendment proposed in the Tax Administration Bill will confirm the deductibility of use of money interest in almost all situations. The interest will be deductible in the year in which it is paid. A deduction is also proposed for expenditure incurred in purchasing funds in a tax pool.
See the Trusts section for more information.
http://davidco.co.nz/index.php?page=trusts#21

NON-RESIDENT BENEFICIARY MAY HAVE A PE IN NZ

Watch out for new and recently re-negotiated tax treaties that contain a provision that deems a non-resident beneficiary to have a permanent establishment in New Zealand if the trust carries on business in New Zealand. The taxation of beneficiary income in such cases is not straightforward.
Refer to the Trusts and Non-residents sections for more on this.
http://davidco.co.nz/index.php?page=trusts#16
http://davidco.co.nz/index.php?page=nonres#81

SECRECY RULES TO BE MODIFIED FOR TAX ADMINISTRATION PURPOSES

The Secrecy rules are to be modified so as to allow access to a taxpayer's information to a support person (who is not a nominated person or an agent) in limited circumstances.

This change is part of a number of administration changes as well as some changes to the tax disputes process contained in the Tax Administration Bill.

Notably, there is a proposed new definition of "document" which will apply for the purposes of legal privilege afforded tax practitioners.

THE FOREIGN DIVIDEND EXEMPTION IS CHANGING

Under changes proposed in the International Investment tax Bill to the exemption for foreign dividends received by NZ companies, dividends received from FIF income interests of 10% or more in non-Australian grey list companies will not be exempt. Foreign dividends received by PIEs will also not be exempt. See the Larger Companies section for more details.
http://davidco.co.nz/index.php?page=largebiz#102

REMEMBER: LOWER PROVISIONAL TAX UNDER THE UPLIFT METHODS

Remember that the formulae for the uplift methods of calculating provisional tax have changed due to the fall in the company tax rate. For companies, there is no uplift required for 2011/2012 provisional tax calculated under the standard prior-year uplift method. Provisional tax payable under the standard10% uplift method it's 105% of the residual income tax for the 2009/2010 income year.

CHARTERED ACCOUNTANTS
DavidCo Limited

HUGE CHANGES TO THE PIE AND FIF RULES IN THE PIPELINE

The tax Bills that were reported from the Finance and Expenditure Committee on 9 May and 20 June contain major changes to the FIF regime and the PIE regime respectively.

Watch out for more on these changes
in coming issues of this newsletter,
with the details set out on this website in due course.

DavidCo Limited
Chartered Accountants
Corporate Tax Consulting & Tax Accounting

Arun David - Director

T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

Level 2, Shortland Chambers
70 Shortland Street
Auckland City
PO Box 2380, Shortland Street
Auckland 1140

PROPOSED TAX POOLING CHANGES

Some changes to the tax pooling rules are proposed under the Tax Administration tax Bill. The timeframe within which a transfer must be requested from a tax pooling account to settle a provisional tax or a terminal tax liability is to be increased from 60 to 75 days following the terminal tax date. Companies (and other members of the same group) with funds deposited by them in the tax pooling account, who have met their return filing requirements, can request transfers into the tax accounts at any time.

The tax types to which tax pooling apply are to be expanded to include tax payable under the PAYE the rules, the ESCT rules, RSCT rules, RWT rules and NRWT rules, as well as income tax, GST FBT, further income tax and imputation penalty tax. See the Larger Companies section for more details.
http://arundavid.biz/index.php?page=largebiz#52

SHAREHOLDING CONTINUITY: DIRECTORS CAN SLEEP (SLIGHTLY) EASIER

The problematic rule that says you cannot rely on the single notional person shareholding concession, in order to avoid a shareholding continuity breach, if directors are aware of the breach, is about to receive a bit of a makeover. The provision will be a lot more specific in terms of how to decide whether a breach would have occurred, and there are two new types of share trading that can be excused. See the Larger Companies section for more details.
http://davidco.co.nz/index.php?page=largebiz#65

INCOME-SHARING TAX CREDITS FROM 1 APRIL 2012

Legislation is in the pipeline to provide a tax credit to each partner in an eligible couple, equal to the difference between tax payable and the tax that would be payable of each partner were to derive half of the couple's combined income.

Couples must be New Zealand residents, and married or in a de facto relationship or civil union, with responsibility for a child up to 18 years old. The tax credit will be available to separated couples with joint responsibility for a child, if a separated partner is in a new relationship that qualifies for the tax credit. The credit will be available from 1 April 2012.