NEWSLETTER

Issue 2
May – July 2019

INSIDE THIS EDITION

Tax Working Group

The Tax Working Group (TWG) released its long awaited Final Report ('the Report') on 21 February 2019, following a 13 month review during which the Group received over 7,000 public submissions. The report contained 99 recommendations for the Government's consideration; including the introduction of a broad Capital Gains Tax ('CGT').

Two months later the coalition Government ruled out the introduction of a CGT for the foreseeable future. The current Government is a coalition and without consensus it could not move forward.

Where does this leave us? What about the remaining 97 recommendations? The government has provided a written response to each of the TWG's recommendations. However, the overall theme is that there will be no significant change or major evolution.

A number of the recommendations by the TWG were to make no change. For example, the TWG recommended the corporate tax rate should remain at 28% and no progressive corporate tax rate system should be introduced. The government has endorsed maintaining the current business and personal income tax regimes as they are.

The government has agreed to investigate taxing land banking, as this may trigger land development. This 'power' could be passed to local government. This has been referred to Inland Revenue to be added to its (IRD) tax policy work programme (TPWP) for consideration.

The Government is to continue its focus on the taxation of multi-national corporations (MNCs). The government is working closely with the OECD to achieve equity regarding income tax received by all jurisdictions in which MNCs operate. A draft discussion document is due to Cabinet by May 2019 regarding the taxation of the digital services economy, informally labelled the 'Google Tax' or 'Facebook Tax'.

Part of the TWG's final report covered what the revenue from a CGT should be used for, and therefore proposed a number of 'spending packages'. The packages included bringing back depreciation on buildings, reducing taxes on income from savings, and increasing the income threshold for the 10.5% personal tax rate from $14,000 a year to at least $20,000 a year.

However, without the additional revenue that would come from a CGT, the Government has ruled out such changes as no longer attainable.

Most of the TWG's recommendations have been referred to IRD for 'potential' inclusion on the TPWP. What action the TPWP drives remains to be seen. Some of these recommendations will be addressed as a by-product of the IRD's ongoing transformation project. Through its improved systems there will be an enhanced focus on data and closer interaction with businesses and individuals using the online platforms, therefore work on enhancing the integrity of the tax system has already been under way for some time.

Ultimately, the outcome of the TWG process is mirrored by NZ's MMP system. Action (as opposed to inaction) by a coalition government requires consensus from the members of that government. That consensus did not exist.

Charities Working Group

The Department of Internal Affairs (DIA) is currently leading a comprehensive review of the Charities Act. With more than 27,000 registered charities in New Zealand and annual total spending of more than $17 billion, the sector forms a significant part of our economy.

The current Charities Act was enacted in 2005, providing a governance structure for charities to promote public trust and confidence in the sector. The Act places annual reporting obligations on charities that register with Charites Services, along with access to charitable tax exemptions under the Income Tax Act.

The DIA, along with representatives of the charitable sector, together labelled informally as the Charities Working Group (CWG), are reviewing the purpose of the Charities Act, how registration decisions are made, businesses operated by charities, reporting obligations and more.

However, the specific issue of the charitable tax exemption is excluded from the review. The definition of 'charitable purpose', which is fundamental to the charitable tax exemption, is also excluded from being considered. From initiation, the CWG noted that the charitable tax exemption would be addressed separately by the Tax Working Group (TWG) and that the outcome of the TWG's review would be considered during their review.

We know the TWG received numerous public submissions that the tax exemption for businesses operated by charitable entities provides an unfair tax advantage over commercial entities that are subject to income tax.

The TWG reported that the underlying issue is the extent to which charitable entities are accumulating surpluses within the trading business, rather than applying such surpluses for the benefit of their charitable activities. Despite the recognition of this concern, the TWG considered that this issue will be addressed by IRD, as the matter is already included on the 'Tax Policy Work Programme'.

The TWG also recommended the DIA consider the introduction of periodic reviews of how charities utilise their tax savings for their intended social outcomes. How the DIA will now factor this into their Charities Act review remains to be seen.

A further key consideration of the CWG relates to charities operated by Maori organisations. Many Iwi groups use charitable structures with the purpose of improving the health and welfare of Maori communities across the country. These charities are often funded by corporate investment arms and businesses of the associated Iwi. Hence, the availability of the tax exemption to these investment entities will likely be of concern to Iwi groups.

Given the important work that is carried out by NZ's charitable organisations it is important that the legislated framework, within which they operate allows them to operate as efficiently and effectively as possible. It will be interesting to see how this develops.

Payments to shareholders

Broadly speaking, a payment from a company to a shareholder is likely to be a salary / wage or a dividend, and therefore taxable income. However, loans from a shareholder to a company and therefore loan repayments are also commonplace. Whilst interest on such loans is taxable to the recipient, loan repayments should not be.

A recent Taxation Review Authority case (2018, NZTRA 9) serves as a reminder to clearly document any payments made to shareholders or associated companies, to ensure wages / dividends are distinguished from loan repayments so that the correct tax treatment is applied.

The taxpayer in the case was shareholder of a number of companies. He had filed 'nil' personal tax returns over a period of four years, on the basis that various payments received from the companies were non-taxable loan repayments. However, Inland Revenue (IRD) reassessed the taxpayer to treat the payments as taxable income, on the basis that they were wages, dividends, and/or income under ordinary concepts. A shortfall penalty for gross carelessness was also imposed.

IRD had considerable evidence supporting its position. For example, company bank statements described some of the payments as 'wages'. The regularity of the payments, alongside the taxpayer's own evidence that they personally carried out work for the companies, further suggested the amounts were wages. The bank statements also showed that the company had directly funded some of the taxpayer's personal expenditure.

In challenging the IRD's position, the taxpayer argued that the various payments by the companies were not wages or dividends but were in fact loan repayments, such that there is no tax liability. However, the onus of proof lies with the taxpayer to prove his position and the taxpayer had no documentary evidence that there was a loan between him and the companies. He was unable to prove that the amounts initially advanced to the companies were loan advances as opposed to share capital. There was no evidence in relation to the terms of the loans or the amounts outstanding during the tax years in dispute, and no corroborative documentary evidence to show that the amounts received from the companies were loan repayments. Hence, the TRA found in IRD's favour and upheld the shortfall penalty for gross carelessness.

The case highlights the importance of maintaining good records, particularly in relation to transactions between companies and shareholders.

If a tax position is being adopted, the onus lies on the taxpayer to provide documentary evidence to support that position. Being unable to corroborate a subjective position can amount to gross carelessness and give rise to significant shortfall penalties.

Tax pooling

Inland Revenue (IRD) charges a high rate of interest on late tax payments (currently 8.22%), and in some circumstances the complexity of the provisional tax regime makes interest charges hard to avoid. Add on late payment penalties, and the cost of meeting your tax obligations starts to feel punitive. Tax pooling was introduced in 2003 to address these concerns.

Although it has been around a long time, the use of tax pooling services is not yet commonplace for all taxpayers, perhaps due to a lack of understanding regarding how the system works. To illustrate, imagine you have had an amazing year and your income has significantly increased compared to prior years. The problem you now have is that you have underpaid your provisional tax. You receive a statement from IRD and it shows your liability has gone up due to interest charged from your third provisional tax date of 7 May 2018.

Meanwhile, your neighbour has had a poor year and her income has dropped. She has received a statement from IRD showing that she is due a refund because she overpaid her 7 May 2018 provisional tax payment. In this situation, a tax pooling intermediary, such as Tax Pooling Solutions (TPS), Tax Management New Zealand (TMNZ), and several others, can connect people that have overpaid their tax with people that have underpaid their tax. Taxpayers deposit tax payments with a tax pooling intermediary to be held as part of the 'pool'. Funds held in the pool can be used to meet a person's own liability or 'sold' to another taxpayer.

Tax pooling basically allows you to purchase your neighbour's "tax" and transfer it into your account with IRD, with an effective date of 7 May 2018. From IRD's perspective, there is no shortfall at 7 May 2018 and therefore no use of money interest (UOMI) is charged.

As another example, if IRD reassess a past tax return resulting in an increased tax obligation for a prior year, historic funds held in the pool year can be 'purchased' and used to offset the increased obligation. This is advantageous to the taxpayer, as the intermediary charges less to purchase the historic tax credits than what IRD charges if paid directly. Conversely, for those taxpayers that have paid excess tax into the pool, the intermediary provides a higher interest return than IRD. Hence, tax pooling provides an advantage to taxpayers that have both underpaid and overpaid their tax.

Tax pooling provides taxpayers with a degree of flexibility regarding how they go about meeting their tax obligations. The days of being hit with excessive IRD interest and penalties if you get your provisional tax wrong are effectively over. Instead, there is a fallback mechanism available at commercially acceptable rates in the event that things go wrong.

Snippets

Tax bounty

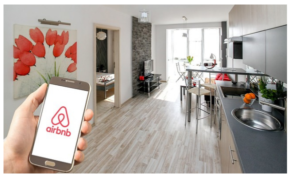
Wanting a job that is flexible? Well a tax informant may be the job for you! An increasing number of countries operate reward or bounty systems where informants receive payments for assisting revenue authorities.

The USA initiated a 'tax bounty' program in 2006, with a Whistleblowers Office established by the US Inland Revenue Service (IRS). This program has seen the IRS collect billions in additional tax revenue over its lifetime, with one famous case resulting in an award to the Whistleblower in excess of US$100 million. The regime has been codified in the US Internal Revenue Code, with informants receiving between 15% to 30% of the additional tax revenue collected in some instances.

The system is not limited to the USA. Singapore offers a 15% reward on tax recovered, capped at S$100,000, whilst Canada offers 5-15% of the additional tax collected (above a de minimis C$100,000). The Canadian scheme extends to "any individual, no matter where they are in the world", leading to concern that the programme will turn Canada into a 'gold mine for tax snoops'. The UK does not have a formal tax bounty regime, however, the public are encouraged to report suspected tax dodgers to its tax evasion hotline, and HMRC have been known to offer informants a reward in some instances where additional tax revenue has been received.

Although New Zealand does not have a tax bounty regime at present, it may be worth Inland Revenue's consideration. But this could lead to further tax issues – is the reward income of the informant???

Short-stay accommodation



Inland Revenue (IRD) is currently consulting on tax obligations that arise on various forms of residential rental, such as renting out a room within your home, or letting property using a peer-to-peer platform, such as Airbnb or Bookabach.

One of the proposed changes relates to the 'standard cost' rules for boarders or home-stay students. Currently, income earned below the threshold of $266 a week for the first two boarders and $218 per week for each subsequent boarder, is tax free and doesn't need to be included in a tax return. IRD propose to reduce this weekly threshold to $183 per boarder (subject to annual CPI adjustments). Or, taxpayers can elect to return all income and expenses relating to boarders in their tax return, which may be favourable if they incur considerable costs.

A similar rule is also proposed for taxpayers providing short-stay accommodation in their own home (e.g. Airbnb), by setting standard nightly costs for deductions, with income above the standard cost needing to be declared. The suggested thresholds are $50 a night for homeowners, and $45 where the host is renting their home. However, there will be various criteria to use this concession, for example a rental limit of 100 nights per year.

Renting out a property that is also used privately is currently a complex tax area, so changes to simplify the regime are welcome.

If you have any questions about the newsletter items, please contact us, we are here to help.